PERSONAL FINANCE

The greedy feed well off your billions

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Billions of rands have been lost to retirement fund members over the past 20 years because of the excesses of an industry that all too often has seen retirement savings as a source of easy profits. Your retirement savings have been subjected to theft by individuals, employers and even trade unionists, and regulatory structures have too often failed you.

Bruce Cameron, associate editor of Personal Finance, who was speaking at a meeting of the Acsis/Personal Finance Financial Planning Club, says that attacks on your retirement savings seem to be becoming more regular and ever greater in scale as the R1.3-trillion industry (which excludes state pension funds) gathers ever more assets.

However, Cameron says, the main reason most retirement fund members do not retire financially secure is not because of the abuses of the industry, but because they fail to save enough, fail to preserve their savings for retirement, and retire too soon.

The abuse and theft of retirement savings adds to the problem.

And he adds that most retirement funds are managed properly. The problem is that when there are attacks on your retirement savings, they tend to be singularly significant and can wipe out your entire nest egg.

Cameron warned that unless a stop can be made to the excesses – both legal and illegal – the willingness of individuals to use retirement savings vehicles could be compromised.

He says that the regulators and other gatekeepers, such as retirement fund trustees and service providers, have to improve their vigilance and often their ethics too, to better protect your retirement savings.

And members themselves also need to play a role in ensuring those with ill intent are kept at bay.

Cameron says a key issue is that all parties have to accept that the money in retirement funds is not theirs to treat as a feeding trough. This is money that belongs to individuals, who have worked hard to save the money.

The billions of rands lost to retirement fund members have been due to:

* Theft and fraud, compounded by a failing justice system, with offenders often either not being prosecuted or getting off lightly. An example is the way in which fraudster Arthur Brown escaped a prison sentence.

* Poorly designed, complex and expensive retirement products, structured on the basis of commissions for product floggers and company profits rather than in the interests of retirement fund members.

* Poor regulation, inept or untrained trustees, and inefficient service providers, particularly retirement fund administrators (see "Protection should come from diverse sources", below).

Cameron says a major underlying cause of the losses is the uncontrolled presence of conflicts of interest. These include employers controlling pension funds in their own interests, through to one-stop business structures where one company provides all services to a retirement fund, acting as fund consultants (which should include advising on abuses by service providers) while also providing services such as asset management and risk assurance.

Cameron says that if conflicts of interest were minimised, it would go a long way to stopping abuses. (See "Conflicts of interest at root of disasters", below).

CONFLICTS OF INTEREST AT ROOT OF DISASTERS

Conflicts of interest, which underlie almost every retirement fund disaster, must be more strictly controlled, says Personal Finance associate editor Bruce Cameron.

He says a conflict of interest in this context is a situation where outside financial interests or obligations (real or perceived) have the potential to bias a decision or cause harm to retirement funds and their members.

"The Financial Services Board (FSB) issued a guidance note (PF130) to retirement fund trustees a number of years ago admonishing the trustees to avoid conflicts of interest.

"Despite this, avoidable conflicts of interest underlie almost every attack on retirement fund savings," Cameron says.

The guidance note states that trustees "should distinguish between conflicts of interest which may be structural, and therefore unavoidable, and those conflicts which can be avoided or, if this does not compromise the credibility of the governance arrangements, can be managed appropriately".

Cameron says Fidentia is a major example of what can go wrong.

Fidentia bought an umbrella trust fund, which managed the benefits due to widows and orphans of retirement fund members. It renamed the trust the Living Hands Umbrella Trust and appointed new trustees, who were all senior executives of Fidentia.

The trustees took a decision to transfer the management of all assets from Old Mutual to Fidentia Asset Management, whose directors, again, were senior executives of Fidentia.

The benefits of the widows and orphans "evaporated" while under the care of Fidentia Asset Management.

A more recent example of conflicts of interest causing a problem is the Rockland Group in Cape Town controlled by an advocate, Wentzel Oaker, who, with others, controlled two companies called Rapicorp 122 & 123, which bought the desolate Schaapkraal sand dunes outside Cape Town for R36 million.

The property was then sold, at R224-million profit, to Rockland Targeted Development Investment Fund (TDIF), managed by Rockland Investment Managers (RIM) which, in turn, was controlled by the Rockland Group.

By December 2010, the property was valued on the TDIF books at R980 million.

Rockland Investment Managers received an asset management fee of two percent plus 20 percent of returns above the inflation rate from TDIF – so the higher the value, the more it earned.

Cameron says that retirement funds often pick up problems because they use consultants that are conflicted.

He says these consultants fail to do their duty, because they should, in fact, be advising trustees when conflicts are avoidable, as recommended by the FSB's PF130 advisory note.

A good recent example is asset management consultant Riscura.

Cameron says retirement funds, such as the Telkom and Sentinel mining retirement funds, pay Riscura to advise the fund trustees on the judicious management of their assets (the members' retirement savings).

Riscura's duties include advising the funds on which asset managers to use, which assets to invest in, which service providers to use for things such as ensuring investments are compliant with prudential restrictions, and effecting the movement of assets from one asset manager to another.

But Riscura, either directly or through one of its associated companies, is conflicted because:

* It receives fees for "transitioning" assets between fund managers. So the more often assets are switched between fund managers, the more it earns.

* It receives fees for "risk assessment " from most but not all asset managers to which it has allocated funds. So the more asset managers from which it receives fees it recommends to retirement funds, the more money it will receive.

* It is involved in jointly managing investment portfolios where it shares in the fee. The more money that goes into these portfolios, the more it earns.

* It receives fees from many of the funds it advises for ensuring compliance with prudential investment regulations. In effect, it is often checking on itself.

* As Riscura earns money from these conflicted services, it could potentially tender its consultancy services at a lower rate than competitors that are not conflicted.

These conflicts have resulted in problems for retirement funds to which Riscura provides consultancy services. The problems include the following:

* A Riscura/Investec high-interest portfolio held R435 million in bonds in imploding company First Strut, on which Riscura was earning a fee.

* Riscura holds itself out as an expert in assessing risk – but it could not detect:

- The 20-year First Strut frauds; and

- The artificial property valuations and conflicts of interest in the Rockland saga, in which it advised retirement funds to invest.

Cameron says the question when it comes to companies such as Riscura, is: “Who guards the guards? The primary duty of a consultant is to guard.

“Also, the trustees of Telkom and Sentinel retirement funds and other Riscura-advised retirement funds cannot argue that resulting losses for individual members are ‘fractional’.

“Retirement fund members have a fiduciary duty to manage your retirement saving properly, and this includes avoiding conflicts of interest wherever possible.

“It is not that conflicts of interest mean that things will go wrong. Conflicts of interest raise the potential for things to go wrong and should therefore be avoided at all times,” Cameron says.

PROTECTION SHOULD COME FROM DIVERSE SOURCES

A significant problem in controlling the excesses of the financial services industry in managing the country’s retirement savings is the often poor regulatory oversight by both the regulators and other gatekeepers.

This is exacerbated when conflicts of interest that can be avoided are not avoided and when retirement funds use one-stop-shop structures, where a single service provider provides all or most services.

This, in turn, is compounded by retirement fund trustees who are not properly trained or badly trained by service providers, misled by service providers, or, in effect, bribed by service providers in numerous ways – from free trips abroad to gifts of iPads.

Personal Finance associate editor Bruce Cameron says the Financial Services Board (FSB) misses too many problems in the financial services sector. He says in many instances the FSB was warned of problems but failed to take timely action.

A major example was Fidentia, where the FSB was provided with proof by Personal Finance at least 18 months before the R1.6-billion collapse that all was not well at the company. The FSB should also have picked up and taken earlier action on others, including Fedsure, Ovation, Dynamic Wealth, Corporate Money Managers and the more recent Relative Value Arbitrage Fund – a Ponzi scheme posing as a hedge fund in which 3 000 investors stand to lose R2 billion.

But there are other gatekeepers, beyond fund trustees and the regulators, who have a statutory and/or fiduciary duty to protect your retirement savings.

Auditors are supposed to play a major role, but time after time fail dismally to pick up even blatant fraud. Lawyers often assist with scams rather than taking action to prevent them. Property valuators do the bidding of their paymasters in providing fanciful valuations. Banks should properly check out bond issues, such as the First Strut issue of corporate bonds, which was based on fraudulent information. Company directors, particularly independent directors, are supposed to act in the best interests of the company and, therefore, its shareholders. Credit rating agencies should properly assess risks, yet fail to pick up the biggest risk: fraud. And retirement fund consultants are supposed to assist in protecting retirement funds from the avaricious, but fail to do so because of their own avoidable conflicts of interest.

LITANY OF ATTACKS ON RETIREMENT SAVINGS

Personal Finance associate editor Bruce Cameron says that over the years the attacks on retirement fund savings have come from many different quarters. These include:

Fedsure

In 2001, financial services company Fedsure imploded, costing retirement fund members hundreds of millions of rands. The main reason was that senior executives were using retirement fund savings to build a financial empire, which collapsed when one of its main investments, Saambou Bank, failed.

However, there were other problems, including maladministration and the offering of investment guarantees that, to attract investors, were above market value.

The result was that members of building industry retirement funds lost 12 percent of their savings (R600 million), pensioners with guaranteed pensions received lower increases, and returns on smoothed bonus policies were reduced.

Secret profits

Alexander Forbes and other retirement fund administrators created structures that enabled them to skim off more than R500 million in secret profits. Most were made from bulking retirement fund bank accounts to earn extra interest.

Fidentia

Fidentia collapsed after the fraudulent use of R1.6 billion that belonged mainly to beneficiaries of deceased members of the National Union of Mineworkers Provident Fund. Most of the beneficiaries have been left destitute.

Glenrand MIB

In 2009, this company, which has now become part of the Aon group, liquidated its retirement administration arm rather than fix the mess it had created in administering 20 retirement funds with 80 000 members. This meant that the funds had to pay twice for the same job.

At the time, a former chief executive of the Financial Services Board (FSB) was on the Glenrand board.

Rockland TDIF

In 2007, an area of 480 hectares of undeveloped, windswept sand dunes in Schaapkraal, facing False Bay, was bought for R36 million through structures created by advocate Wentzel Oaker. The

properties were then sold to Rockland Targeted Development Investment Fund (TDIF), a vehicle controlled by Oaker, for R260 million. Six retirement funds had invested R519 million in TDIF by the time it was placed under curatorship by the FSB. Investors were led to believe that the land, which didn't have the correct zoning rights, would be transformed into a mini-city.

Dynam-ique/Aon

In 2011, the South African arm of Aon, the world's biggest retirement fund administration company, was suspended for seven months from taking on new business. The reason was that umbrella funds it was administering, including four it had taken over from another administrator, Dynam-ique, were in an administrative mess.

The 11 000 members of the four Dynam-ique funds could lose 2.5 percent (R20 million) – the cost of rebuilding the records of the funds – of their savings. However, the Pension Funds Adjudicator has ruled that former trustees of the umbrella funds must meet the cost. The determination is set to be appealed.

The problems in the Dynam-ique funds have still not been resolved.

Trilinear/Canyon Springs

Five retirement funds associated with the Southern African Clothing and Textile Workers' Union (Sactwu) stand to lose about R470 million as a result of major investment scams, leaving the funds unable to meet their commitments to their 25 000 or so members, who are among the lowest-paid industrial workers in the country.

The potential loss of R470 million is a result of the channelling of retirement fund assets through the Trilinear Empowerment Trust and then into failed investments, such as Canyon Springs and Pinnacle Point. Extraordinarily high fees were deducted as the money was directed through the various channels.

Associated with this failure is troubled asset manager Interneuron, which was placed under curatorship after it lost money investing in Trilinear and lost R500 million in rogue derivative trading.

There is a potential loss of R102 million for the Paper Printing Wood and Allied Workers Union (Ppwawu) National Provident Fund, which invested in Trilinear via Interneuron.

First Strut

The recent collapse of the country's biggest unlisted company, First Strut, could see the loss of hundreds of millions of rands, mainly in bank loans.

However, there is also more than R800 million in retirement savings that were invested in First Strut corporate bonds by asset managers including Investec (R435 million), Sanlam (R236 million), Prudential (R51 million), Stanlib (amount unknown), Momentum (amount unknown) and Fairtree Capital (R131 million).

Unregistered products

Cameron says that, despite much legislation and a regulator with increased powers, products that should be registered and regulated still seem to elude the regulators. These include:

* **Ovation.** This asset manager imploded in the wake of losses of R200 million after investing in an unregistered money market fund, Common Cents. The money was stolen by Ovation owner Angus

Cruickshank. No adviser checked whether Common Cents was registered as a collective investment scheme.

* **Dynamic Wealth.** The company, now shut down, operated a specialist income fund that posed as an investment club to avoid the limitations that the Collective Investment Schemes Control Act would have imposed on it. It invested R230 million in an unregistered money market fund managed by Corporate Money Managers (CMM). Instead of investing in money market instruments, CMM invested in property developments that failed, with potential losses of R1.1 billion.

Construction industry

Cameron says retirement fund members will, in effect, be the ones picking up much of the R1.46 billion in fines imposed by the Competition Tribunal on 15 construction companies, including the country's five largest companies, which were found to be colluding on prices, particularly during the construction phase of the soccer World Cup. The reason is that retirement funds are major shareholders in these companies. More losses could follow, with anticipated civil action against the companies.

Employer attacks

* **Non-payment of contributions.** The non-payment of contributions collected from employees and due by employers to umbrella retirement funds is a growing problem. This has been exacerbated by the failure of the justice system to prosecute offenders and by the fact that offending employers often liquidate their companies.

Participating employers (security companies) in the Private Security Sector Provident Fund, an umbrella fund, have been the worst offenders.

Non-payment of contributions has an almost immediate impact on members, because the fund is primarily a provider of life and disability assurance to members, who are in a high-risk job as security guards. The non-payment of contributions by employers means the non-payment of premiums and the ensuing loss of assurance cover, leaving members and their dependants financially vulnerable in case of injury or death.

Changes to the law are being considered that will make employers and company directors personally both criminally and civilly liable for any non-payment of contributions.

* **Surplus stripping.** Currently under way is the criminal trial of Simon Nash, chief executive of industrial company Cadac, one of a number of employers that stripped surpluses from retirement funds in the 1990s, with the complicity of companies in the financial services industry.

Trade unions

Trade unions have found many ways to attack the retirement fund savings of their members, mainly by exerting excessive control over fund trustees, whom they often simply hire and fire to ensure that their bidding is done.

Things that have gone wrong:

* The SA Commercial, Catering and Allied Workers Union (Saccawu) National Provident Fund was placed under curatorship in 2002 after estimated losses of R1.7 billion for 90 000 Saccawu members.

* Commissions were paid by life assurance companies to unions for retirement fund risk assurance business.

* In 2007, the Ppwawu National Provident Fund trustees had to get High Court protection from the Chemical Energy Paper Printing Wood and Allied Workers Union, which tried to make them subject to decisions by the union management.

* Trade unions set up retirement fund service provider companies to provide services to their associated retirement funds, with the trustees being instructed to give mandates to these companies, which, in turn, mainly outsource the work, adding to costs.

Poor products

A mainly hidden cost for retirement fund members lies in poor products that are not suitable for their needs. Most of these are individual retail products, such as retirement annuity (RA) and preservation funds, rather than occupational retirement funds, with the exception of many umbrella funds, which are poorly structured.

Cameron says it is difficult to assess the total amount involved, but it would probably be many billions of rands. The causes are multiple and include:

* High costs, particularly of individual life assurance retirement products. Research undertaken by an independent actuary, Rob Rusconi, in 2004 showed that life assurance retirement annuities were the most costly of retirement products – judged not only on South African benchmarks, but also internationally. The costs are often opaque and difficult to assess.

* Confiscatory penalties, levied by life assurance companies when you cannot afford to maintain contributions to an RA fund. In 2005, the Finance Minister at the time, Trevor Manuel, imposed, in effect, a R3-billion fine on the assurance industry and placed limits on the penalties. However, penalties still apply and amount to losses for members. Penalties do not apply to non-life assurance RAs.

* Double-charging for asset management. Performance fees on top of annual asset management fees are becoming increasingly common. An annual asset management fee is already a performance fee, because the fee is a percentage of assets, and the better the returns, the more money the manager earns.

Mis-sold (but not necessarily bad) products

Cameron says there are a number of financial products that are sound but they are sold to the wrong people. The worst example has been the mis-selling of investment linked living annuities (illas), particularly immediately after their introduction in the 1990s. Most product providers and financial advisers failed to consider the risks of illa pensioners drawing down too large a percentage of their capital while attempting (mainly unsuccessfully) to counteract this with high-risk investment strategies. While the situation has improved in recent years, many pensioners have been condemned to eventual destitution at the very time when they are hardly likely to find alternative income.

And a few more …

Cameron says desperate pensioners, who have not saved enough for retirement, have been caught up in various scams and high-risk schemes trying to get a better return. These have included:

* Masterbond, the original biggie in 1984, in which 22 000 investors, many of whom were pensioners, lost a significant part of the R600 million they invested. At least 16 pensioners who were left destitute committed suicide.

* The Leaderguard forex scam, run from Mauritius, in which investors recovered only about R27 million of the R300 million lost.

* Property syndications. Cameron says this is probably one of the biggest tragedies, but because the losses come from various companies, the full extent will probably never be known. The authorities, which failed to take action to stop the disaster, seem loath to launch a comprehensive investigation. There has already been one known suicide of a pensioner who was left destitute.