EMPLOYEE BENEFITS

Low financial literacy in this country is fact, not fiction

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Beneficiary funds: A unique SA phenomenon

The South African long-term insurance industry is faced with a unique challenge with regard to beneficiary funds, as prevailing third world levels of financial literacy are often at odds with the first world insurance products offered in the marketplace.

A recent study commissioned by the Financial Services Board (FSB) on financial literacy in SA found that 49% of respondents were unable to live within their means, while 30% had encountered financial difficulty. The research also found that people with the least education suffered the greatest financial shortfall. Respondents who couldn't meet their monthly financial obligations said they borrowed money from family and friends.

These findings illustrate the low levels of financial literacy prevalent in SA, which means a significant proportion of the population is unable to make sound financial decisions. Based on that stark reality, it's easier to understand the need for beneficiary funds.

Trustees: protecting the vulnerable

When a minor loses a parent they fall under the care of a legal guardian: a person who has the legal authority and duty to care for their personal wellbeing, their property and financial interests.

A board of trustees has a common law mandate to ensure that a guardian is able to execute their duty of care of a minor. Accordingly, trustees need to establish if a guardian is able to manage a death benefit originating from a pension fund responsibly and competently to benefit the minor in their care. The board therefore needs a toolkit to assess and deliberate on these factors, and understand how this money will be utilised to benefit the minor directly until they reach age of majority (18 years old).

Trustees also need to apply their minds in terms of the type of payment used in distributing these funds. The board can choose to pay the benefit out in instalments, or pay a lump sum to the legal guardian on behalf of a minor. However, due to financial literacy levels these modes of payment may carry significant risk. The board therefore needs to manage this risk, which is what led to the development of beneficiary funds.

Social funds

Deliberating trustees should keep in mind that a death benefit originating from a pension fund is really a social fund that aims to ensure people do not become reliant on the state. Trustees then need to make a value judgement on the guardian's ability to manage this windfall amount as certain circumstances and situations may dictate that a beneficiary fund is the most suitable option. While this decision is generally made in the best interests of the child, the Pension Funds Act also states that there is an onerous duty on trustees to carefully consider all the facts before denying anyone the right to administer funds on behalf of a minor.

The Pension Fund Adjudicator deals with numerous complaints when boards unilaterally decline to give lump sum pay-outs as guardians see this as an infringement of their right to care for the minor. For these decisions to stand up to the scrutiny of the adjudicator, the board must offer good reason to withhold the funds from the guardian, or show an inability on the part of the guardian to execute duty in the best interest of the minor.

In addition, common law dictates that the board may not deprive a guardian the right to administer a fund on behalf of the minor. Accordingly, industry best practice guidelines require that trustees first consider direct payments. Only when there is good reason, both in law and in fact, can they consider other options.

When the beneficiary fund option is selected it is important to consult with the beneficiary and guardian (where reasonable) to ensure that they feel their best interests are served, and that they understand the rationale behind the decision.

Despite the challenges, trustees should also embrace this option as low financial literacy in this country is fact, not fiction. Until the basic level is raised boards need to protect the interests of minor beneficiaries and beneficiary funds are a safe, reliable and prudent legal means to address this problem.