EMPLOYEE BENEFITS

A mortality analysis of retirement funds - an exploration of various causes of death of a terminating retirement fund

Corné Heymans, senior actuary and member of the Retirement Matters Committee at the Actuarial Society of South Africa (ASSA)

Since the implementation of the Pension Funds Act in 1956, many retirement funds have come and gone. With more than 25 500 funds registered to date and only around 1 500 of these still active today, it translates into a survival rate of around 6% of all funds ever registered.

While some funds have managed to survive for decades and decades by continuously adapting to an ever changing industry, retirement funds generally have a surprisingly limited lifespan with various causes of death. In this article, we will delve into the different methods of retirement fund termination and examine how stakeholders can navigate these scenarios.

The birth and death of funds

A retirement fund officially comes to life with its registration under the Pension Funds Act. Similarly, the time of death of a fund is marked by its deregistration.

In exceptional cases, deregistered funds can be brought back to life where it is found that the fund was wrongfully deregistered. Such resurrections give rise to complex legal and administrative challenges for the former administrators who are generally tasked to lay these ghosts from the past to rest, again.

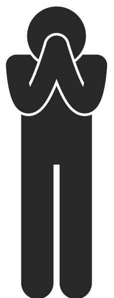
The importance of proper governance and controls when a fund is heading towards termination can therefore not be emphasised enough. Different methods of termination as allowed for in the Pension Funds Act may be appropriate under different circumstances and each should be carefully considered.

Cancellation or suspension of registration (Section 27)

The non-starters

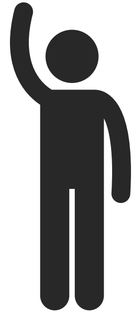
The Registrar may terminate a fund, even before it goes into operation, if it should be mutually agreed that the fund was registered by mistake. However, such occurrences are extremely rare.

Death by natural causes



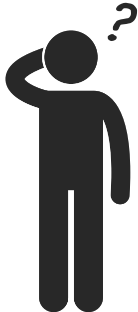
The most common form of termination occurs when a fund completes its useful life, and the trustees apply for deregistration once all assets and liabilities have been disbursed. For example, where the fund has been closed to new entrants for some time and the final member(s) leave employment, or following a bulk transfer of members to an alternative fund.

Trustees must ensure that no excess assets remain after all members have left the fund as this may lead to an unnecessarily cumbersome second round of top up distributions. On the other hand, there must be adequate assets to pay the very last member in full. The ongoing accumulation of expenses should further be closely monitored as it could place a disproportionate burden on the last remaining member(s). Winding assets down to zero, synchronizing with the payment of the last member's benefit, therefore requires a delicate balancing act.



A process of natural selection

Numerous pension funds have been absorbed into bigger corporate and industry umbrella funds over the past couple of decades. This industry wide consolidation is seen by many as a process of natural evolution through which smaller funds that were never financially viable have been eliminated from the herd. Everybody is not necessarily in agreement with this view but, be it as it may, the emergence of umbrella funds has reshaped the industry as we know it and directly resulted in the termination of thousands of funds.



The forgotten

Many dormant funds have been left in a deep slumber for years and years after the departure of the last members, where the fund was just never deregistered, most likely due to administrative oversight at the time. Unfortunately these funds have since fallen foul of all regulatory requirements, posing considerable administrative and regulatory challenges.

Administrators have been hard at work for a number of years now to catch up on regulatory requirements and clear these funds off their books through the appointment of Section 26 boards. Improved checks and controls from all involved will hopefully prevent orphaned funds from being forgotten again in future.

"Voluntary" dissolution of a fund (S28 liquidation)

Accidental death

There are instances where the termination of a fund is forced upon it due to unforeseen circumstances. When an employer is placed in liquidation, the associated retirement fund is usually automatically, and often very abruptly, also placed in liquidation in terms of its rules. Notwithstanding the heading of this section of the Act, there is nothing "voluntary" about this unexpected event.

Once a company is placed in liquidation it can become a brutal battleground between members, employers and creditors for whatever may be left on the table. The fund liquidator who is appointed by the trustees then has the critical duty to ensure that everybody's interests are protected through the legal means at his or her disposal.

Not only did the victims of this perfect storm lose their jobs, but they may also find their retirement benefits caught up in a potentially protracted liquidation process. Trustees must be prepared to navigate the complex challenges that arise in such scenarios. The key is to engage as early as possible in the process with all stakeholders, under the guidance of appropriately experienced experts.

Calling in the terminator

Trustees may voluntarily choose to terminate a fund for various reasons through the appointment of a liquidator. Liquidation provides a structured process for the independent management and equitable distribution of a fund's assets during its final days. This option does not necessarily indicate financial distress, as the more common use of the unfortunate term "liquidation" might imply, but rather allows for an orderly winding down of operations.

To the contrary, the liquidator, following prescribed steps outlined in the Act, is obligated to ensure that all members' minimum benefits are secured as far as practically possible, even if the fund is in a shortfall at the time of liquidation. The voluntary liquidation process offers further advantages in terms of independence, transparency and fairness.

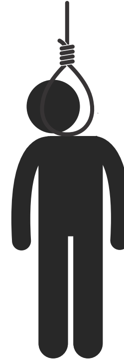
Trustees may opt for voluntary dissolution when members or employers no longer wish to participate in the fund while they are not necessarily terminating employment or being transferred to an alternative fund. Funds with historical data uncertainties may also be well advised to apply for voluntary liquidation to ensure that proper processes are followed to address these uncertainties.

Once the fund enters liquidation, the trustees are relieved of their duties and the fund no longer needs to make the usual regulatory submission like annual financial statements or statutory actuarial valuations. Voluntary liquidation therefore offers the administrative advantage of drawing a line under a fund's ongoing administrative and regulatory requirements.

There have unfortunately been instances where funds went into voluntary liquidation at the insistence of members as the only way to cash in their benefits in the fund, or from the employer to receive the balance in an employer surplus account. However, this course of action is generally not advisable as this early inheritance from the deceased fund will in all likelihood just erode members' retirement savings in the end.

The liquidation process may clearly be appropriate, and often necessary, under specific circumstances. However, there are disadvantages which must be carefully weighed up, including costs and the duration of the liquidation, before deciding to go this route.

Winding-up by the court (Section 29)



Capital Punishment

Section 29 of the Act sets out the final route to termination of a fund. The court may place a fund in liquidation by removing trustees from office and appointing a liquidator to terminate the fund. This rare measure is generally reserved for instances of extreme non-compliance or financial distress when all other remedies have failed.

Always be prepared

Preparing for the potential termination of a retirement fund, much like preparing a living will, should not only be considered once the writing is on the wall. It should always form part of any fund's ongoing risk management strategies.

Trustees should ensure that the fund's rules adequately cater for different termination scenarios, and they must act swiftly as soon as there are any red flags indicating the potential termination of the fund. It probably goes without saying, but the fund's regulatory affairs should remain up to date since clearing historic regulatory issues is often the most difficult hurdle to cross when terminating a fund, regardless its cause of death.

In conclusion, although a retirement fund is never established with its eventual termination in mind, history has shown that it generally has a limited lifespan. Understanding the various methods of termination and preparing for a fund's potential demise are critical to protecting the interests of all stakeholders by proactively managing risks and seeking expert guidance.