All you need to know of retirement funding
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Introduction

The “ALL YOU NEED TO KNOW” booklet has been compiled by Liberty from many years of experience in the design, sale and administration of a wide range and variety of retirement benefit plans together with their associated death and disability cover. The answers to the questions posed have been collated from the experiences of both our staff and financial advisers over many years and provide the solution to questions that employers and trustees often ask.

The legislation relating to retirement benefit plans is constantly being changed by the legislature. No publication of this nature can comprehensively respond to all situations that will be met in the day-to-day negotiation of retirement benefit plans. To help you with this problem, advisers located in all the major centres can assist you with the answers to problems which are not answered here.

PLEASE NOTE:
The purpose of this booklet is not to serve as a textbook, but rather to provide answers to frequently asked questions. It is also intended for use by laypersons and less experienced trustees and therefore an effort was made not to make the answers too technical.

If you have comments, more questions or would like any information about Liberty and our product range, we would like to hear from you.

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Liberty Corporate
P O Box 2094
Johannesburg 2000
Fax: (011) 408 2726

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General

1.1 Establishing a retirement fund

1.1.1 Why does an employer need a retirement fund?

There are many reasons why a retirement benefit plan is an essential part of every employer’s staff remuneration package. However, for the sake of convenience we have grouped them under three main headings, as follows:

Social pressures
The community at large is rapidly accepting and demanding facilities for proper retirement planning. The employer who denies these facilities to staff is probably going to encounter pressure to provide them. Trade unions have played, and will continue to play, a leading role in demanding adequate benefits for their members. Many Committees of Enquiry have, after many years, strongly recommended that all employers make facilities available for employees to save regularly for their retirement.

The consequence of a lack of retirement provision may mean that staff will only receive the limited social pension benefits provided by the State.

Moral pressures
Few employers can bring themselves to bid farewell to a retiring employee or dismiss the spouse of a deceased employee with only a few well chosen words and no monetary payment. In addition, the effect on the morale of the workforce of doing this could be quite disastrous.

Economic pressures
By far the most important reasons are dealt with under this heading. There are many examples, where, left to their own devices, most employees have made inadequate retirement provision for themselves.

As a result, an employer who wants to assist employees at retirement could end up financing it almost entirely alone. It is far better to build up a fund in advance by regular monthly payments to a retirement fund. Such payments are generally tax deductible so the cost is to some extent subsidised by the State.

Attraction and subsequent retention of key personnel is a major economic motivation for any business. Any employer who fails to provide a competitive and comprehensive range of attractive staff benefits will soon lose key staff members.

Social security and retirement reform
Government announced in 2007 reform of our pension system and integration with social security. The proposals are still being finalised and will be the subject of wide public consultation and relatively lengthy transition process. The reform seeks to ensure a sustainable and efficient system of income support in old
age and will be based on best international practice when it comes to retirement provisioning. Members can look forward to a more comprehensive system of retirement planning, better equipped to ensure a brighter retirement for all South Africans. Those currently making provision for retirement should continue to do so based on sound financial planning and advice.

1.1.2 What is the difference between a defined benefit (or final salary) and a defined contribution (or money purchase) fund?

A defined benefit fund is a fund where one’s retirement benefit is determined by formula in the fund’s rules. Most often the person’s benefit is based on their final salary (or some average) and their years of service.

A defined contribution fund is a fund where one’s retirement benefit is the amount of money contributed to the fund, plus growth on that money, less expenses.
The main features of each type of fund are summarised in the table below:

<table>
<thead>
<tr>
<th></th>
<th>Defined contribution / money purchase</th>
<th>Defined benefit / final salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement benefit</td>
<td>Based upon accumulated contributions and fund growth</td>
<td>A pre-determined percentage of salary at retirement based on years of service</td>
</tr>
<tr>
<td>Early retirement penalties</td>
<td>None, but the benefit is limited to whatever has been accumulated.</td>
<td>Usually a reduction in pension of each year by which early retirement precedes the normal retirement date</td>
</tr>
<tr>
<td>Amount of member’s interest in fund</td>
<td>Share of fund</td>
<td>According to accrued liabilities</td>
</tr>
<tr>
<td>Ease of understanding</td>
<td>Easy, since benefits are directly linked to amounts contributed.</td>
<td>Can be difficult to understand</td>
</tr>
<tr>
<td>Suitability</td>
<td>Small, medium or large companies</td>
<td>Medium to large companies</td>
</tr>
<tr>
<td>Advantages</td>
<td>Contributions are limited to a predetermined, affordable level</td>
<td>Benefit levels at retirement are guaranteed in terms of a percentage of final salary</td>
</tr>
<tr>
<td></td>
<td>Transparency: Accrued benefits are easily identifiable and member can see savings grow</td>
<td>Downside of market does not directly affect the member</td>
</tr>
<tr>
<td></td>
<td>Flexibility: Individual choice can be offered</td>
<td></td>
</tr>
<tr>
<td>Disadvantages</td>
<td>Risk of poor investment returns borne by member, as poor investment returns may result in lower retirement benefit</td>
<td>Open-ended contribution liability for employer</td>
</tr>
<tr>
<td></td>
<td>Member does not participate in the upside of the market</td>
<td>Little / no member choice and hence flexibility for tailoring retirement solutions</td>
</tr>
</tbody>
</table>


1.1.3 What is an “audit exempt” fund and a “valuation-exempt” fund?

An audit-exempt fund is one which has been exempted by the Registrar of Pension Funds from having to complete an audit.

A valuation-exempt fund is one which has been exempted by the Registrar from having to submit a statutory actuarial valuation.

Prior to the 1993 amendments to the Pension Funds Act, “underwritten” funds (funds which were invested exclusively in insurance policies and administered by life insurers) were exempt from most of the provisions of the Pension Funds Act. This position changed after the introduction of the 1993 amendments, which introduced the concepts of “exempt” and “non-exempt” funds, replacing the concept of “underwritten” funds.

A fund may be audit-exempt, valuation exempt or both, i.e., audit- and valuation-exempt. Funds are required to apply to the Registrar for audit or valuation exemption. The requirements for audit and valuation exemption are published by the Registrar of Pension Funds.

1.1.4 What is a pension fund?

A pension fund is a fund set up by an employer for the benefit of its employees. The object of this fund is to provide annuities or pensions for the members (employees) upon their retirement, or to provide lump sum benefits for the dependants of such members upon death of the members.

1.1.5 What is a provident fund?

A provident fund is a fund set up by an employer for the benefit of its employees. The object of this fund is to provide a cash lump sum benefit for the members (employees) upon their retirement, or to provide lump sum benefits for the dependants of such members upon death of the members.

1.1.6 What is a retirement annuity fund?

A retirement annuity fund is set up by an administrator or insurer for the benefit of individual investors. The object of this fund is to provide annuities or pensions for the members upon their retirement, or to provide lump sum benefits for the dependants of such members upon death of the members. No employer/employee relationship is therefore required. If one is a member of a retirement annuity fund, one cannot retire before the age of 55. Retirement annuities are often used as a retirement savings vehicle by self-employed people and by those wishing to make additional provision for retirement.
1.1.7 What is a preservation fund?

A preservation fund is a pension preservation fund or provident preservation fund to which a member's paid-up pension or provident fund benefits respectively can be transferred in certain instances. It not only preserves the member's accrued tax status, but generally also allows the member one withdrawal prior to retirement. Preservation funds may also accept:

- pension or provident fund withdrawal benefits;
- unclaimed benefits;
- pension interest amounts assigned to non-member spouses in terms of the Divorce Act;
- unclaimed surplus apportioned to former members;
- an unclaimed benefit under a liquidation in terms of section 28 of the Pension Funds Act;
- unclaimed pension or annuity amounts; and
- unclaimed lump sums awarded to beneficiaries under death claims.

1.1.8 What is an umbrella fund?

An umbrella pension or provident fund is a single fund, established and managed by a retirement fund administrator, to which any employer or group of employers can apply for membership as a participating employer.

One advantage of an umbrella fund is that the employer joins a fund which is already registered and approved and has an established board of trustees.

Also, no general rules need to be drawn up for each employer, as a master set of rules already exists, which governs all participating employers. Variations applicable to each participating employer known as "special rules" are registered and approved for each participating employer.

1.1.9 What is a beneficiary fund?

A beneficiary fund is a fund established for the purposes of accepting lump sum death benefits awarded in terms of Section 37C of the Pension Funds Act to a beneficiary (dependant or nominee) on the death of a member, which are not paid directly to that beneficiary (or his/her recognized care giver or guardian in the case of a minor), or to a trust nominated by the member, or to the member's estate or to the guardian's fund.

This replaces the previous payments to trusts and a fund can now only pay to a trust if the trust was nominated by the member, a major dependant or nominee; a person recognised in law or appointed by a Court as the person responsible for managing the affairs or meeting the daily care needs of a minor or incapacitated major dependant or nominee.

Any association of persons or business carried on under a fund or arrangement established with the object of receiving, administering, investing and paying benefits, referred to in section 37C on behalf of beneficiaries,
payable on the death of more than one member of one or more pension funds is a beneficiary fund and must be registered and approved.

1.1.10 What is the difference between an inclusive and an exclusive fund?

An inclusive fund is a fund where the administration fees and costs of insured benefits offered by the fund are deducted from contributions and not charged separately. As death and disability costs increase with age, the portion of the contribution available to fund retirement benefits therefore reduces.

An exclusive fund, on the other hand, is one where the above-mentioned costs are separate from the portion available for investment; consequently the entire contribution is allocated to retirement provision.

1.1.11 Can a retirement fund be administered by an employer?

Yes, an employer can operate a fund which is known technically as a self-administered fund. Generally, only the funds of larger employers are self-administered as the associated costs make it uneconomic when compared to the fees charged by life insurers. A self-administered fund has to be registered with the Registrar of Pension Funds (as do funds operated by life insurers) and has to conform to the provisions of the Pension Funds Act. In addition, the employer or fund is required to register as a fund administrator in terms of section 13B of the Pension Funds Act.

It is not possible for the employer to operate or administer an unregistered fund in terms of section 31 of the Pension Funds Act. Any person who does so will be subject to administrative penalties. There will also be no tax relief on contributions paid, because the fund will not have been approved by the South African Revenue Service in such an instance.

1.1.12 Is the fund an asset of the employer?

No. In terms of section 5 of the Pension Funds Act, a registered fund is a separate body corporate capable of suing and being sued in its own name. As it is a separate legal entity from the sponsoring employer, it cannot form a part of the assets of the employer. As a result, should insolvency of the employer occur, the assets of the fund cannot be used to liquidate the company’s debt. If the principal employer was declared insolvent, the fund could still continue for the remaining participating employers (assuming that there were any and they were not part of the insolvency). If there were no remaining employers it would make practical sense to liquidate the fund although this is not a legal requirement.

1.1.13 May a fund invest in or loan to the employer’s business?

In terms of section 19(4) of the Pension Funds Act a fund may invest in or loan up to 5% of the fair value of the fund’s assets to the employer’s business without the Registrar’s approval.

The Registrar may grant permission, on application by the trustees, to the fund to invest in or loan up to 10% of
the fair value of the fund’s assets to the employer’s business on any conditions determined by the Registrar and if the trustees have certified:

- that they have consulted with the members about the proposed investment or loan to the employer’s business and
- that the members support the making of the investment or loan.

In both instances, no assets of a fund may be invested in or lent to the employer’s business unless the trustees are satisfied that it is in the best interest of the fund to do so.

1.1.14 Who is accountable to the Registrar in respect of the fund?

The board of trustees is accountable to the Registrar and may, for example, represent the fund in litigation. For practical purposes, the fund’s principal officer liaises with the Registrar.

1.1.15 What are the duties of the Principal Officer?

Every fund must appoint a Principal Officer in terms of section 8 of the Pension Funds Act. This requirement is in addition to that of a board of trustees which must be appointed.

The Registrar may object to such appointment if the registrar reasonably believes that a principal officer is not, or is no longer, a fit and proper person to hold that office.

The Principal Officer will be in a position of trust and the associated duties will be generally determined by the fund rules and the Pension Funds Act including:

- the signature and submission of rule amendments;
- the submission of annual financial statements to the Registrar;
- the signature of all fund documents to be submitted to the Registrar;
- the furnishing of prescribed information to fund members.
1.2 Eligibility

1.2.1 What constitutes eligibility?

The trustees or employer in consultation with the employees have to formulate who is eligible to join the retirement fund. This must be decided in such a way as to comply with the requirements for approval detailed in the definitions of “pension” and “provident” funds contained in the Income Tax Act. The rules of the fund will not be approved by the South African Revenue Service if the classes of eligible employees have not been laid down in the rules. Some of the criteria for eligibility, which must be objectively determinable, and must not be unfairly discriminatory in terms of the Constitution.

The important point is that once an employee complies with the eligibility criteria, membership of the fund is compulsory and a condition of the employee’s employment.

1.2.2 Can the employer choose who can join the fund?

The employer may establish the eligibility conditions which must apply to all employees meeting the eligibility conditions. The employer may not agree to exclude an employee who meets such conditions for membership.

The South African Revenue Service will not approve a set of rules which allow entry at the full discretion of the employer. In terms of the Labour Relations Act, an employer must consult the employees before entrenching any eligibility conditions. The effect of this is that the employer cannot unilaterally choose who may join a fund. Further, trustees must be appointed to the fund in terms of section 7A of the Pension Funds Act. These trustees, once appointed, will be in a position to formulate/change eligibility conditions.
1.2.3 Can employees who do not wish to become members of a fund, refuse to join?

In terms of the Income Tax Act, one must distinguish between two scenarios:

- Where a new fund is instituted, all existing employees who are eligible for membership must decide, within 12 months of inception of the fund, whether or not they wish to become members. Should they decide not to become members, once the 12 month period has expired, they are permanently ineligible unless a special concession is received from the South African Revenue Service. This does not, however, mean that they are ineligible to join any other fund which may be instituted by the same employer. In some cases an employer may offer a choice between membership of a pension or provident fund.
- Where an employee becomes employed by an employer who already has a fund and is eligible to join, he or she may not refuse to become a member. It is a condition of approval of the fund by the South African Revenue Service that membership of the fund be a condition of employment for all eligible employees.

One of the immediate consequences for an employer who does not ensure that all eligible employees are in fact members of the fund is that the South African Revenue Service may withdraw the tax approval of the fund, which in turn, would mean that the tax concessions that the employer and employees may use, will be lost.

1.2.4 How does the Constitution affect the eligibility of employees to join a fund?

The Constitution is aimed at creating a democratic, non-racial and non-sexist South African society.

This means that where any law or practice is inconsistent with these objectives, it will be regarded as unconstitutional and of no force and effect.

The implication of this for the retirement funds industry is that members may be able to institute legal proceedings against funds on the basis of unfair discrimination, should the fund be discriminating unfairly against certain employees.

In many cases, funds provide different levels of benefits for different classes of employees. This differentiation is usually based on factors such as type of work, level of seniority in the company and whether or not the member has dependants, etc. The question whether or not this will be unconstitutional in terms of an unfair discrimination practice is an open question. Care should also be taken not to contravene the provisions of the Labour Relations Act.

For example, a fund allowing only women to be eligible for membership, will be discriminating unfairly against men on the basis of gender and will clearly be unconstitutional.
1.2.5 Can a person be a member of more than one fund with the same employer?

As long as the employee is eligible, there can be membership of as many funds as the employer might operate.

For example, an employer might have a pension fund and decide to institute a provident fund. The member might not wish to transfer from the pension fund, but simply become a member of the provident fund as well.

A second or even a third fund could be instituted to “top up” contributions to obtain the maximum tax relief. These practices are perfectly legitimate.

1.2.6 Can a person be a member of more than one fund with different employers?

The persons affected by this would normally be directors, who might serve on the boards of several different companies. The South African Revenue Service’s practice is such that only full-time working directors for a particular company may join that company’s fund. This effectively prevents a person from being a member of more than one fund with different employers as you can only work full-time for a single company.

1.2.7 Can members withdraw from the fund without leaving the company?

When members are eligible and have joined the fund, they cannot simply withdraw or retire from the fund. They have to leave the service of the employer through resignation, retrenchment or dismissal or retirement as provided for in the fund’s rules, before they are entitled to fund benefits.

If the members do withdraw from the fund without leaving the company, the continued approval of the fund by the South African Revenue Service will be jeopardised.

1.2.8 Who may be a member of an employer’s fund?

In general, all persons who are permanent employees can be members of their employer’s retirement fund.

The exception to this rule is a sole trader or sole proprietor. The reason for this is that they are not employees. They can belong to a long-term disability income plan and an unapproved group life fund and may become members of retirement annuity funds in their own right.

Irrespective of the fact that a sole trader cannot join a fund, which has been set up for the business, all other staff may participate in the fund.

A business trust, as long as it employs people, is capable of instituting a fund in the same way as any other employer. Furthermore, while it has never to our knowledge been tested in law, it appears that the trustees of such a trust may be members of the fund even where they are also trust beneficiaries, as long as the necessary employer/employee relationship exists.
1.2.9 Can temporary staff or part-time employees be members of a fund?

The law does not exclude temporary staff or part-time employees, but generally this group has not joined funds because of the high turnover in employment and the resultant high costs involved.

In most instances, fund administrators restrict membership to permanent full-time employees. However, this practice is changing, especially as far as part-time employees are concerned, as they are demanding similar benefits to those available to full-time staff.

It must be noted that the definition of employee in the Labour Relations Act does not distinguish between full-time and part-time staff and as such, both should be treated equally. As far as directors are concerned, however, it is a departmental practice of the South African Revenue Service that only full-time working directors can join a fund.

1.2.10 Can members of a club join a fund?

It is not possible for participants in so-called “affinity” groups such as members of sports and social clubs, to become members of a fund as there is no valid employer/employee relationship. These people can, however, become members of retirement annuity funds in their own right.

1.2.11 What is the minimum permitted number of members of, and the minimum permitted amount of contributions to a fund?

In terms of the Income Tax Act, one of the conditions of approval of a fund is that it must be a permanent bona fide fund. The South African Revenue Service interprets this to mean that a fund must have a minimum of two members, but a fund of this size will invariably be too small to justify on economic grounds.

There is no stipulated minimum contribution, but the South African Revenue Service would certainly regard a fund with contributions of R5 per month per member, for example, as not really being a bona fide fund. Most life insurers do impose minimum membership and contribution levels before they will provide a quotation for a fund. This is purely for reasons of financial viability.
1.3 Fund administration

1.3.1 What is a pension fund / provident fund and what are the advantages of having one?

A pension fund is a vehicle to provide for the economic security of retired people by means of a regular income, i.e. a pension. A provident fund has similar objectives except that the full benefit can be paid as a cash lump sum. (A provident fund may also be structured so that the benefit is paid as a pension which may be commuted for a lump sum with the trustees’ permission.)

For both pension and provident funds, the joint contributions of the employer and the employees are invested to build up assets in advance of the benefits becoming due.

There is no hard and fast rule as to which organisation should have a pension fund and which should have a provident fund.

The advantages of pension and provident funds are:

- Advance funding by employers and employees in order to provide retirement benefits
- Creation of a separate legal entity from the sponsoring employer
- Tax concessions on contributions and benefit payments
- Peace of mind is given to both employer and employee
- Attraction and retention of staff is made easier.

1.3.2 What are the usual standard provisions for fund rules?

All rules must be registered by the Registrar of Pension Funds and as such are required to deal with certain issues as laid down in the Pension Funds Act and Regulation 30.

These are, for example:

- the name of the fund, date of commencement and registered office
- the object of the fund
- the requirements for membership of the fund and the circumstances under which membership would cease
- the calculation of contributions
- the conditions under which members or other persons may become entitled to benefits
- the nature and extent of benefits
- the appointment, removal and powers of the fund’s “officers”, including trustees and the principal officer
- the manner in which the fund’s rules may be changed
- the method of settling disputes
- the manner in which the fund may be terminated or dissolved.
1.3.3 What are the minimum and maximum permitted retirement ages of retirement funds?

Section 1 of the Income Tax Act defines “normal retirement age” as:

(a) in the case of a member of a pension fund or provident fund, the date on which the member becomes entitled to retire from employment for reasons other than sickness, accident, injury or incapacity through infirmity of mind or body;

(b) in the case of a member of a retirement annuity fund, a pension preservation fund or a provident preservation fund, the date on which the member attains 55 years of age;

or

(c) in the case of a member of any fund contemplated in this definition, the date on which that member becomes permanently incapable of carrying on his or her occupation due to sickness, accident, injury or incapacity through infirmity of mind or body;

The rules of a retirement fund must have a retirement age of not less than the normal retirement age as indicated above and therefore age 55 is regarded as a practical minimum retirement age. There are no restrictions on a maximum retirement age.

1.3.4 Is it permissible to have a fund where only the employees contribute?

While not very common, it is possible and permissible to have a fund where only the employees contribute. Neither the Pension Funds Act nor the Income Tax Act has any provision compelling the employer to contribute to the fund. Liberty Corporate will only consider the administration of funds where the employer contributes, including where members contribute to a pension fund and the employer contributes to a provident fund. The most common type of retirement funds where only employees contribute are retirement annuity funds.
1.3.5 What is “salary sacrifice” and how does it work?

Simply put, salary sacrifice is the practice of reducing an employee’s cash salary and providing some other benefit in its place, e.g., as a contribution to a provident fund or medical aid fund. Our courts have held that salary sacrifice arrangements are perfectly legal, that is, employers and employees are entitled to structure salary packages as it suits them in order to achieve maximum tax effectiveness.

The following example illustrates the concept of salary sacrifice:

Assume an employee earns a salary of R6 000 per month and is a member of a provident fund. In terms of his/her contract of employment the employee pays the monthly contributions to the provident fund, which amounts to R600 per month. The employee’s tax and “take home pay” are calculated as follows:

<table>
<thead>
<tr>
<th>Salary</th>
<th>R6 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Employee’s tax on R6 000 (say 32%)</td>
<td>R1 920</td>
</tr>
<tr>
<td></td>
<td>R4 080</td>
</tr>
<tr>
<td>Less: Contribution to provident fund</td>
<td>R 600</td>
</tr>
<tr>
<td>Take home pay</td>
<td>R3 480</td>
</tr>
</tbody>
</table>

Should the employer and employee enter into a valid and effective salary sacrifice arrangement and intentionally amend the employee’s contract of employment so that the employer pays the contributions and in return the employee’s salary is reduced to R5 400, then the employee’s tax and “take home pay” will be calculated as follows:

<table>
<thead>
<tr>
<th>Salary (after sacrifice)</th>
<th>R5 400</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Employee’s tax on R5 400 (say 32%)</td>
<td>R1 728</td>
</tr>
<tr>
<td>Take home pay</td>
<td>R3 672</td>
</tr>
</tbody>
</table>

To be valid, the salary sacrifice fund must divest the employee of his or her liability to pay any part of the member’s contribution to, say, a provident fund and to shift liability for the total amount to the employer. This will be achieved by having the employee sacrifice an amount of his salary equal to the contribution that he was no longer liable to pay, as illustrated in the example above. Otherwise, i.e., if the amount sacrificed still accrues to the employee after salary sacrifice has been implemented, the South African Revenue Service may question the arrangement in terms of the anti-avoidance provisions in section 103 of the Income Tax Act. The salary on which contributions are based may not be more than 100 per cent or not less than 60 per cent of the salary before sacrifice.

The South African Revenue Service will permit a salary sacrifice to be implemented at a non-increase time, even if it results in a reduction of income, as long as the necessary amendments to the affected employee’s terms and conditions of employment are agreed.
Such an agreement need not be in writing to comply with legal formalities. However, it is advisable for it to be written down in order to record the terms accurately. It is possible for an employer to use one agreement for all the affected employees, as long as that agreement is binding on and accepted by all the relevant parties. In the agreement the employer must set out the commercial reasons for the restructuring of packages.

Since the amendment of an employee’s contract of employment is the most important requirement for a valid salary sacrifice arrangement, it is important that such contract is correctly worded to accurately reflect and confirm the composition of the employee’s total remuneration package. The contract must set out all the key components of an employee’s package including:

- his or her gross remuneration
- details of the employer’s contributions to medical aid, pension and provident funds,
- details of the employee’s leave and bonus entitlements and how they are calculated, and
- fringe benefits.

It is vital that the details and justification for fringe benefits and any other allowances are carefully detailed in the employee’s contract of employment.

Apart from the rules of the fund to which the salary sacrifice relates, the employment contract is one of the documents that the South African Revenue Service inspectors will scrutinise should they perform an employees’ tax review at the workplace. Following these inspections it is not unusual for the South African Revenue Service to levy an employer with a bill for arrear employees’ tax, penalties and interest, where there is a lack of information or incorrect wording in employment contracts and/or in the rules of the fund. However, the employer has the right to recover such additional employees’ tax from his employees.

More than one salary sacrifice can be implemented during the employee’s employment with regard to that particular employee. However, the provisions of section 103 of the Income Tax Act, which imposes penalties for funds which result in tax avoidance, should be kept in mind.

**NOTE:** WHERE AN EMPLOYER WISHES TO IMPLEMENT A SALARY SACRIFICE, IT IS STRONGLY RECOMMENDED THAT PROFESSIONAL ASSISTANCE IS SOUGHT FROM A TAX CONSULTANT REGARDING THE CORRECT STRUCTURE OF THE SALARY SACRIFICE.

**1.3.6 What happens if contributions are not paid to the fund within seven days of the end of the month, as is required in terms of the Pension Funds Act?**

Section 13A of the Pension Funds Act requires employers to pay over fund contributions to administrators within seven days of the end of the month for which they are due. Accompanying the contributions (or within 15 days of month-end) must be an Initial Contribution Statement which will contain specific information, e.g. the fund’s name and registration number, employer’s details and each member’s details regarding the contribution deducted and paid over.
Thereafter a Subsequent Contribution Statement must be supplied which will contain the same information as mentioned above or a reconciliation with the statement of the previous period showing, for example, changes in membership or member emoluments, etc.

A contact person at the administrator will report to the principal officer or the fund’s monitoring person, who will monitor this compliance for the fund, within 15 days of the seven day period if the contributions have not been received in full or where there is a discrepancy of more than 2.5% of the total contributions payable for that period.

The principal officer or the fund’s monitoring person will then have to submit a written report to the fund’s trustees within seven days of receipt of the report of the employer’s failure to furnish the fund with the Initial Contribution Statement and the Subsequent Contribution Statement and to pay the contributions to the administrator within the prescribed seven day period. The trustees must then inform the members of the fund as well as the Registrar of Pension Funds.

Should this failure to pay the full contributions continue for 90 days, the principal officer or the monitoring person must report the matter in detail, within 14 days of the expiration of the 90 day period, to the Registrar of Pension Funds.

The Registrar has the discretion to inform the Commissioner for the South African Revenue Service of any non-compliance with section 13A of the Pension Funds Act.

Compound interest will be payable by the employer on late payments or unpaid amounts of contributions at the maximum rate that is applicable. The interest will constitute investment income for the fund. In addition, the employer and/or the trustees may be subject to administrative penalties.

Where employees are required to make contributions, non-payment of such contributions is considered a criminal offence and reportable to the South African Police Services.

Section 13A further provides that should the employer wish to amend the rules of the fund to reduce, suspend or discontinue contributions, it cannot do so with retrospective effect and it will still be liable for the contributions before the date the resolution was taken to amend the rules.
1.3.7 Does the employer have a fiduciary duty toward the fund?

The employer owes the fund a fiduciary duty. This is because the employer has, by establishing a fund, entered into an agreement with his employees to help provide for their retirement and because the contributions paid to the fund constitute fund assets.

The most important fiduciary duty the employer owes to the fund is the duty to act in good faith, care and diligence. This duty should be exercised when setting up the fund, appointing trustees, ensuring that eligible employees join the fund, paying over contributions to the fund etc.

There is also a duty to co-operate fully with the trustees and administrators of the fund and to ensure that the fund is properly managed. The employer may not place pressure on the trustees in an attempt to influence decision-making.

1.3.8 Can the employer use fund assets as security for loans?

It is not possible for an employer to use the assets of the fund as security for business loans, because the fund is a separate legal entity and does not belong to the employer or the business. Similarly, fund assets may not be used as security for personal loans.

Fund assets can however be used to grant housing loans to fund members, to redeem existing housing loans or to purchase a dwelling or make alterations. A fund may not stand surety for a member’s loan (section 19 of the Pension Funds Act), unless it is a housing loan.

Funds operated by life insurers cannot make funds available for the purposes of housing loans, as assets must be invested in policies of insurance. Thus there are no cash assets to lend to the members. In these cases the fund will, however, be able to stand surety for a housing loan granted to a member by a third party.

1.3.9 Do members have a say in the management of the fund?

Section 7A of the Pension Funds Act states that members have the right to elect at least 50% of the board of trustees (except in the case of umbrella funds and retirement annuity funds). In this sense members will have a say in the management of the fund. Members can raise any concern they have with their fund’s board of trustees.

1.3.10 Who can sign documentation relating to a fund?

All documentation must be signed by the principal officer and one other authorised person. If a board of trustees has been appointed then the chairperson, the principal officer and one other trustee must sign fund documentation etc.
1.3.11 Is a retirement fund required to have a board of trustees?

In terms of section 7A of the Pension Funds Act, every fund shall appoint a board of management to run the affairs of the fund. The members of this board are commonly referred to as “trustees”.

At least four trustees must be appointed and members have the right to elect at least 50% of these trustees. A fund may apply for exemption from appointing a full board if it will be “too expensive or inconvenient” to do so. In this instance, members will still have the right to elect at least 50% of whatever number of trustees is appointed.

Umbrella funds and retirement annuity funds may apply for exemption from appointing member elected trustees. In this instance, these funds will have at least one independent trustee sitting on the board of trustees.

1.3.12 What is a fiduciary duty?

A fiduciary duty is usually referred to in the context of a trust, where the trustees are controlling the assets of the trust for the benefit of the beneficiaries of the trust.

In the context of a retirement fund, the trustees’ fiduciary duties are the duties conferred upon the trustees which require the trustees to exercise their powers for the benefit of the retirement fund and in such a manner as to always act in the best interest of the retirement fund.

When a person acts as a trustee, he/she accepts fiduciary responsibilities and duties to act in the best interests of the members, to act impartially, to act in line with the fund rules and to act prudently, responsibly and honestly.

1.3.13 What are the fiduciary duties of trustees?

The object of a board of trustees and the statutory duties of trustees are stated in sections 7C and 7D of the Pension Funds Act respectively.

In terms of subsections 7C (1) and (2):

(1) the object of a board shall be to direct, control and oversee the operations of a fund in accordance with the applicable laws and the rules of the fund.

(2) In pursuing its object the board shall –

(a) take all reasonable steps to ensure that the interests of members in terms of the rules of the fund and the provisions of this Act are protected at all times, especially in the event of an amalgamation or transfer of any business contemplated in section 14, splitting of a fund, termination or reduction of contributions to a fund by an employer, increase of contributions members and withdrawal of an employer who participates in a fund;

(b) act with due care, diligence and good faith;

(c) avoid conflicts of interest;

(d) act with impartiality in respect of all members and beneficiaries.
In terms of Section 7D of the Pension Funds Act, the duties of a board shall be to:

(a) ensure that proper registers, books and records of the operations of the fund are kept, inclusive of proper minutes of all resolutions passed by the board;
(b) ensure that proper control systems are employed by or on behalf of the board;
(c) ensure that adequate and appropriate information is communicated to the members of the fund informing them of their rights, benefits and duties in terms of the rules of the fund;
(d) take all reasonable steps to ensure that contributions are paid timeously to the fund in accordance with the Pension Funds Act;
(e) obtain expert advice on matters where board members may lack sufficient expertise;
(f) ensure that the rules and the operation and administration of the fund comply with the Pension Funds Act, the Financial Institutions (Protection of Funds) Act, and all other applicable laws.

Good governance standards for trustees have been set out in the Registrar's circular PF130. Trustees are urged to read the circular.

1.3.14 How do you convert a pension fund to a provident fund?

Where a pension fund is to be converted to a provident fund:

• The pension fund must be terminated, tax paid on the employees’ withdrawal benefits and the remainder of the benefits transferred to the approved provident fund. The employer’s interest in the pension fund in respect of the employees concerned must be transferred to the provident fund.
• The rules of the provident fund must provide for the acceptance of all funds transferred to it from the pension fund.
Employees who retired from employment prior to the termination of the pension fund and who are in receipt of pensions must have the right to the continuation of their pensions entrenched in the rules of the provident fund, should they also transfer to the provident fund.

When a pension fund is converted to a provident fund, the member’s withdrawal benefits may, without any tax implication:

• remain in the existing pension fund as a paid-up benefit; or
• be transferred to a new approved pension fund (if any), but not a preservation fund; or
• be transferred to a retirement annuity fund.
1.3.15 What is the procedure that must be followed when a fund or participation in a fund is liquidated?

In terms of section 28 of the Pension Funds Act a liquidator must be appointed, either in the manner directed by the rules or, failing such a provision, by the trustees managing the business of the fund. Although the Act is not prescriptive as to the appointment, it is subject to the Registrar's approval. The liquidator will, from the date of appointment, for the purposes of the Act be deemed to be the person managing the business of the fund.

The liquidator will, as soon as possible, deposit with the Registrar the following:

(a) A preliminary revenue account and balance sheet signed and certified as correct, showing the assets and liabilities of the fund at the commencement of the liquidation.
(b) A document setting out the manner in which the assets will be realised and the liabilities discharged including any liabilities in respect of members.

In the case of a defined benefit fund or a privately administered fund, the Registrar may require a report by an independent valuator in respect of the preliminary account and balance sheet.

The preliminary account, balance sheet and report (if any) will lie open for inspection by interested persons for a period of 30 days at the Registrar’s office and at the fund's registered office.

In addition, a notice must be published in one English and one Afrikaans newspaper, or any other official language, if deemed necessary in the circumstances, circulating in the district where the fund's registered office is located, stating the period during which, and places at which the preliminary account will lie open for inspection.

Objections must be made in writing to the Registrar within a period of 14 days.

In terms of section 28(7A), the Registrar may, on application, and in circumstances which justify an exemption, exempt a fund from the requirement that:

• the preliminary account must lie open for inspection for a period of 30 days and
• a notice be published calling for objections.

This will mean that the retirement fund's liquidation will be expedited.

In terms of section 28(12A), the Registrar may, on good cause shown, authorise the liquidator to make payment of any amounts to the members and beneficiaries of the fund before submission of the final accounts and report (if any). This may assist fund members who are in dire financial straits when the retirement fund is liquidated.

In terms of the Registrar’s prescribed conditions, he will not grant permission unless:

(a) preliminary accounts and report (if any), or any other information acceptable to him have been lodged with the Registrar; and
(b) the payment to be made to the member of the fund concerned does not exceed the lesser of:
- the total of the member’s own contributions to the fund, or
- 50% of the liquidation benefit.

If no objections are lodged, the liquidator may finalise the liquidation.

If objections are lodged, the Registrar may direct that the preliminary account be amended or give such other directions as seen fit. The Registrar’s direction must be posted by the liquidator to members and interested parties within 14 days. Any aggrieved party must make application to the High Court within 28 days.

After completion of the liquidation, the liquidator must within 30 days lodge with the Registrar the final account together with the final balance sheet signed and certified as correct.

If the Registrar is satisfied that the revenue account and balance sheet are correct, and that the liquidation has been completed, the registration of the fund will be cancelled.

1.3.16 What happens to the fund if the employer’s business or a portion of the business is sold or liquidated?

If the employer’s business is sold, there are various potential outcomes in respect of the fund, which would depend on the nature of the transaction and the rules of the fund. Some of the potential outcomes could be:

- Replacement of the original employer in the fund; or
- A transfer of the members from the old employer fund to the fund of the new employer; or
- Liquidation or partial liquidation of the fund
- If the employer’s business is liquidated, the original employment relationship terminates and the fund is generally liquidated, depending on the rules of the fund.

1.3.17 What protection against insolvency is there for the employer or the member of a fund?

As the fund is a separate legal entity capable of owning its own assets, fund assets are separate from both the assets of the employer and the members. Fund assets cannot be appropriated for the benefit of creditors if either the employer or the members become insolvent.

Retirement benefits to which a member is entitled may not be taken into account in determining the value of the estate for insolvency purposes. This effectively protects retirement benefits within the fund.

However, if a lump sum payment in terms of a provident fund or a commuted portion of a pension fund benefit has been received by the member prior to insolvency, this money will not be protected and will be available for distribution to creditors on that member’s insolvency.
1.3.18 Fund transfer and amalgamation: What does section 14 of the Pension Funds Act provide?

Section 14 provides that the transfer or amalgamation of the assets and liabilities of a registered fund with any other entity cannot be effected without the Registrar’s explicit approval. To effect such transfers or amalgamation, the provisions of section 14 and any directive issued by the Registrar must be complied with.

Transfers will only be considered where the fund of transfer is:

- fair and equitable;
- accords full recognition to:
  - members’ rights,
  - members’ reasonable benefit expectations in terms of the rules of the fund, and
  - any additional benefits, the payment of which has become established practice; and
- does not affect the financial soundness of the receiving fund.

Applications for transfers must be made in the manner by the Registrar.

1.3.19 Does a change in the company name mean a change in the fund name?

The fund name does not necessarily have to change when the company name changes, but the fund rules must be amended to reflect the company name change.

1.3.20 Why do we pay FSB levies?

The functions of the Financial Services Board are to supervise and exercise statutory control in terms of relevant law over the activities of financial institutions and to advise the Minister of Finance on matters concerning financial institutions.

The activities of the Financial Services Board are financed by fees charged and levies imposed on financial institutions. The Financial Services Board can set its own fees and determine the levies payable. Part of these levies is used to finance the office of the Pension Funds Adjudicator, which is a service to members.
1.4 Benefit structure

1.4.1 Do employees have a say in the design of the benefit structure of a fund?

It would be beneficial for all employers to talk to their staff to negotiate the most suitable benefit and cost structures. In terms of the Labour Relations Act, employees have a right to be consulted by the employer when any change is to be made which will affect their terms and conditions of employment. This implies that the employer will have to consult the employees prior to designing or changing the benefit structure of the fund.

1.4.2 What happens when there is a reduction or a suspension in salary?

A reduction in salary is possible in the case of, for example, when working hours are reduced. In a defined contribution fund, the employee is automatically going to pay lower contributions. In the case of defined benefit funds a salary reduction may result in a lower pension at retirement as pensions are based on salary at retirement.

Suspension of salary generally occurs during a period of temporary absence from work, for example in the case of extended study leave or maternity leave. Most fund rules would usually provide for membership to continue during a period of suspension of contributions for up to 12 months. Retirement benefits will not accrue if contributions are unpaid during the period of absence. Life insurers will generally allow insured benefits to continue during these periods provided the premiums are paid.

1.4.3 May pension benefits be reduced or used as security?

Section 37A of the Pension Funds Act stipulates that a member’s benefits payable in terms of the rules of a fund (including an annuity purchased by the fund from an insurer for a member) may not be reduced, transferred, ceded, pledged, hypothecated, subjected to any form of execution under a judgment or order of a court of law or taken into account in the determination of a judgment debtor’s financial position in terms of section 65 of the Magistrates’ Court Act for an amount exceeding R3 000.

Should a member or beneficiary attempt to reduce his or her benefits or right to such benefits, the fund may withhold or suspend payment thereof.

However, the Pension Funds Act allows the following exceptions where pension benefits may be reduced:

- The payment of income tax in respect of lump sum payments from retirement funds and in respect of arrear taxes;
- Deductions permitted in terms of section 37D (see question 1.4.6);
- A maximum amount of R3 000 can be taken into account in terms of section 65 of the Magistrates’ Court Act.
1.4.4 Can a fund provide a housing loan or provide a guarantee in relation to a housing loan of a member?

In general yes, but the practice is regulated by section 19(5) of the Pension Funds Act and the specific fund’s rules. Section 37D provides for the deduction of housing loans from members’ benefits in cases of exit from the fund, default whilst still a member and in cases where there is a transfer to another retirement fund in terms of section 14.

1.4.5 What may be deducted from a member’s pension benefits?

In terms of the Pension Funds Act, a fund may deduct the following:

a. Income Tax payable in terms of the Income Tax Act;

b. Any amount outstanding in respect of housing loans which were granted to members directly by the fund or the employer;

c. Any amount for which the fund or employer is liable in terms of a guarantee given by the fund or the employer in respect of a housing loan;

d. Damages caused to the employer by the member as a result of theft, fraud, dishonesty or misconduct, provided that:
   • the member has admitted liability in writing to the misdemeanour, or
   • judgment has been obtained against the member in a court of law;

e. With the member’s consent, medical aid subscriptions and insurance premiums;

f. Maintenance orders payable by the fund in terms of the Maintenance Act;

g. Pension interest payable to a non member spouse in terms of a divorce order;

h. Judgment debt orders in terms of section 65 of the Magistrates’ Court Act up to a maximum of R3 000;

i. Such other deductions as the Registrar of Pension Funds may allow.

1.4.6 What are the requirements in respect of deductions from a member’s pension benefits due to the member’s theft, fraud, dishonesty or misconduct?

In terms of section 37D(b)(ii) of the Pension Funds Act, a fund may deduct from a member’s benefit payable in terms of the rules of the fund, any amount in respect of damages caused to the employer by the member as a result of theft, fraud, dishonesty or misconduct, provided:

• the member has admitted liability in writing, or
• judgment by a court of law has been obtained against the member.

The theft, fraud, dishonesty or misconduct must have been committed while the employee was still a member of the fund.

Contractual debts such as car loans or computer loans in respect of which the employee still owes a balance to the employer on the date of withdrawal from the fund, do not fall within the ambit of section 37D(b)(ii). It follows therefore that such contractual debts may not be deducted from the member’s benefit payable in
terms of the rules of the fund, and must be liquidated through other means, e.g. by the employer instituting civil proceedings against the member in a court of law.

The member’s written admission of liability
The member’s written admission of liability must be clear and unambiguous and should specifically allow for deductions to be made in respect of a wrongdoing or delict committed by the member against the employer.

Judgment by a court of law
The judgment by a court of law must relate to either of the following:

- A civil judgment sounding in money, i.e. a judgment made consequent to a civil action and specifically awarding damages to the employer as compensation for the financial loss suffered; or
- A compensatory order made by a criminal court in terms of section 300 of the Criminal Procedure Act, specifically allowing compensation to the employer for the financial loss suffered. Presumably in his application for such an order the employer has to claim that some wrongdoing or delict has been committed by the employee which amounts to theft, fraud, dishonesty or misconduct in terms of section 37D(b)(ii).

1.4.7 If the employer makes a housing loan to a member and the member leaves the fund, can the employer be compensated from the benefit payable to the member?

Yes. In terms of section 37D of the Pension Funds Act, a fund may make certain deductions from benefits, which includes any amount due by the member to the employer in respect of a housing loan or any amount for which the employer is liable under a guarantee granted in respect of a housing loan by some other person to the member.

1.4.8 Who receives the retirement fund benefit in the case of the death of a member with more than one spouse?

In terms of the Pension Funds Act, the spouse of the member is always a dependant. Section 37C of the Pension Funds Act states that in the case of more than one dependant, the persons managing the business of the fund, i.e. the trustees, must pay the benefit to the dependants in such proportions as they deem equitable.

This means that each spouse may receive a portion of the benefit, or that one of the spouses may receive the entire benefit, but the trustees have the discretion to decide what proportion each spouse will actually receive. They will exercise this discretion after an investigation into the matter and applying their minds to the facts at hand.
1.4.9 Under which circumstances can a death benefit be paid to a trust?

In terms of section 37C(2) a benefit can be paid to a trust on behalf of a dependant or nominee in any of the following circumstances:

- If the trust was nominated by the deceased member
- If the trust was nominated by a major dependant or nominee;
- If the trust was nominated by the guardian of a minor dependant or nominee or the curator of a major dependant or nominee where the person is unable to manage his or her own affairs.

The testamentary trust or the trust deed of an inter vivos trust has a special clause dealing with benefits from the retirement fund. It should provide for:

- the fund benefits to be dealt with by the trustees of the trust in the manner directed by the board,
- the fund benefit must be ring-fenced, and
- the trust deed must vest capital and income in the particular beneficiary.

1.4.10 Is a beneficiary nomination binding on the fund upon the death of a member?

No, the trustees have to determine how to apportion the death benefit between the member's various dependants and nominated beneficiaries in accordance with the provisions of section 37C.

1.4.11 What is the point of completing a beneficiary nomination form if the trustees have a discretion as to how they will pay out a deceased member's approved benefits?

By completing the beneficiary nomination form, a member indicates to the trustees the persons he would prefer to receive his death benefits. It also indicates what portions of the benefit the member would ideally like the trustees to pay to the dependants and nominees.

Ideally, the beneficiary nomination form should be updated annually and if it is kept up to date, it makes the trustees’ task of identifying dependants and nominees and paying the death benefits, a lot easier. It also improves the chances of the trustees paying out according to the member's wishes.

1.4.12 Will trustees fail to fulfil their duties if the nominated beneficiary does not receive a benefit upon the death of a member?

No, as Section 37C requires that trustees must apportion the benefits equitably. The task of deciding how to apportion the benefit is not a simple one, yet it is a task which the trustees cannot avoid or delegate to someone else.

Trustees will only be failing to fulfil their fiduciary duties in paying death benefits if they do not act in good faith, do not in fact apply their minds to the problem or fail to exercise their discretion after taking into account all the various facts at their disposal.
1.4.13 When having to calculate the proportion of each dependant and nominated beneficiary’s benefit, what are the factors that the trustees will have to consider?

In a number of determinations the Pension Funds Adjudicator has indicated that in order to act equitably, the fund should have regard to a basket of factors, including:

- the age of the parties
- relationship with the deceased
- the extent of dependency
- the wishes of the deceased as reflected in his beneficiary nomination form and/or his will
- the amount available for distribution
- the financial affairs of the dependants and
- the future earnings potential and prospects of the dependants.

1.4.14 Does a member’s death benefit from a retirement fund form part of his estate?

No. In terms of section 37C of the Pension Funds Act, the death benefits do not form part of the member’s estate for purposes of the distribution of the benefits. The benefits are placed under the control of the retirement fund and the trustees have the discretion to pay the benefits to the member’s dependants in such proportions as they deem equitable.

1.4.15 Who is regarded as a dependant for the purposes of distribution of a member’s death benefits?

“Dependants” are defined in section 1 of the Pension Funds Act and are the following:

(a) a person in respect of whom the member is legally liable for maintenance;
(b) a person in respect of whom the member is not legally liable for maintenance, if such a person –
   (i) was, in the opinion of the trustees, upon the death of the member, in fact dependent on the member for maintenance;
   (ii) is the spouse of the member,
   (iii) is the child of the member, including a posthumous child, an adopted child and a child born out of wedlock.
(c) A person in respect of whom the member would have become legally liable for maintenance, had the member not died.

“Spouse” is in turn defined a person who is the permanent life partner or spouse or civil union partner of a member in accordance with the Marriage Act, the Recognition of Customary Marriages Act, or the Civil Union Act, or the tenets of a religion. This implies that people in same sex unions can legally be recognised as spouses.

Dependants in respect of whom the member is legally liable for maintenance referred to in (a) are minor children and a spouse who rely on the member for the necessities of life.
Grandparents, parents and grandchildren can also qualify as dependants, but this will be dependent on the circumstances.

It is important to note that all children qualify as dependants, whether they are minors or majors, and must be taken into consideration by the trustees when allocating the benefits. The fact that all the member’s children are taken into account does not mean that all the children will definitely receive a portion of the benefits.

1.4.16 What effect does divorce have on a member’s entitlement to benefits?

Current divorce law provides that a non-member spouse in a divorce action may be assigned a portion of the “pension interest” of the member spouse.

In terms of pension and provident funds, the “pension interest” is an amount equal to the withdrawal benefit which would have become payable in terms of the rules of the fund if the member had resigned on the date of the divorce.

In terms of retirement annuities, the “pension interest” is equal to the sum of all the contributions, plus simple interest at the prescribed rate of interest applicable on the date of divorce. The value of the simple interest cannot exceed the actual value of the actual investment return.

For preservation funds, the “pension interest” is the amount that the member would be entitled to if membership terminated on the date of divorce. Upon divorce, the court can include an order assigning a portion of each party’s “pension interest” to the other party.

The non-member spouse can claim the pension interest award, which may either be paid to the non-member spouse or transferred to a fund of the non member spouse’s choice.

1.4.17 Are there any tax implications when the non-member spouse receives his/her portion of the pension interests once the benefits become due and payable?

In terms of Section 37D, when the non member spouse submits a court order which is enforceable against the fund and an accompanying settlement agreement and makes an election to be paid or when the member becomes entitled to a benefit, whichever occurs first.

1.4.18 When will the pension interest become payable to the ex-spouse?

In terms of Section 37D, when the non member spouse submits a court order which is enforceable against the fund and an accompanying settlement agreement and makes an election to be paid or when the member becomes entitled to a benefit, whichever occurs first.
1.4.19 What effect does a maintenance order have on a member’s pension benefits?

In terms of section 37A and Section 37D of the Pension Funds Act, a member’s pension benefits may be reduced by way of maintenance orders. The court order must be provided to the administrator of the member spouse’s fund, which will note the maintenance court order.

If the maintenance order is enforceable against the fund the amount may be deducted from the member’s minimum individual reserve or benefit and paid over in accordance with Court’s instruction.

In terms of the Income Tax Act, the fund will deduct the tax payable on the maintenance award from the member’s minimum individual reserve or benefit as the case may be.

1.4.20 What happens if a member withdraws but dies before the withdrawal benefit is paid?

The benefit will still remain a withdrawal benefit and section 37C of the Pension Funds Act will not apply in this instance. The withdrawal benefit in such instance is payable to the deceased estate and not to a beneficiary.

1.4.21 How does a preservation fund work?

A preservation fund preserves the member’s accrued tax status, but may allow the member one withdrawal prior to retirement in respect of each amount transferred into the preservation fund.

Transfers to preservation funds must be like for like funds, i.e. a pension to a pension preservation fund or provident to a provident preservation fund. Transfers from retirement annuities to preservation funds are not allowed.

1.4.22 When may one transfer retirement fund benefits to a preservation fund?

Only upon resignation, retrenchment or dismissal from employment or if the employer’s retirement fund is wound up or liquidated. In addition, a non-member spouse can transfer the award of pension interest to a preservation fund.

1.4.23 May I transfer my benefits to a preservation fund when I retire from employment?

No.

1.4.24 If one resigns from employment and you want to preserve your retirement fund benefit, are you allowed to split the benefit between different insurers’ preservation funds?

No, the benefit may only be transferred to a single preservation fund.
1.4.25 If one is a member of your employer’s pension and provident funds, are you allowed to transfer the respective benefits to different preservation funds?

Yes, the benefit in respect of each fund can be treated individually and may be transferred to different preservation funds, i.e. the pension fund benefit will be transferred to a pension preservation fund and the provident fund benefit will be transferred to a provident preservation fund.

1.4.26 May one make ongoing contributions to preservation funds?

No, as preservation funds may only receive payments in the form of direct “translocation” (transfer) payments from an employer’s pension or provident fund.

1.4.27 If a pension fund is converting to a provident fund, will members be allowed to transfer their benefits to preservation funds?

Members are specifically prohibited from transferring their benefits to preservation funds during a conversion from a pension to a provident fund as there is no cessation of employment.

1.4.28 If one retires from employment, are you obliged to retire from your preservation fund too?

No, you are not obliged to take retirement. However, the rules of the preservation fund may insist on retirement after certain circumstances, but after attaining age 55.

1.4.29 If one wants to preserve your retirement fund benefit upon leaving employment, are you allowed to split the benefit into a retirement annuity and a preservation fund and if so, will this affect your one withdrawal?

You are allowed to split your retirement benefit in this way, provided that once you have transferred the requisite amount to the retirement annuity, the balance of your benefit must be transferred to the preservation fund. Transferring a portion of the benefit to a retirement annuity will not affect your one permissible preservation fund withdrawal.

1.4.30 If one wants to preserve your retirement fund benefit upon leaving employment and you have a housing loan provided by the fund which is outstanding and must be settled, what impact does this have on the transfer of the benefit to a preservation fund?

Any amounts deducted from the retirement fund benefit in terms of section 37D, i.e. housing loans, theft or fraud by the employee etc. are regarded as your one and only withdrawal from the preservation fund. In such circumstances you will therefore not have another withdrawal at your disposal once the reduced benefit is transferred to the preservation fund.
1.4.31 May I take a tax-free lump sum before transferring the balance of my benefit to a reservation fund?

No, the Income Tax Act only allows for the gross benefit to be transferred to a preservation fund. The only ways in which a retirement fund benefit may be reduced prior to transfer to a preservation fund is when there is a section 37D reduction or a transfer to a retirement annuity.

1.4.32 May I transfer my preservation pension (provident) fund benefit to my new employer’s pension (provident) fund, even though I have already taken my one withdrawal?

No, benefits may only be transferred between like preservation funds.

1.4.33 May members who have previously belonged to public sector funds, transfer their benefits to preservation funds?

Yes, where the rules of the public sector fund allow for such transfer. However, certain conditions may be imposed on the preservation fund in respect of such transferred benefits.

1.4.34 Can one transfer retirement benefits to overseas countries and from overseas countries into South Africa freely?

After tax foreign retirement benefits can be transferred between countries subject to exchange control regulations and section 14 of Pension Funds Act. Payments of such benefit into a South African fund can only be in the form of contributions.

Benefits from a South African fund can only be paid into foreign bank account subject to exchange control regulations. Exchange control approval for payment of monthly pension/annuity payments may be paid more easily obtained as opposed to lump sums.

1.5 The Surplus legislation

1.5.1 What does the Pension Funds Act stipulate regarding surplus?

The Pension Funds Second Amendment Act came into effect on 7 December 2001. For ease of reference this amendment legislation will be referred to as the “Surplus legislation”. The purpose of the Act is to address instances of deemed improper use of surplus in the past, minimum pension increases and minimum benefits on withdrawal.
The Act provides for the distribution of actuarial surplus to:

• Former members, if on leaving the fund after 1 January 1980, they received less than their full share of the fund or actuarial reserve. They may be entitled to receive the difference between the benefit that they actually received and their full share of fund or actuarial reserve at the time, together with interest calculated to the present day.
• Pensioners receiving an income from the fund, and deferred pensioners, if the pensions have not been increased to counteract inflation since their retirement.

Then, if the needs of former members and pensioners have been met:

• existing members, and
• the employer.

The apportionments must be done in accordance with legislation, as well as the subordinate legislation and practice notes issued by the FSB.

Minimum benefits as defined in the Pension Funds Act must be paid to members irrespective of the member’s reason for leaving the fund.

The Act also prescribes minimum pension increases to be granted to pensioners and deferred pensioners targeting the Consumer Price Index.

1.5.2 What is surplus?

In a defined contribution fund the surplus (if any) constitutes the assets in excess of the total sum of the individual shares of the members. In a defined benefit fund, surplus is calculated by the actuary as the excess of assets over the actuarial liabilities of the fund, on the basis of actuarial assumptions.

1.5.3 What are “minimum benefits”?

The Surplus Legislation defines the minimum benefit prescribed as the member’s “minimum individual reserve”.

In the case of defined benefit funds, the minimum individual reserve will be the full actuarial value and in the case of defined contribution funds, the member’s share of fund. That is, in both instances a refund of both employer and member contributions with fund interest, as well as a share in certain reserve accounts.

Minimum benefits in respect of active members for the future will be paid irrespective of the member’s reason for leaving the fund.
1.5.4 What constitutes minimum pension increases?

The Act also prescribes minimum pension increases where pensions are being paid from a pension fund. These must be the lesser of a full inflation adjustment and the increase that the fund can afford, given the provision made and investment returns.

1.5.5 Payment of the surplus benefit

Payments to former members who retired from the fund may be paid as a cash lump sum or as pension/annuity. Deferred pensioners and active members will have their minimum individual reserve increased within the fund.

It should be noted that the estate of a person who died prior to the surplus apportionment date will not be entitled to surplus, whereas an estate of a person who died after the surplus apportionment date may receive the surplus windfall in respect of the deceased.

If a former member transferred to another fund by way of a section 14 transfer, the surplus windfall will be transferred to the new fund by way of an additional section 14 transfer.

1.5.6 Taxation of surplus amounts

1. Distributions to former members and pensioners
   1.1 Distribution by way of a lump sum payment
       After 1 January 2006, these distributions are tax free. They are not even included as part of the recipient’s gross income.
   1.2 Distribution by way of an additional pension/annuity
       This distribution will be taxable as a pension/annuity.
       Where an existing pension was purchased from a long-term insurer and where the long-term insurer cannot reasonably be expected to accept the surplus distribution as payment for an increase under the existing pension arrangement, the retirement fund or long-term insurer, as the case may be, may pay the surplus distribution to the taxpayer in the form of a once-off bonus pension.
       This once-off bonus pension will not be subject to the provisions of the Second Schedule to the Income Tax Act and will be taxable in full at the taxpayer’s marginal rate of tax, after taking into account the existing pension.

2. Distribution to active members and deferred pensioners
   An increase in the benefit to such members is taxable as and when they become entitled to benefits in terms of the rules of the fund. The normal provisions in terms of the Second Schedule to the Income Tax Act continue to apply.

1.5.7 What does the Pension Funds Act stipulate regarding the future use of surplus?

After the needs of the former members and the pensioners have been satisfied, the balance of any surplus amount not explicitly allocated can be transferred to the employer and member surplus accounts.
Member and employer surplus accounts may be created, and once the surplus has been allocated to the respective accounts, they may be used in the following way:

The surplus allocated to the member surplus account can be used to
• improve the benefits for existing members
• improve the benefits previously paid to former members or the amounts previously transferred in respect of former members;
• reduce current member contributions, and;
• meet expenses which would otherwise reduce benefits.

The employer-appointed trustees on the board will not have a vote on the usage of surplus allocated to members. This will be the prerogative only of the member-elected trustees.

The surplus allocated to the employer may be used for the following purposes (notwithstanding anything to the contrary in the rules of the fund):
• funding a contribution holiday;
• benefit improvements;
• transfer to the employer surplus account in another fund in which the employer participates;
• payment in cash, but only on liquidation of the fund or to avoid retrenchment of a significant proportion of the workforce.

The member-appointed trustees on the board will not have a vote on the usage of surplus allocated to the employer. This will be the prerogative only of the employer-appointed trustees.

1.6 Actuarial reviews

1.6.1 What is an actuarial review?

In terms of the Pension Funds Act all funds which are not valuation exempt must be valued by an actuary every three years. Valuation at more frequent intervals may be conducted at the request of the trustees. These would normally be requested when the membership of the fund changes significantly, where changes to benefit structures are contemplated, or where the trend of investment returns changes significantly.

The actuary, in terms of a directive from the Registrar of Pension Funds, is required to report specifically on certain aspects of his findings.

The structure of the report is as follows:
• The first section briefly describes the pension fund and any significant changes that may have occurred since the previous valuation.
• The second section gives the basic information which is to be used in the valuation.
• The last section relating to the assumptions must contain details of the finding of the valuation, which includes a comparison between the assets and liabilities of the fund and the actuary’s recommendations as to the rate of contribution for the ensuing three year period, plus his reasons therefore.

1.6.2 What are the actuary’s prime duties?

It is the actuary’s primary duty to evaluate the financial soundness of the fund by valuing assets and liabilities and to advise on:

• The level of contributions required to fund the benefits.
• The financial soundness of benefits (the actuary might be of the opinion, for example, that the cost of particular benefits could escalate at a rate which the fund would not be able to afford in the future).
• The value of the benefits of particular members in the fund. This could apply to one member or extend to all members in the case of a takeover or merger.
• The rate at which the fund commutes annuities for cash, if appropriate.
• The increases that can be granted to pensioners.
• When members transfer into a defined benefit fund bringing with them an amount of money (usually from a previous fund), the actuary will advise how much past service can be recognized in the fund in return for the amount of money brought in.
• Analysis of membership profiles, for example the ratio of pensioners to actively employed members or the age pattern of withdrawals, both of which will affect the financial soundness of the fund.
• It is the actuary’s duty to examine the expected income from, and capital growth on, the investments held by the fund as compared to the expected benefit outflow. The actuary advises the trustees whether the choice of investment, usually by sector, is appropriate to the fund’s requirements.

1.7 State and Bargaining Council funds

1.7.1 How does the State Social pension grant work?

The most significant points of the fund are the following:

• Minimum age to qualify for the benefit: 60 years for females, 63 years for males. (Note that the government is in the process of reducing the age for males to align with the age for females);
• In general, one has to be a citizen of South Africa
• The State applies a means test to see if one qualifies for the grant (this takes into account other income and assets);
• The maximum pension is announced yearly by the Minister of Finance in his Budget Speech;
• The cost of providing these pensions is financed from general taxation.

Government is considering proposals for a national savings fund as part of the overall Social Welfare System in South Africa, which is likely to incorporate provision for a national old age pension.
1.7.2 What are Bargaining Council funds and how do they operate?

Bargaining Councils are established in terms of the Labour Relations Act. These Councils represent the interests of employers and employees within a specified industry for which they are registered and are formed by agreements (referred to as “collective agreements”) reached between trade unions and employer organisations which are gazetted and thereafter have the force of law.

Once the collective agreement is concluded, it is binding on all the parties thereto and the minister of Labour can extend the operation of the agreement to employer organisations and trade unions in the industry that were not a party to the agreement.

Bargaining Councils are entitled to facilitate agreements between the parties which affect the conditions of employment of employees within the industry for which they are registered. These agreements include:

1. The Main Agreement
2. The Pension Fund Agreement
3. The Medical Aid Fund Agreement.

Since the collective agreement is a contractual arrangement, it follows that if any of the parties terminate their participation in the Bargaining Council unilaterally and without the prior approval of the Council, they could be liable for civil and even criminal sanctions.

Thus, if the employer organisations and trade unions have agreed to establish a retirement fund by way of collective bargaining at Bargaining Council level, membership of the fund is usually compulsory and all the parties would be locked into the fund for as long as the agreement is binding.

Some Bargaining Council Funds allow an employer to apply for an exemption in terms of the collective agreement. Exemptions can usually be applied for where the employer operates an in-house fund that provides the employees with more favourable benefits to the Bargaining Council Fund. Application in a prescribed form and manner must be made for the exemptions. The conditions for the exemption vary from case to case.

Nonetheless, exemption from participation in a Bargaining Council Fund is not guaranteed and the Bargaining Council has the discretion to withhold its approval.

The implication for employees is that they have to join the Bargaining Council Fund.

In some of these funds, members do not receive a benefit on leaving the employer. The benefit will move with the employee to the next employer in the industry.

Bargaining Council Funds are required to be registered in terms of the Pension Funds Act.
1.8 The Pension Funds Adjudicator

1.8.1 Who can lodge a complaint with the Pension Funds Adjudicator’s office?

A complainant may be

1. Any person who is or claims to be
   a. A member or former member of a fund;
   b. A beneficiary or former beneficiary of a fund;
   c. An employer who participates in a fund;
2. Any group of persons referred to in 1a – c above;
3. A board of a fund or member thereof;
4. Any person who has an interest in a complaint.

1.8.2 What is the procedure to lodge a complaint with the Pension Funds Adjudicator’s office?

In terms of the Pension Funds Act, if someone wants to lodge a complaint with the Pension Funds Adjudicator’s office, the complaint must first lodge a written complaint with the fund or the employer.

The fund or the employer must properly consider the complaint and reply to it in writing within a period of 30 days after receipt of the complaint.

If the complainant is not satisfied with the reply, or if the fund or employer fails to reply within the 30-day period, the complainant may lodge the complaint with the Adjudicator’s office. However, in practice the office of the Pension Funds Adjudicator accepts complaints where this procedure has not been followed.

1.8.3 What may one complain about to the Pension Funds Adjudicator?

One may complain about:

• The administration of a fund;
• The investment of its funds;
• The interpretation and application of the fund’s rules.

The complaint must relate to a specific complainant.

1.8.4 Is there a time limit for lodging complaints?

The act or omission to which the complaint relates must not have occurred more than three years before the date on which the Pension Funds Adjudicator receives the complaint.
If the complainant was unaware of the occurrence of the act or omission, the three year period will only commence on the date on which the complainant became aware of, or should have become aware of the occurrence.

1.8.5 What happens to complaints and responses that are sent to the adjudicator?

After the Adjudicator has received the complaint and the response from all relevant parties, an assistant Adjudicator will investigate the complaint by phoning or writing to any of the parties for more information, if necessary. Any further written replies must be copied to all parties so that they can comment. The Adjudicator will determine and apply the relevant law to the facts of the case and make a decision.

You will receive the decision in the form of a determination or a letter stating reasons for the finding. Determinations of the Adjudicator can be taken on appeal to the High Court within six weeks of the decision being made.

1.8.6 What is conciliation?

Conciliation is a process where an independent person meets with the parties to a dispute, and explores ways to settle the dispute by agreement. The office of the Pension Funds Adjudicator usually uses two methods of conciliation: teleconference conciliation; or mediation and facilitation. The first method (teleconference) is only utilised in exceptional circumstances. The latter method is more frequently utilised by the Adjudicator whereby the conciliator physically meets both parties and acts as a mediator or facilitator in the meeting. If a settlement agreement is reached at conciliation, a written agreement containing the terms of the settlement is usually signed. Such an agreement has a binding effect similar to that of a determination by the adjudicator.

1.8.7 How do I know if a matter has been referred to conciliation?

The office of the adjudicator determines whether a specific matter is appropriate for conciliation. Once the adjudicator determines whether a matter can be conciliated, the office of the adjudicator will notify the parties of the date, time, venue, and method of conciliation.

1.8.8 What are the costs of lodging a complaint with the Adjudicator?

There is no charge to lodge a complaint with the Adjudicator. One does not need legal representation either.

1.8.9 Where can one find more information on the Adjudicator’s office, procedures, complaints processes etc?

See the Adjudicator’s website: www.pfa.org.za
1.9 What is FAIS?

FAIS is the Financial Advisory and Intermediary Services Act No 37 of 2002, which came into effect on the 30th September 2004. The FAIS Act was introduced to regulate the business of all Financial Service Providers who give advice or provide intermediary services to clients.

The Act aims to achieve the following:

- Ensure that the Financial Services industry is and will remain a professional and responsible sector in the economy.
- Ensure that the consumer is better informed of all the options available to them when making financial decisions or entering into financial transactions.
- Ensure that the appointed representative in the Financial Services industry maintain professionalism or conduct themselves professionally at all times when dealing with clients.

Anyone who seeks to establish or maintain a retirement fund should ensure that they are dealing with an FAIS accredited Financial Adviser.
2 Tax

PLEASE NOTE THAT NATIONAL TREASURY AND THE SOUTH AFRICAN REVENUE SERVICE CONTINUOUSLY REVISE THE TAXATION PRINCIPLES IN RESPECT OF RETIREMENT FUNDS. IT IS ADVISABLE TO SEEK EXPERT TAX ADVICE BEFORE RELYING ON THE INFORMATION BELOW.

2.1 Taxation at a glance

The following table compares the taxation concessions of both pension and provident funds.

<table>
<thead>
<tr>
<th>Contributions</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee</strong></td>
<td>Pension Scheme</td>
</tr>
<tr>
<td>Section 11(k) of the Income Tax Act</td>
<td>The deduction allowed is the greater of:</td>
</tr>
<tr>
<td></td>
<td>(a) 7.50% of remuneration derived from retirement funding income, or</td>
</tr>
<tr>
<td></td>
<td>(b) R 1 750 per annum.</td>
</tr>
<tr>
<td></td>
<td>2 Additional contributions up to R 1 800 per annum</td>
</tr>
<tr>
<td><strong>Employer</strong></td>
<td>Provident Scheme</td>
</tr>
<tr>
<td>Section 11(l) of the Income Tax Act</td>
<td></td>
</tr>
<tr>
<td><strong>On Retirement</strong></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td><strong>Second Schedule to the Income Tax Act</strong></td>
<td><strong>Tax-free portion of lump sum benefits</strong></td>
</tr>
<tr>
<td></td>
<td>Tax free amount is a flat R 315 000 applicable once off on sum of all lump sums due on retirement, plus</td>
</tr>
<tr>
<td></td>
<td>Member’s own contributions not previously allowed as a deduction, plus</td>
</tr>
<tr>
<td></td>
<td>Contributions made to a public sector fund, if applicable, on or before 1 March 1998, less</td>
</tr>
<tr>
<td></td>
<td>Any tax-free benefits previously received from other approved schemes on or after 1 March 2009.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>On Death</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Second Schedule to the Income Tax Act – paragraph 5(2)</strong></td>
<td><strong>Tax-free portion of lump sum benefits</strong></td>
</tr>
<tr>
<td></td>
<td>Tax free amount is a flat R 315 000, applicable once off on sum of all lump sums due on death, plus</td>
</tr>
<tr>
<td></td>
<td>Member’s own contributions not previously allowed as a deduction, plus</td>
</tr>
<tr>
<td></td>
<td>Contributions made to a public sector fund, if applicable, on or before 1 March 1998, less</td>
</tr>
<tr>
<td></td>
<td>Any tax-free benefits previously received from other approved schemes on or after 1 March 2009.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>On Withdrawal</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Second Schedule to the Income Tax Act – paragraph 6</strong></td>
<td><strong>Tax-free portion of lump sum benefits</strong></td>
</tr>
<tr>
<td></td>
<td>Tax free amount is a flat R 22 500, per life time plus</td>
</tr>
<tr>
<td></td>
<td>Member’s own contributions not previously allowed as a deduction, plus</td>
</tr>
<tr>
<td></td>
<td>Contributions made to a public sector fund, if applicable, on or before 1 March 1998, less</td>
</tr>
<tr>
<td></td>
<td>Any tax-free benefits previously received from other approved schemes on or after 1 March 2009.</td>
</tr>
</tbody>
</table>
Notes

1. Annuities (pensions) are taxed as income, at the member’s marginal rate.

2. On retirement, death or withdrawal; any lump sum in excess of the tax-free portion will be taxed at the rates described in the table below.

<table>
<thead>
<tr>
<th>Tax rates for Pension and Provident Scheme lump sums on retirement or death</th>
<th>No rebates will be allowed when taxing the lump sum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>Tax Rate</td>
</tr>
<tr>
<td>First R 315 000</td>
<td>Tax-free see tables above</td>
</tr>
<tr>
<td>R 315 000 — R 630 000</td>
<td>18%</td>
</tr>
<tr>
<td>R 630 001 — R 945 000</td>
<td>27%</td>
</tr>
<tr>
<td>R 945 001 and above</td>
<td>36%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tax rates for Pension and Provident Scheme lump sums on withdrawal</th>
<th>Amount</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>First R 22 500</td>
<td>Tax free see tables above</td>
<td></td>
</tr>
<tr>
<td>R 22 500 — R 600 000</td>
<td>18%</td>
<td></td>
</tr>
<tr>
<td>R 600 001 — R 900 000</td>
<td>27%</td>
<td></td>
</tr>
<tr>
<td>R 900 001 and above</td>
<td>36%</td>
<td></td>
</tr>
</tbody>
</table>

3. Please note that all lump sums accruing to the member on or after 1 March 2009 will be aggregated for the purpose of determining tax free and taxable amounts.

<table>
<thead>
<tr>
<th>APPROVED</th>
<th>UNAPPROVED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Relief on premiums in respect of insured benefits</td>
<td></td>
</tr>
<tr>
<td>EMPLOYEE</td>
<td>No tax relief available</td>
</tr>
<tr>
<td>EMPLOYER</td>
<td>Treated as employer contributions (see principles relating to section 11(l) above)</td>
</tr>
<tr>
<td></td>
<td>Employee pays fringe benefit tax on premiums paid (Seventh Schedule to Income Tax Act)</td>
</tr>
<tr>
<td></td>
<td>Employer may claim deductions as an operational expense in terms of section 11(a) of Income Tax Act.</td>
</tr>
</tbody>
</table>

Tax on Benefit Payments

<table>
<thead>
<tr>
<th>APPROVED</th>
<th>UNAPPROVED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treated as a benefit paid by a pension or provident scheme (see principles above)</td>
<td></td>
</tr>
<tr>
<td>Lump sum payments tax-free.</td>
<td></td>
</tr>
</tbody>
</table>

Note: The tables above are subject to the accumulation principle.
2.2 General

2.2.1 What is the difference between approved and unapproved funds?

In terms of section 4 of the Pension Funds Act, all retirement funds have to be registered with the Registrar of Pension Funds. A retirement fund is not allowed to carry on the business of a pension, provident or retirement annuity fund without registration.

Approval by the Commissioner of the South African Revenue Service, however, is optional. To ensure that the employer and members of the fund can make use of the tax concessions pertaining to retirement funds provided for in the Income Tax Act, funds have to be approved by the Commissioner for the South African Revenue Service. These funds are known as approved funds.

2.2.2 In which circumstances will the South African Revenue Service approve a fund?

Pension funds
If the Commissioner is satisfied that the fund is a permanent fund, bona fide established to provide annuities for employees on retirement (or their dependants on their death) and that the fund rules have been complied with, the fund will be approved. The Commissioner will not approve a fund unless he is satisfied that

• recurrent contributions will be made in accordance with specified scales;
• membership of the fund is a condition of employment for all eligible employees;
• existing employees can apply to become members within 12 months of the fund’s establishment;
• a maximum of one third of the total annuity may be commuted for cash. If the annual annuity is less than R75 000-00 the entire annuity may be commuted;
• the employer cannot control the management or assets of the fund or derive any monetary advantage from it;
• the South African Revenue Service must be notified of all amendments to the rules and
• an annuity payable to a dependant of a member can be commuted at any time after the member’s death.

Provident funds
The same requirements apply as for a pension fund, except that there is no requirement limiting commutation to a maximum of one third of the benefit available at retirement.

Approval is not a once off application, but in terms of the Income Tax Act theoretically applies on an annual basis for funds.
2.2.3 What will the South African Revenue Service do if a fund does not comply with the requirements of the Income Tax Act?

If the conditions for approval of a fund as described in the Income Tax Act are breached at any time, the South African Revenue Service may withdraw the fund’s approval and therefore also the right to tax concessions. Tax concessions previously enjoyed could possibly be reclaimed and penalties imposed.

2.2.4 What is “retirement funding income”?

Firstly, we have to examine “retirement funding employment” which is, in essence, the employment of or holding of an office by someone who is a member of or contributes to an approved pension or provident fund.

The definition of “retirement funding income” includes only income derived from pensionable emoluments earned by an employee or “office holder”, from the firm, organisation or body which has instituted such pension or provident fund.

So much of a member’s travelling allowance which is taken into account for purposes of determining contributions to the fund, forms part of retirement funding income. That part of a travelling allowance which is not retirement funding income, minus expenses claimed and allowed as a deduction, remains non-retirement funding income.

Therefore, only the remuneration which is taken into account in order to determine the contributions by a member or an employer to a pension or provident fund will be regarded as “retirement funding income”. This will include a non-contributory fund where only the employer contributes on behalf of the member.

“Non-retirement funding income” is that part of a member’s remuneration which is not remuneration in respect of which the member’s or his employer’s percentage retirement fund contribution is calculated. Non-retirement funding income includes lump sum benefits payable in terms of pension, provident, retirement annuity and deferred compensation funds.

2.2.5 Are employer contributions to a pension or provident fund for a member considered a fringe benefit?

The Seventh Schedule of the Income Tax Act does not include employer contributions to a pension fund or provident fund as being a taxable fringe benefit. Thus, fringe benefit tax is not levied.
2.2.6 On retirement from a pension or provident fund, can the member use the proceeds to purchase a retirement annuity and claim the 15% deduction in terms of the Income Tax Act?

Should a member retire from a retirement fund, any portion of the benefit which is commuted for a lump sum may be used as a contribution to a retirement annuity and will be eligible for the deduction of 15% of non-retirement funding income.

2.2.7 Can a fund be backdated to a previous year?

The main reason for wanting to backdate a fund’s inception date, usually to the previous tax year, once profits have been established, is to take advantage of the tax relief available on contributions to approved funds.

There are however, various problems with this.

• To claim tax relief on contributions to funds, payment of the contributions must be made during the year in which the tax relief is claimed. If no fund is yet in existence clearly this is not possible and the Commissioner will not allow such deductions.

2.2.8 What does “past service” mean?

Past service, is a period of employment (service) with an employer prior to becoming a member of a pension or provident fund from which retirement benefits are eventually taken. The desire to grant retirement benefits that incorporate recognition of this prior service is sometimes found in defined benefit funds.

The same practice is often adopted by employers for new employees, in respect of periods of service with previous employers in the same or a related industry.

In respect of a Defined Benefit fund, this would mean that in addition to the benefits recognized in terms of the period of actual membership, often called “future service”, additional benefits would accrue in terms of the agreed period of past service recognised by the employer.

The rate of benefit accrual for past service would generally be the same as that for future service, i.e. “pensionable service” in the formula that is used to determine the value of the retirement benefit would be the sum of the future and past periods of service, but the benefit accrual rate for the past service could be at a different rate to that for future service as recommended by the fund’s actuary.

The cost associated with the recognition of past service would be borne by the employer, as an increase in the employer’s funding rate.

Where the assets and liabilities of a previous fund are amalgamated with the employer’s current fund in respect of members where there is deemed to be no break in employment, then, in general, the transferee
rules may allow for the period of membership (service) under the transferor fund to be recognised by the transferee fund as a period of past service.

It is important to note that if less than 100% of the assets representing the period of membership or service recognised by the transferor fund in respect of a member are transferred, the period of past service recognised by the transferee fund will be proportionately reduced.

2.2.9 Can one partially retire?

In a pension fund or provident fund one cannot partially retire. “Retire” means to retire from employment and is thus a question of fact. One cannot “retire” from a fund and not retire from employment. The principal objective of partial retirement would be to mitigate the tax payable on any lump sum by deferring the pension into a subsequent tax year, and would be considered to be tax evasion by the South African Revenue Service.

2.2.10 Are retirement funds subject to Capital Gains Tax?

Currently, retirement funds are not subject to capital gains tax.

2.2.11 What are the income tax implications of a pension that is received from an overseas source?

The basis of taxation in South Africa changed from a source basis to a residence basis of taxation with effect from 1 January 2001.

Briefly, this means that South African residents will be taxed on the income that they earn from all sources, including overseas sources. If South Africa has a double taxation agreement with another country, the tax will be levied in terms of the relevant double taxation agreement. If no such an agreement exists, tax may be payable in both countries.

2.2.12 What are the requirements and procedures for a fund to purchase an annuity in the name of the member?

Should a fund wish to purchase a compulsory purchase annuity in the name of the retiring member, thereby terminating its liability in respect of that member, it must comply with the following requirements:

• The fund’s rules must provide that, on purchase of the annuity in the name of the member, the fund’s liability towards the member will cease;
• The retiring member must be the owner of the policy;
• The capital remaining after the deduction of a commutation, if any, must be used to purchase the annuity, which must be non-commutable, non-assignable and payable for the life of retired member;
• There are restrictions and requirements imposed by the South African Revenue Services if more than one annuity will be purchased at retirement.
2.2.13 What are the estate duty consequences for pensions provided by pension, provident and retirement annuity funds?

A pension or annuity that becomes payable as a result of a member's death, whilst being a member or pensioner of a pension, provident or retirement annuity fund, is exempt from estate duty. If, for example, a member died prior to retirement, any spouse's or orphans' pension provided by the fund will be exempt from estate duty.

If a member died after retirement, any annuity provided by a pension, provident or retirement annuity fund as a result of the member's death, will be exempt from estate duty, e.g. a survivor pension in respect of a joint and survivor pension.

2.2.14 What are the estate duty consequences for lump sums provided by pension, provident and retirement annuity funds?

All lump sum benefits which are due and payable by pension, provident and retirement annuity funds as a result of a member's death are no longer subject to estate duty.
### 3.1 General principles applicable to risk benefits

#### 3.1.1 What are the advantages and disadvantages of self-insurance and reinsurance of risk benefits?

<table>
<thead>
<tr>
<th></th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tr>
<td><strong>SELF-INSURANCE:</strong></td>
<td>(a) Since the risk of death and disability benefits is wholly carried by the fund, profits due to favourable mortality or morbidity experience accrues to the fund and not to an insurer.</td>
<td>(a) If the mortality or morbidity experience of the fund during a year or over a period of time is adverse, it could place an unacceptable financial strain on the fund to the point of insolvency.</td>
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<td>(b) Self-insurance offers the opportunity to be flexible in the application of benefit restrictions.</td>
<td>(b) Fund personnel may lack the expertise to accurately assess the nature of risks and changes therein, thus leaving the fund vulnerable to substantial losses</td>
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<td></td>
<td>(c) The premiums are retained by the fund.</td>
<td>(c) No cover will be provided against catastrophic events.</td>
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<tr>
<td><strong>REINSURANCE:</strong></td>
<td>(a) There will be no risk of insolvency of the fund if a series of large claims are paid out in a short space of time.</td>
<td>(a) As the fund does not carry the risk of death and disability benefits, it does not make profits due to favourable mortality or morbidity experience.</td>
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<td></td>
<td>(b) The insurer’s staff are experts at risk assessment.</td>
<td>(b) No flexibility in the application of benefit restrictions.</td>
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<tr>
<td></td>
<td>(c) Cover will be provided for catastrophic events.</td>
<td>(c) Premiums constitute a capital drain.</td>
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**NOTE:** Sometimes funds (especially the large funds) may choose to partially re-insure risk benefits, particularly the provision of catastrophe cover. Generally, only the funds of larger employers are self-insured, as the associated costs make it uneconomic when compared to the fees charged by life insurers.
3.1.2 What is the maximum level of group life insurance within a fund?

In principle there is no maximum, but high levels of group life insurance cover can become expensive. The maximum cover is limited by what the insurance company is prepared to underwrite, on the grounds of representing a reasonably acceptable moral hazard.

3.1.3 Does group life insurance and disability benefits have to be included in a pension or provident fund?

No, they do not have to be included, but it is practical to have both life and disability cover. Sometimes a separate unapproved group life fund might be better for tax reasons. (See section on Tax).

3.1.4 Can the group life insurance benefit in a fund be used as partnership assurance?

No, it cannot.

3.1.5 What is a medical free limit?

The medical free limit is the amount of cover granted by an insurer of a fund, or the fund itself if self-insured, which contains risk benefits, below which level medical examinations or other evidence of health will not be required.

It is very expensive to have all the members of a fund medically examined, thus it is not financially worthwhile to examine everyone, particularly those with low cover.

Within any group of people there are those who are medically sound and those who are not. An insurer or fund will only wish to examine those people with high death and disability cover. Medical free limits may sometimes be applied where there is a minimum number of members or a minimum total some assured.

The medical free limit can be amended at any time, however, once a member’s cover in terms of the medical free limit available is granted, it cannot be taken away.

3.1.6 When does the cover commence?

Cover commences on the date that a member satisfies the eligibility requirements for membership.

If the member is unable to work due to illness or injury on the day he satisfies the eligibility conditions or during any of the 20 working days before such date, then cover will only commence once he has completed 20 consecutive days of full time work after the date he first satisfied the eligibility conditions.
3.1.7 What happens if a member’s cover exceeds the medical free limit?

The member will be asked for medical information or to undergo a medical examination to provide evidence of health to obtain cover in excess of the free limit. Whilst waiting for this information the amount of cover will generally be the full cover in terms of the rules, but subject to any maximum amounts that the insurer may impose.

The member will receive full cover for a period of the earlier of 60 days from the commencement of cover date (to allow time to provide the evidence of health) or until a decision on the provision of cover is made.

If a claim for benefits is lodged during the above period or within one year of the commencement of cover, and the claim is as a result of a pre-existing condition, the benefit will be restricted. No benefit will be payable if the claim is in respect of the Income Plus Plan benefit.

3.1.8 Is a member covered if he enters a fund between two anniversary dates?

Yes, provided the rules of the fund permit entry at any time.

3.1.9 What is spouse’s cover?

Spouse’s cover is a separate, unapproved group life assurance fund usually running in conjunction with a retirement fund, where the member’s spouse is covered for up to 2 x the member’s annual salary in respect of death or disability of the spouse. There are usually no medical examinations required.

3.1.10 What are Spouse’s and Children’s Pensions?

On the death of a member, the benefit payable to a surviving spouse and dependent children, may take the form of either,

- a monthly pension, or
- a lump sum payment in combination with a monthly pension.

The spouse covered in terms of this benefit will be defined in the fund’s rules but generally follows the definition of spouse in the Pension Funds Act.

Similarly, the fund’s rules will define a dependent child.

3.1.11 How long is a spouse’s pension payable for?

Most spouse’s pensions are payable for the life of the spouse or in certain cases, until remarriage.
3.1.12 How long is a child's pension payable for?

A child's pension is payable until reaching the age of maturity, ceasing tertiary education, or attainment of a specified age. A child who is physically or mentally handicapped may receive a pension for the life.

3.1.13 Can pensions/annuities be paid in arrears and if so what are the possible tax implications?

Yes, annuities/pensions may be paid in arrears provided that the first payment is made no later than the last day of the month in which retirement occurs.

3.1.14 What is a continuation option?

A continuation option is the ability to continue risk cover enjoyed at standard rates and conditions in the fund, in an individual policy once a member has left the fund, provided the member meets specific conditions.

A continuation option has to be exercised within a specified period after leaving the fund and does not give the member a right to continued fund cover. Once the member leaves the fund, his/her fund cover ceases until an individual policy in terms of the continuation option is accepted by the insurer.

3.1.15 What is multi-national pooling?

Multi-national pooling is an arrangement specifically targeted at multi-national companies, whereby their group life insurance cover (or a portion thereof) for their subsidiary companies worldwide can be brought together internationally.

Losses arising from the operation of the worldwide pool or from a number of different local group life assurance funds can be offset against each other.

3.1.16 What is permanent health insurance (“PHI”)?

It is the generic term for long-term disability income insurance, also known in the market place as Income Security Plan (“ISP”). Liberty Corporate’s product is the Income Plus Plan (“IPP”). Whatever the name, the concept is to provide an income for a temporarily or permanently disabled person during the period of disablement.

3.1.17 What are the territorial limits of risk benefits?

In principle, cover will only be provided for members who are ordinarily resident in the Republic of South Africa. Residents in other countries will only be included if specifically agreed to by the insurer.

Insurers usually require the employer to notify the insurer within a specified period of time if the member
becomes temporarily resident outside the Republic and wishes to remain covered provided the insurer agrees. Usually the cover will cease if the period of residence outside the Republic is of an extended duration.

Benefits in the course of payment to non residents may cease if the person does not return to the republic.

3.2 Disability Insurance

3.2.1 What is a lump sum disability benefit?

A lump sum disability benefit is an alternative, cheaper form of providing for disability, but only in the case of total and permanent disability. In essence, part of the group life assurance benefit is advanced on disability. For a pension fund, 1/3rd is paid in cash and the balance is paid in the form of a monthly income. In terms of a provident fund, the whole payment may be made in cash.

The disadvantage of a lump sum disability benefit, as opposed to an IPP payment, is that all the benefits are paid out as accelerated death benefits and little or nothing is left to pay on subsequent death. When receiving an IPP benefit, the member remains on the fund and on death, the death benefit is still payable – which is the preferable situation.

3.2.2 What are the different types of lump sum disability?

Disability insurance can be provided for:

• disability from performing your own occupation;
• disability from performing any occupation;
• disability resulting from contracting certain medical conditions.

3.2.3 What is permanent health insurance (“PHI”)?

It is the generic term for long-term disability income insurance, also known in the market place as Income Security Plan (“ISP”). Liberty Corporate’s product is the Income Plus Plan (“IPP”). Whatever the name, the concept is to provide an income for a temporarily or permanently disabled person during the period of disablement.

3.2.4 Will IPP disability benefit payments keep up with inflation?

IPP benefits may not keep up with inflation unless there is a built-in escalator included in the IPP.
3.2.5 Is a member in receipt of IPP monthly disability benefits liable for tax on such payments?

Monthly IPP payments, being a replacement of income, are fully taxable as gross income.

3.2.6 What are “pre-existing conditions” which apply to risk benefits and how can they affect fund members?

These are medical conditions, which a member is or was suffering from, prior to membership of the fund. Most policies have clauses indemnifying the insurer against new members who are already suffering from some or other illness. In the event of a claim within the first 12 months of membership arising from a pre-existing medical condition, the member’s benefits will be restricted unless the insurer received satisfactory medical evidence and notified acceptance of the benefits in writing. The employer must notify each new member of this pre-existing condition and its implications. Failure by the employer to do so will not invalidate the operation of the pre-existing condition restrictions.

3.2.7 What are waivers in respect of IPP?

There are two types of waivers. The first is premium waiver, where the employer does not pay any premium for the IPP benefit attributable to a member whilst the member is in receipt of IPP benefits.

The second waiver is an employer contribution waiver. In terms of this waiver, the employer insures his monthly contributions to the retirement fund for those members who are in receipt of IPP benefits.

Membership of the retirement fund continues and there is no loss of pensionable service on recovery from disability. Death and retirement benefits will still be paid.

3.2.8 Are different options available on IPP?

Yes, various options are available from insurers.

3.2.9 Is there a waiting period in an IPP?

Depending on the terms of the policy, the insurer may offer a variety of waiting period before a claim for benefits will be admitted. The longer the waiting period, the cheaper the premium.

3.2.10 What is the Plus Benefit?

This is a Liberty Corporate product. When disabled and receiving the IPP benefit, the claimant’s salary is frozen at the level at the time of disablement. Thus, contributions to the associated pension or provident fund remain unchanged from that point in time. Due to inflation, this means that the eventual retirement benefit will be eroded in real terms. The Plus Benefit provides that after the end of two years of an IPP claim, 1/9th of the monthly income benefit is paid into the retirement fund each month to boost the eventual retirement payment.
4. Investments

4.1 Why does a retirement fund invest?

The primary purpose of a retirement fund is to provide the members of the fund with the best retirement benefits possible given the circumstances of the fund. In order to do this the trustees need to optimise the structure of the fund and then make prudent investment decisions in order to grow the assets of the fund in real terms (in excess of inflation).

Retirement funds have many choices but in general terms these investments most often take the form of

- Equities (shares)
- Gilts or Government Bonds
- Property
- Cash and other money market instruments

These investments can be in South Africa and denominated in Rand terms, or they can be offshore and denominated in a host of foreign currencies (usually by way of asset swap).

4.2 What is a pooled portfolio?

A pooled portfolio is an investment portfolio in which many different investors participate. The fund manager "pools" the investments of all the participating investors into one fund and manages them as such.

- The daily unit price of a pooled portfolio is not quoted in the press
- The costs of a pooled portfolio is contained in an annual investment management fee
- Pooled portfolios are traditionally the offering of life insurers
- Pooled portfolios are generally cheaper to invest in, particularly where larger funds are concerned.

4.3 What is a unit trust?

A unit trust is a collective investment fund whereby the unit trust administrator collectively invests funds for a range of investors. The value of the underlying assets is disclosed to the unit holders in the form of a unit price.

- the daily prices of unit trusts are quoted in the press
- the costs associated with unit trusts are explicitly funded upfront at the date of purchase. Unit trusts are regulated by the Collective Investment Funds Control Act.
4.4 What is a wrap fund as opposed to a fund of funds?

A wrap fund is a fund where the fund manager wraps together a selection of funds (mostly unit trusts) to suit a particular risk profile or set of investor needs. More often than not these funds conform to a wide range of risk profiles, e.g. conservative, moderate or aggressive. The investor chooses a risk profile, which suits their need and does not need to be concerned about a mismatch between the underlying funds, their strategy and the chosen profile. It is the function of the wrap fund manager to ensure compliance to the profile at all times.

- Wrap funds are not regulated;
- The daily values are not quoted in the press.

A fund of funds is a unit trust that invests in other unit trusts. Whilst it is ostensibly the same as a wrap fund, there are some important differences. The fund of funds is in fact a unit trust itself.

- Fund of funds are regulated by the Collective Investment Funds Control Act;
- Daily values are quoted in the press.

4.5 What are multi-manager funds?

A multi-manager fund is a fund where the multi-manager focuses on the use of other underlying asset managers. The multi-manager concentrates on the choice of a host of underlying asset managers to make up a portfolio. The multi-manager will undertake an intensive study of the process employed by other asset managers and make a selection based on the skill, ability, process, people, performance consistency and complementary nature of the underlying asset managers.

A portfolio will then be constructed using the services of these chosen asset managers who are carefully selected to provide investment synergy. Each underlying manager is given a specific investment mandate, usually in the form of a segregated fund. The multi-manager will also ensure that the underlying asset managers constantly meet the required standards and conform to the mandate they are given.

4.6 What is an asset swap portfolio?

Exchange control regulations permit asset managers and pension funds to invest a prescribed maximum percentage of their assets offshore. An assets swap is where two parties agree to swap the assets that they own. A South African unit trust agrees to give local assets to a foreign party in return for foreign assets to the same value. In this way the local unit trust acquires an overseas asset. This enabled asset managers to construct offshore portfolios denominated in foreign currency. Retirement funds can use these portfolios to diversify the risk of Rand devaluation as well as to give the fund exposure to other economies.
4.7 Is individual member choice a better option?

There is no concise answer to this question. It is really a question of what is appropriate for the body of fund membership. It is, however, important that members be aware when this option is available to them. Individual member choice inherently requires a high level of advice at member level and will go hand in hand with a personalised risk profile analysis and financial needs analysis, taking cognisance of the individual member’s circumstances. It will also require regular review to ensure that it remains appropriate.

Where individual member choice is offered, the trustees will need to ensure that the members are either competent to make the investment choices themselves, or that they are provided with the necessary resources in a comprehensive format, to enable them to make an informed and appropriate decision.

Some of the benefits of individual member choice:

- enables the members to tailor-make an individualised investment decision;
- incorporates retirement funding into the overall financial plan of the member;
- enables the members to take control of their retirement fund investment.

Disadvantages of individual member choice:

- it is onerous for the trustees;
- requires a high level of administration and communication capability;
- it increases costs;
- it increases the risk of the member making inappropriate investment choices;
- it inherently requires a high level of understanding and insight from the member.

4.8 What about investment guarantees?

The fact that an investment portfolio offers a guarantee is a very important consideration. This is often not granted the level of consideration it deserves in the investment decision-making process.

Given the nature of retirement funds and the volatility we see in today’s markets, it is often essential that some members (particularly those unskilled in financial matters and members close to retirement) consider portfolios with investment guarantees.
4.9 What are the Prudent Investment Regulations and Prescribed Assets?

Regulation 28 to the Pension Funds Act imposes limits on the investments of retirement funds. These are intended to protect funds against making imprudent investments (once the old requirement to invest in prescribed assets had fallen away).

Over the past few years, the investment avenues available to retirement funds have become significantly more complicated with the incorporation of derivatives, structured products and foreign investments over which the trustees may have no control in terms of the sectors in which the foreign investment manager invests.

4.10 How do you measure investment performance?

Traditionally investment surveys concentrated on nominal returns, i.e. actual returns achieved by participants. There is, however, increasing recognition that it is just as important to measure the risk or volatility inherent in achieving the returns.

Investment return is in itself, quite meaningless. One needs to judge an investment return, given the level of risk taken to achieve that return.

4.11 How do you measure risk?

The measure commonly used for risk is the standard deviation of the monthly returns. This measures the extent to which the returns over a number of years vary. A high standard deviation reflects high volatility or risk and conversely a low standard deviation would reflect low risk. There are other measures of risk and reward, like return per unit of risk. This unitises the risk and attaches a return to it. In this case the higher the return per unit of risk, the better.

These are commonly used measures. Of course, there are many sophisticated mathematical and statistical measures of the various components, but, suffice to say that risk and return have a strong correlation and that the one needs to be viewed in terms of the other.
4.12 What is the difference between a money-weighted and a time-weighted rate of return?

**Money-weighted performance basis**
This method of measuring performance depicts the actual return specific to the fund and is dependent on the particular cash flow of that fund. This measure is also known as the internal rate of return. The timing of cash flowing in or out of a portfolio can have a profound influence on the measured investment return achieved by a fund.

**Time-weighted performance basis**
This measure is particularly useful in comparing the returns of different asset managers against each other. A lump sum investment is invested at the beginning of a period and the resultant value at the end of the period is calculated, assuming that there is no cash flow in or out of the portfolio during that time. In other words, it assumes full investment for the whole period. This method avoids the distortion created by specific cash flows of each particular fund. It measures the performance over time only.

**Consider an example:**
R120 invested in a bank account at 10% per annum for one year, delivers interest of R12 (ignoring compounding). Another investment of R10 per month in the same bank account also involves R120 in capital over one year, but given the same return of 10% per annum it only generates R6.70 in interest or 5.58% of the capital – hence the reason we show money weighted returns, as they account for the cash-flow. This is a real return given the cash-flow. The complication arises in that interest always goes forward, as, in this example at 10% per annum. Portfolios move forward and backward and at different rates of change.

4.13 What is the difference between a guaranteed and a market value investment?

**Guaranteed investments**
Guaranteed portfolios are generally only offered by life insurers and relieve the trustees of some of the investment risks.

The guarantee provided under these types of portfolios, means that regardless of the market values of the underlying assets, the insurer guarantees that the fund will be paid a certain nominal value, although this nominal value is usually payable over a period of time.

The essential advantages of guaranteed portfolios to the investing fund are:

- investment returns
- guaranteed values, should the fund need to realise assets to pay benefits

Under the guaranteed (stable bonus) system, the actuary declares a bonus rate which is expected to be maintained for a reasonable period in the future. In other words, there is an attempt to even out the peaks
and troughs of investment returns and also retain a margin to allow for future uncertainties. As such, these portfolios are particularly suitable for funds with erratic cash flows and for funds where the trustees, and/or members, would understand the movement in market values.

**Market value investments**

With a market value investment (managed/direct investment), there can be no question of hidden reserves, as the unit price fluctuates immediately with the value of the portfolios assets. Each pension fund receives its true return. The insurer usually provides no guarantees and the fund experiences the full volatility of the market.

In a managed portfolio, the trustees could decide how to split investment cash flow between the various portfolios or even concentrate investment in one area. Subject to suitable notice periods, new cash flow can be diverted into other areas when opportunities arise. Further, a suitable portion of the investment must comprise of cash and gilts, in order to satisfy the statutory investment limits.

The essential advantage of the managed fund portfolio is that it provides the fund with full participation in investment returns – concurrently however, there is the corresponding volatility.

The disadvantages, in comparison to the guaranteed portfolio, are that there are no guarantees of investment values and hence, if the trustees or members do not fully understand the fluctuation of market values, they may distrust the fund manager when (not if) investment values fall.

A fair number of large retirement and other funds, do not use the services of insurers to manage their investments but do so themselves. An asset manager appointed by the trustees of such a fund usually makes all the investments.

The investment manager will also supply regular valuations of the portfolio and will hold meetings to report back to the trustees on the portfolio. The investment plan may be modified to suit changing conditions. Often the assets are split between two or more asset managers.
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