10X INVESTMENTS

THE SEVEN FAILURES OF TREASURY'S REVISED DEFAULT PORTFOLIO REGULATIONS

Executive summary

National Treasury's retirement reforms appear to have lost their way. The promise, to transform the retirement fund system to better serve investors, has been broken. Definitive and well-considered default portfolio rules has been diluted into vague guidelines. Rather than protect savers who are invested in default portfolios, the revised draft regulations protects the status quo and the industry's vested interests.

The interest of retirement investors – who ultimately own the assets managed by this industry - remain secondary. Which means that most South Africans will continue to be invested in complex and expensive products that deliver poor value and poorer retirements. Treasury's seven points of disappointment:

1. **From clear rules to vague principles:** Treasury has moved away from setting best-practice standards that deliver objective value, to principle-based guidelines that open the door to subjective interpretation and diminished accountability. It allows the industry to carry on as before, and to justify almost any default product. This contradicts Regulation 28, which provides that, given the level of expertise on trustee boards, "the regulation must give stronger direction through rules rather than guiding principles."

2. **RA's are now EXCLUDED, prejudicing the most vulnerable investors and the only investors who are subject to compulsory preservation.** The original draft regulations promised to curtail one of the biggest obscenities in the South African retirement landscape, the early termination charges levied by life insurance companies on RAs. This won't happen now. Hundreds of thousands of savers will continue to buy these expensive, inflexible and punitive products, unaware of the implications. The life insurance industry will continue to plunder their savings with impunity.

3. **Performance fees permitted, despite Treasury's research concluding that "there appears to be little reliable evidence that even well-constructed performance fees improve manager performance."** SA investment managers have free rein to keep charging some of the highest fees in the world even when underperforming the index.

4. **Cost-effective rather than low cost.** Although Treasury is fully aware of the dramatic impact of fees on the long-term savings outcome, the revised draft merely specifies "cost-effective" portfolios. In this context, Treasury refers to fees that are "reasonable and competitive". That is most unhelpful: in an industry that does not compete on fees, charges that are high in absolute terms may still appear reasonable and competitive on a relative basis. Four years on, Treasury's damning discussion paper on charges in South African retirement funds appears all but forgotten.

5. **"Alternative assets" are now permitted, this after the first draft tacitly barred them, for being complex and opaque investments that charge excessive fees.** It is difficult to fathom how they now meet the "simple" standard. We challenge any retirement fund trustee, professional or otherwise, to give a proper account of the workings, charges, hurdle rates and high water marks of such investments. If Treasury can't see through the marketing hype of alternative investments, what hope is there for trustees?

6. **Existing defaults not required to conform.** Another astonishing about-turn is to exempt default arrangements in place before the regulations come into effect. This is despite Treasury's concern that "in many cases, members have been automatically enrolled into excessively complex, unreasonably expensive or otherwise inappropriate default investment portfolios."

7. **Guarantees and smooth bonus policies allowed, even though the first draft effectively limited the use of such products.** Again, we challenge any retirement fund trustee to give a proper account of how these products work, how much they really cost and what benefits are due to any member at any time. Treasury knows very well that such complexity does not serve investors, which is why the first draft advocated simplicity.