Whose billions?

the state of the industry

Allan Horwitz examines the current state of the retirement industry, and concludes that workers would benefit from the creation of a new kind of working class financial services organisation.

A recent COSATU policy paper emphasises that the retirement industry plays a pivotal role in our society. It gives much needed social security to workers and their families, but is also a source of investment capital. The retirement industry has an active membership of 10,8 million people and paid out close to R61,6-billion in 1998 to beneficiaries. The assets in retirement funds amount to about R700-billion. As an area of mass contractual savings, the retirement industry has become a vital part of the financial sector. According to the Financial Services Board (FSB), the sector accounts for 22% of South Africa's gross domestic product (GDP). It is an important source of profit for foreign-based multinationals and local elites.

Workers' life savings are funnelled to institutions that manage them, ostensibly to the benefit of the workers, by earning the best possible interest. In reality, the asset management companies, and the class to which they belong, are the main beneficiaries.

Retirement funds are heavily invested in the stock market and other new products of the financial sector, based on speculation. Such investments promise immediate and high returns. More productive forms of investment are restricted, often entirely blocked. This is particularly true of investments that are of longer term social use to a wide range of people, but seem to offer lower interest yields to individual fund members.

Speculative investments

Do such speculative investments deliver the promised high returns?

In some cases, and for relatively short periods, the answer is yes. But generally, over the past 50 years, they have not. The growing volatility of global financial markets suggests that they will rise and fall sharply in value as speculators spin the wheels. By and large, fund members' savings have barely kept pace with inflation, never mind achieving real growth. The other result is that little capital is available for productive investments that can generate social wealth and provide work.

Fund members have suffered a further penalty: there is often a major difference between the overall return earned by a fund and the interest rate granted to members. In fact, returns to members are regularly reduced – ostensibly because of 'smoothing' over good and bad investment years – and the building of surpluses is often exaggerated. In this way, more money remains locked into speculative investment than is paid to members in the form of withdrawals, and for retrenchments and retirements. This is not to say that funds must not have healthy reserves to cover their liabilities. The deficit in many state funds arises from their past manipulation in favour of mainly Afrikaner civil servants.

Two faces

In regard to its key role in the financial sector, the industry has two faces. In the first place, it is a source and manager of contractual savings available for enriching a small class of experts and administrators. These in turn act on behalf of a wider but still limited ruling class – the shareholders. Secondly, it is a means of forcing capital accumulation on a social level whose objective is to benefit each member equally and fairly, to provide for times when the individual has no livelihood. It is an uneven but necessary mass-based security net.

The establishment of efficient member controlled organisations or companies that manage funds for members' personal and social interests can be justified. The implication is that a new type of institution is needed, which can practise social entrepreneurship with integrity, efficiency and vision.

The need for such an institution will become clear from an analysis of the existing decision makers and service providers.

Who controls the funds?

In large industry and company funds, control is shared between employer organisations and company nominated trustees on the one hand, and trade unions on the other. State funds are represented by trustees appointed by the state and trade unions. Equal representation between employers and employees has been achieved, at least formally.

However, a new institution has emerged over the past decade – the trade union controlled fund, whose trustees are elected or appointed by union structures and whose general secretary is often the principal officer.

At first glance, this seems progressive. At last, funds are wholly controlled by worker organisations.

But when we examine the reality of the benefits and services provided by many of these funds – which contract out their administration, insurance and much of their investment management to the private sector, and whose rules are often drafted by these companies – a fresh look is needed. There are many important questions of principle and operational matters to be considered.

Companies like Old Mutual, Liberty Life, Sanlam, Investec/Fedsure, Metropolitan Life, Alexander Forbes and NBC try to serve their shareholders by maximising dividends and keeping their share prices high.

At the same time, as retirement fund administrators, they have a legal and fiduciary duty to their clients, the members of the funds held in trust. This entails carrying out proper financial accounting and maintaining complete records; providing full and timeous information; offering unbiased and expert advice to trustees, and not influencing them in order to secure secret, unfair or otherwise unjustifiable commercial gain; training trustees; and cooperating with state bodies that monitor the financial sector.

The retirement fund industry paid out almost R62-billion in 1998.

Do they balance these objectives fairly and effectively? In some instances, they do, but they are rare.

Generally, the main shareholders' interests conflict with the provision of good services at the lowest possible cost to members of funds they administer and insure, and to whom they give legal, actuarial and investment services.

The demand for higher profits puts constant pressure on service levels. Fees now make up about 1% of the fund members' total wage bill – an increase of almost 100% over the past five years. The administration fees of retirement funds are high, though still lower than those of banks. Of course, providing good administration requires a considerable outlay. But there are minimum requirements for turnaround times in the payment of benefits and proper accounting to members that cannot be compromised. Where possible, these should be subsidised by funds. The profits demanded by the industry put additional and unwarranted burdens on these costs.

Choosing service providers is, therefore, a key issue. And because many and varied skills are required, fund trustees must have a good grasp of how to service and communicate with thousands of members.

Commissions and sponsorships

Over the past ten years the commissions and sponsorships paid to trade unions, employer organisations and bargaining councils have become very controversial. Many of these organisations are under financial pressure, and their motives for awarding tenders are often suspect.

Lacking outside funding on the scale of

the past, whether from international union organisations or business, they have become more and more reliant on funding from the insurance industry. This often leads to the payment of kickbacks in cash or kind.

Trustees and organisations are subject to pressures and temptations offered by competing companies eager for new business.

It is very difficult for unions to handle the dubious ethics of the marketplace. Worker leaders and full-time officials try to strike the best possible deals for their organisations, and sometimes, corruptly, for themselves. Often overlooked is the question of whether the companies that offer commissions or sponsorship are really effective, and whether the benefits of the funds that are set up with private sector partners are in the best interests of members.

The impulse behind the decision to set up union controlled funds is a sound one – to wrest control from a profit-driven industry. But not enough has been achieved in terms of members' interests, both social and personal.

Brokers, agents and consultants

The functions performed by brokers, agents and consultants on behalf of financial service companies cannot be underestimated – they generally slow down processes and push up costs. The industry has spawned this class of marketers and traders to provide incentives and cut the cost of marketing and sales.

These third parties try to give the impression of being independent and objective experts, but generally receive commissions from the companies or products they promote, as well as fees from the funds who pay them.

Who legally controls funds?

Boards of trustees at company, industry and state levels now have to comprise an equal number of employer and employee representatives. What does this imply about the position of trustees?

In terms of circular 98 of the FSB, issued in May this year, a board of trustees is responsible for controlling and directing the operations of a fund in accordance with a fiduciary duty, the relevant laws and the fund's rules.

Member trustees must be elected by all active members, pension members and deferred pensioners.

The principle behind this is that institutions must be made accountable to, and serve the interests of, their members. Large numbers of people, for whom retirement savings are the only saving because of low wages, the high cost of basic goods and services and poor job security, are affected.

Is democratisation a reality?

After a ten year lapse, the union movement recently began making demands on retirement funds. But many employers remain hostile to the notion of equity and the need to recognise the primacy of members.

A critical factor holding back democratic change is that most black workers were only admitted to funds in the 1980s. There is still inadequate experience and knowledge of the issues. A second factor is that most white, coloured and Indian workers, though enjoying many decades of membership of funds, were never given real access to the boards of trustees, never mind the right to elect them.

Until the late 1980s, almost all funds were controlled from above and dominated by interests other than those of the members. In terms of most fund rules,

Union controlled funds have not achieved enough in terms of members' interests.

employers had the right to appoint trustees and occasionally introduce a few token employees. This was true of thousands of company funds. At industry level, employee trustees were appointed by trade unions, often on a proportional basis related to union membership. But the union trustees had grossly inadequate reporting and mandating processes, and had hardly any contact with fund members. Similarly, employer trustees functioned largely in isolation from their own constituencies. As long as contribution rates were kept low, they were rarely challenged. The upshot was that the bulk of workers' savings were controlled by small, narrow minded cliques representing bureaucratic trade unions and conservative employer organisations.

By the early 1990s, affiliates of COSATU and NACTU had begun to push for union controlled funds. These new funds now have significant membership, but have entrusted their operations to the private sector while setting up independent asset management companies. The latter have undertaken many commercial deals which have no relevance to working class interests, but which seem to offer high monetary returns to the unions concerned and their funds. Several unions have been badly compromised by such activities.

Another dangerous practice is that many unions now try to tie union members to membership of a fund controlled or endorsed by the union. This violates members' freedom of choice and may take no account of the merits of the union fund, as compared with other options. Often, unions refuse to act on the mandate of their members when they turn against union funds.

A new conception of the retirement industry has recently emerged in response to poor service levels, inadequate and expensive benefits and poor communication with members.

It is also based on COSATU's initial thinking. A COSATU commission on the industry in the early 1990s made the following practical recommendations:

- retirement funds should be set up at industry level, and all company funds should merge with these;
- all trade unions and employer organisations in particular industries should have representation on the boards of trustees of sector funds, proportional to their membership;
- employers and workers should have equal representation on boards of trustees;
- COSATU should set up independent administration, insurance and investment companies to manage these funds;
- the investment policies of these funds should drastically reduce speculative investments;
- the Pension Funds Act, the Revenue Act and the FSB should be radically overhauled to reflect the new principles; and
- once these measures are in place a national fund should be started, with state and industry representatives, drawn from both unions and employers, forming the board of control.

COSATU unions have mostly not followed these positions. As a result, a new generation of ideas, based on the earlier principles but with interesting differences, have emerged to strengthen working class independence and organisation.

The new positions

The following principles have now been identified as critical:

- members – and employers who are willing to participate – should directly elect trustees, who should not be appointed by outside organisations;
- decision-making structures need to be broadened, so that boards of trustees do not function in isolation, but receive recommendations from member representatives elected at workplace level (in other words, shopstewards who specialise in fund matters);
- self administration and insurance capacity should be built by mixing those who have and those who lack experience, averting the need for outside specialists;
- transparency and regularity in reporting and accounting – members should receive savings statements every six months, and meetings should be held with members on fund issues to update and educate them;
- freedom to choose and transfer between funds. The idea is to permit competition in every workplace by offering employees a range of funds, which must be chosen in negotiations between employees and employers. Each worker should be able to evaluate his or her choice of fund every few years, and transfer without penalties;
- maximisation of benefits at the lowest possible cost could be achieved through economies of scale, as large funds have advantages. However, size also creates its problems. A balance between cost effectiveness and administrative efficiency must be found.

Underlying these proposals is the idea that working class interests have to be combined with the need to maximise the right of individual members to the best possible retirement benefits and comprehensive, affordable insurance.

Striking this balance, between individual and collective needs, means rethinking accepted practices. The ideological struggle on boards of trustees revolves around the recognition that the fund belongs to its members, not to contributing companies or organisations that have the power to appoint trustees, whether unions or employer organisations. The purpose should not be to benefit fund officials or service providers.

Unions and boards of trustees

The competency of trade union structures like national executive committees (NECs) to decide on behalf of boards of trustees is very doubtful. NECs have to deal with so many other matters that they cannot fully apply their minds to fund-related issues, which require a great deal of training and experience.

Despite this, NECs of most unions usurp the powers and duties of the legally responsible structures by deciding policy for the trustees and awarding contracts. This is dangerous, particularly when it comes to deciding on benefits and costs and in setting up new organisations or companies to give effect to socially useful and productive investments.

One must distinguish between trade union influence and involvement – which is highly desirable, indeed necessary – and trade union control. The establishment of union controlled funds has, in practice, led to the domination of union officials and a new class of investment specialists who claim to be serving members' interests by generating profits in a traditional capitalist way. They are barely accountable to fund members, because they report mainly to union structures, which have difficulty in dealing with the issues.

What is the solution?

Any solution must recognise the principles and day-to-day practices involved in running financial and commercial organisations. Bearing these in mind, the best option is to set up a new kind of working class economic organisation that acts as an umbrella for various financial and other services to workers.

A retirement fund can set up subsidiaries that invest money and expertise in areas that vitally affect workers. These include the development of houses and flats; employment creation through the establishment of a venture capital fund for small business; the formation of savings and credit cooperatives; the establishment of low cost medical aid schemes, and the creation of independent administration and insurance entities.

Union officials and office bearers would find it difficult to perform this role effectively and, in many instances, honestly, particularly in unions with financial problems. It seems that only a new cadre of working class activists could succeed. Such activists should have specialist training in the necessary areas and be employed directly by funds and/or their subsidiaries. They would work with trustees and grassroots membership structures set up by funds.

The importance of the funds lies in the fact that they are repositories and managers of vast amounts of money. The social entrepreneurs and technicians best placed to manage them must be well grounded in politics and directly answerable to fund members. They will have to maintain their integrity, and the integrity of their organisations, in the face of political pressures and financial blandishments. But if they succeed in building viable and useful organisations and companies, many will benefit. ★

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