

## PREPARATORY SESSION

### EISA Example

#### QUESTION 1

##### **SCENARIO 1**

Consider the following scenario faced by a fund in the distribution of death benefits in terms of section 37C of the Pension Fund Act:

- A deceased member, Mr Martin Ndebele, had a wife (Zandi) and two children, aged 15 and 23. Zandi and Martin are the parents of both children, but the older child, Nomsa has moved out the house, lives with her boyfriend and is employed at a well- known bank. Her boyfriend works for the same bank.
- The younger child (Lerato) is a star-pupil at high school and is planning to go to university one day with the aim of becoming a medical doctor.
- At the time of his death, Martin was living with Zandi and Lerato. They had been living in the same house for 19 years.
- 5 years before passing away, Martin had a child with another woman. The child (Zweli) is currently 4 years old, and has diagnosed speech and learning difficulties. After thorough investigation, the board of trustees confirm that Martin consistently sent the child's mother, R2500 per month to help maintain Zweli.
- Martin's nomination of beneficiary form split his benefit from the fund 50% to Zandi, 25% to Nomsa and 25% to Lerato. Martin's last will and testament leaves his entire estate to his wife, Zandi, and their two children in equal proportions. It does not mention Zweli.
- Martin's death benefit (apart from his fund credit) was 6 times annual salary.

Based on this set of facts answer the following questions:

**Questions:**

1.1.	List all the dependants of Mr Martin Ndebele, with due consideration of the definition of “dependant” in the Pension Funds Act. <p style="text-align: right;"><b>[2 Marks]</b></p>
1.2.	Does the content of Mr Ndebele’s last will and testament guide the trustees in the distribution of the death benefit in this specific case? Motivate your answer. <p style="text-align: right;"><b>[3 Marks]</b></p>
1.3.	Apply a reasonable distribution of the death benefit between the various dependants in this case. Motivate your answer. <p style="text-align: right;"><b>[6 Marks]</b></p>
1.4.	Create a communications check list that the board could follow in this case. The checklist should demonstrate your understanding of the communication processes and requirements that the fund would need to follow from the receipt of the notification of the member’s death to the final distribution of the benefit. <p style="text-align: right;"><b>[4 Marks]</b></p>
<b>Additional Information for question 1.5:</b>  Shortly after Mr Ndebele’s death and before the board has made their distribution decision, Zandi (his wife) approaches the board and requests that an advance be made to her in order to cover expenses related to Mr Ndebele’s funeral.	
1.5.	Discuss the considerations the board should keep in mind in this situation. (Explain how the Board of the fund should approach this situation). <p style="text-align: right;"><b>[2 Marks]</b></p>
<b>Additional Information for question 1.6 and 1.7:</b>  At the next meeting of the Board, this case is considered. The Board is satisfied that a thorough investigation has been conducted and that all the facts are at hand. The Board then decides the following: (1) The benefit should be split equally (1/3 each) between Mr Ndebele’s children: Nomsa, Lerato and Zweli. (2) A beneficiary fund should be used to administer the benefit for Nomsa, Lerato and Zweli.	
1.6.	Do you think this distribution is reasonable and equitable? Motivate your answer. <p style="text-align: right;"><b>[3 Marks]</b></p>
1.7.	Is the use of the beneficiary fund appropriate? Why / why not? Motivate your answer. <p style="text-align: right;"><b>[3 Marks]</b></p>

## QUESTION 2

### SCENARIO 2

You are the newly appointed Principal Officer of the Contract Cleaning Pension Fund, which is a defined contribution fund.

The fund receives a divorce order (issued by the Divorce Court) from a non-member spouse, Mrs Lockwood, against her former husband, Mr Lockwood, who is a current member of the fund. The divorce order states that Mrs Lockwood is entitled to 50% of Mr Lockwood's pension interest in the Contract Cleaning Pension Fund. Mr Lockwood's pension interest (his total fund credit) is R1 000 000. Many years ago, he helped buy the apartment that he and Mrs Lockwood lived in, and he requested the fund to provide a guarantee against his pension benefit. The current outstanding balance on that home loan is R250 000. Mr and Mrs Lockwood have two children, aged 7 and 10. Mr Lockwood moved out of the house 8 months ago, before the divorce was finalised.

#### Questions:

2.1.	In 2007, amendments to the Pension Funds Act introduced the "clean break" principle. Explain what is meant by this principle. <p style="text-align: right;"><b>[2 Marks]</b></p>
2.2.	Describe <b>THREE</b> (3) aspects the fund should ascertain, in assessing whether the divorce order the fund has received from Mrs Lockwood is valid. <p style="text-align: right;"><b>[3 Marks]</b></p>
2.3.	With specific reference to the time periods outlined in the Pension Funds Act for the fund to action the order, describe the various steps the fund will have to take from receipt of the divorce order (assuming it is valid) until the process of dealing with Mrs Lockwood's divorce benefit is finalised. <p style="text-align: right;"><b>[5 Marks]</b></p>
<b>Additional information for question 2.4 and 2.5</b> When researching this matter, you discover that a week before Mrs Lockwood lodged the divorce order with the fund, she lodged a maintenance order she obtained from court against Mr Lockwood for arrear maintenance, with the fund. This had slipped your attention, since correspondence was lodged with your assistant, and she has been off sick. The order for arrear maintenance is to an amount of R150 000.	
2.4.	Calculate the amount of pension interest to be awarded to Mrs Lockwood assuming there was NO maintenance order. Show all your workings. <p style="text-align: right;"><b>[ 1 mark ]</b></p>
2.5.	Calculate the amount of pension interest to be awarded to Mrs Lockwood taking all the factors into account in this case, INCLUDING the maintenance order. Show all your workings. <p style="text-align: right;"><b>[2 marks]</b></p>

**Additional information for question 2.6**

The Contract Cleaning Pension Fund has had problems in the past receiving contributions from the employer. Engaging with the employer over time, it is apparent that due to financial difficulties, they often pay contributions late. The fund has a monitoring person (Mrs Ndlalane), and she is very efficient at bringing issues relating to payment of contributions to the attention of the principal officer and the board. On 29 April 2016, Mrs Ndlalane informs you that contributions from the employer for March 2016 were not received.

2.6.	Considering provisions made in Section 13A of the Pension Funds Act and Regulation 33, provide details of <b>five</b> (5) levels of non-payment of contributions reporting that are required by all parties. Details of the reporting requirements and the responsible person for each required level of reporting should be included. <p style="text-align: right;"><b>[5 Marks]</b></p>
2.7.	Section 13A of the Pension Funds Act states that individuals may be held personally liable for the compliance with the section and for the payment of contributions. Name the individuals specified in this section and the consequences of conviction for non-compliance. <p style="text-align: right;"><b>[4 Marks]</b></p>
2.8.	Contributions from the employer are still not received by 7 July 2016 even after numerous meetings with the employer, and the board and monitoring person decides to inform members via a special newsletter. Draft a <b>SHORT</b> newsletter for consideration by the board, which is to be distributed to members and posted on notice boards which members have access to, explaining what steps the board has taken. <p style="text-align: right;"><b>[4 Marks]</b></p>
<p><b>Additional Information for question 2.9 and 2.10:</b></p> <p>9 months later the employer announces that it is closing down and cannot continue operations. At a special meeting of the board of the fund, it is decided that the fund must be liquidated in terms of section 28 of the Pension Funds Act and monies paid to all members that would be owing to them. The board appoints a liquidator, Mr Steyn (the brother of the Chairperson), in line with stipulations in the fund's rules. No trustee on the board has ever been involved in a fund liquidation. They feel that there may be various risks involved in the process.</p>	
2.9.	The Board asks you to briefly explain the section 28 liquidation process to them. With reference to specific timeframes, draft a <b>SHORT</b> memo to the Board describing the section 28 liquidation process and actions the liquidator must take (bullet form is acceptable). In your memo, also highlight <b>THREE</b> (3) possible risks you can think of that might be involved. <p style="text-align: right;"><b>[10 Marks]</b></p>
<p><b>Additional Information for question 2.10:</b></p> <p>A retirement fund in the same industry, the SuperDuper Cleaning Retirement Fund is also facing financial difficulties and is in an unsound financial position. It is a defined benefit fund.</p> <p>The fund has had a number of audits conducted on it over the past two years, all of which have identified control weaknesses, poor adherence to sign-off procedures, some instances of trustees accepting lavish gifts from service providers, and cases where the fund's rules have been breached.</p>	
2.10	Draft a risk register for SuperDuper Retirement Fund, listing <b>THREE</b> (3) items on the risk register that are likely to be relevant to this situation, and include at least one control measure for each that you would suggest to that fund in order to reduce or manage the risk concerned. <p style="text-align: right;"><b>[6 marks]</b></p>

### QUESTION 3

#### SCENARIO 3

Consider the following extract detailing the actual asset allocation of the total assets of the Gold Refineries Pension Fund from their monthly Fund Administration report:

Category of investment	% of total assets
Property with market cap between R3bn and R10bn	8%
United States (US) Government Treasury bonds	12%
Private Equity funds	9%
Krugerrands	6.5%
Listed Equities (domestic)	
Issuer market cap greater than R20 billion	14%
Issuer market cap between R2 billion and R20 billion	7.5%
Issuer market cap less than R2 billion	6%
Overberg Hedge Fund (single fund)	3%
Fund of Hedge Funds	4.5%

**ADDITIONAL RESOURCE - REGULATION 28 TABLE SUMMARY**

<b>Asset Class</b>	<b>Asset sub-category by issuer type</b>	<b>Per Issuer</b>	<b>Total Limit</b>
<b>Cash up to 100%</b>			
	SA banks	25%	100%
	Foreign banks	5%	
<b>Debt instruments, incl. Islamic debt- up to 100% for debt instruments issued by/ guaranteed by the Republic, otherwise 75%</b>			
	SA government		100%
	Foreign governments	10%	
	SA banks		75%
	I. market cap >R20bn	25%	
	II. market cap R2bn- R20bn		
	III. market cap <R2bn	15%	
	IV. not listed	10%	
		5%	25%
	SA parastatals	10%	50%
	I. listed	10%	50%
	II. unlisted	5%	25%
	Other debt	5%	25%
	I. listed	5%	25%
	II. unlisted	5%	15%
<b>Equities (SA and Foreign) up to 75%</b>			
	Listed preference and ordinary shares in companies (excl shares in property companies)		75%
	I. market cap >R20bn		
	II. market cap R2bn- R20bn		
	III. market cap <R2bn	15%	
	IV. not listed	10%	
		5%	
		2.5%	10%

<b>Immovable Property (SA and Foreign) up to 25%</b>			
	<p>Listed Preference and ordinary shares and linked units comprising shares linked to debenture in property companies or units in a CIS in property</p> <p>I. market cap &gt;R10bn  II. market cap R3bn- R10bn  III. market cap &lt;R3bn  IV. not listed</p>	<p>15%</p> <p>10%</p> <p>5%</p> <p>5%</p>	<p>25%</p> <p>15%</p>
<b>Commodities (SA and Foreign) up to 10%</b>			
	<p>Kruger Rands and other listed commodities, included exchange traded commodities</p> <p>I. gold  II. each other commodity</p>	<p>10%</p> <p>5%</p>	<p>10%</p>
<b>Investment in the business of a participating employer (within SA)</b>			
	In terms of section 19(4) of Pension Funds Act		5%
	To extent allowable by an exemption in terms of section 19(4) of Pension Funds Act		10%
<b>Housing loans granted to members in accordance with the provisions of section 19(5), up to 95%</b>			

<b>Hedge Funds , private equity funds and any other assets not referred to in this table (SA and foreign), up to 15%</b>			
	Hedge Funds		10%
	I. Funds of hedge funds	5% per fund of hedge funds	
	II. Hedge funds	2.5% per hedge fund	
	Private Equity funds		10%
	I. Funds of private equity funds	5% per fund of private equity funds	
	II. Private equity funds	2.5% per private equity fund	
	Other assets not listed		2.5%

**Questions:**

3.1.	Identify, from the asset allocation table above, any breaches that the Board of the fund should consider when comparing the asset limits of their pension fund with those prescribed in Regulation 28. When identifying the breach, also list the relevant Regulation 28 limit. <b>[4 Marks]</b>
3.2.	Identify and describe <b>three</b> (3) control measures that the fund could put in place to ensure that a fund's investments are in line with the Fund's Investment Policy Statement and Regulation 28. <b>[6 Marks]</b>
3.3.	Describe the actions the fund will need to take if they subsequently receive notification that due to a big market move, the fund has significantly breached one of the Regulation 28 limits. <b>[3 Marks]</b>

**Additional Information for question 3.4, 3.5 & 3.6:**

The Gold Refineries Pension Fund has split the management of the bulk of its equities across three asset managers: Alpha Asset Management, Beta Asset Management and Gamma Asset Management. The mandates it has given to each is that they should aim to beat the benchmark (the Swix), thereby earning the fund additional return. You are the fund's principal officer, and you decide to compare how these managers have performed over the past year on some basic metrics. The following information has been provided to you by each asset manager:

Name of Asset Manager	Return on portfolio	Benchmark return	Risk free rate	Standard deviation of portfolio	Fund tracking error
Alpha	10%	6%	4%	2%	2%
Beta	6,3%	6%	4%	0,7%	0,08%
Gamma	14%	6%	4%	3%	1,5%

3.4.	Calculate the Sharpe ratio for each asset manager. Which is the worst performing manager, on the basis of the Sharpe ratio? <b>[2 Marks]</b>
3.5.	On the basis of the information provided, calculate the information ratio for each manager. Which is the worst performing manager, on the basis of the Information Ratio? <b>[2 Marks]</b>
3.6	You show your calculations out of interest, to the Chairperson at your next face-to-face meeting with him. He is very upset with Beta Asset Management and says that they are acting like a passive asset manager. Why would he hold this view, based on the information provided? <b>[2 Marks]</b>

**Additional Information for question 3.7:**

Overberg Hedge Fund, one of the Gold Refineries Pension Fund's other appointed asset managers has consistently underperformed over the last 3 years. They are not however able to provide the Board of trustees with a convincing explanation or performance attribution to demonstrate the source of their underperformance. Having lost confidence in them, the Trustees have decided to terminate this mandate and conduct a due diligence exercise in order to find a replacement hedge fund asset manager.

The Board of trustees invite a host of hedge fund managers to be participate in their Request for Proposal process.

3.7.	Describe <b>three</b> (3) suitable topics for each of the following headings, which each asset manager should be asked to address, in their response to the Request for Proposal.
3.7.1	Organisational Structure <b>[3 Marks]</b>
3.7.2	Investment Philosophy and Process <b>[3 Marks]</b>
3.7.3	Risk and Compliance Policies: <b>[3 Marks]</b>

## QUESTION 4

### **SCENARIO 4**

You are the Principal Officer of the Quadcor Steel Pension Fund, which is a defined contribution (DC) fund. The sponsoring employer, Quadcor Steel (Pty) Ltd operates across 3 provinces: KwaZulu Natal, Gauteng and the Western Cape. Members of the fund are all employees of Quadcor Steel (Pty) Ltd and are scattered across the three provinces. The head office of the employer, is in Gauteng, and it is also the registered address of the Fund.

The board uses ABC Administrators, a professional and section13B licensed administrator. However, the board of the fund has over time increasingly become unhappy with the service from ABC Administrators and has decided to replace them.

The fund also re-brokers its risk benefits annually, to ensure that the rates that their insurer charges for group life assurance are reasonable.

Since the fund is a relatively large fund, the Board has established five sub-committees to assist it in its duties:

- (1) Audit and risk committee
- (2) Investment committee
- (3) Administration committee
- (4) Communications and education committee
- (5) Death benefits committee

4.1.	Describe how you would project plan a re-broke of the fund's risk benefits. Your answer should address from start to finish the process you would follow. <b>[6 Marks]</b>
4.2.	Describe how you would project plan a member election to enable the filling of the two vacancies on the Board of the Fund. Your answer should address from start to finish the process you would follow in order to help the Board get the job done, and all the stakeholders involved. <b>[5 Marks]</b>
<b>Additional Information for 4.3:</b>  The Chairperson highlights to you that only the Investment sub-committee has a proper terms of reference (or mandate). The others for the remaining sub-committees still need to be drafted. He instructs you to choose one of the remaining four sub-committees and to prepare a short term of reference for discussion and adoption by the Board at the next meeting.	
4.3.	List <b>FIVE</b> (5) key short points that you would include in such a terms of reference document, including specific issues that committee would consider. (You must choose <b>ONE</b> of the remaining sub-committees listed). <b>[5 Marks]</b>
<b>Additional Information for question 4.4:</b>  The Audit and Risk committee following an audit of fund documentation brings to your attention that a trustee code of conduct has not yet been put in place for the fund. They request you to draft one for consideration at the next Board meeting in one month's time.	
4.4	When drafting a fund's Code of Conduct, articulate <b>five</b> (5) key points (one or two sentences each) that should be included. <b>[5 Marks]</b>
<b>Additional Information for question 4.5:</b>  A member of the fund lodges a complaint with the fund. He has just resigned but disagrees with the administrator as to what his withdrawal benefit from the fund is. The member is certain that the withdrawal amount based on his fund credit is totally incorrect. He is also threatening to escalate the matter to the Pension Funds Adjudicator within 3 working days. It is clear from the member's correspondence however, that he doesn't really understand the complaints or Adjudicator's process	
4.5	Draft a brief letter to the member outlining the timeframes involved in the lodging of a formal complaint with the fund and the Adjudicator in terms of the stipulations of the Pension Funds Act (from the complaint to the fund, to the Adjudicator and any possible appeal process). <b>[6 marks]</b>

**TOTAL MARKS: 120**