thinktank

Feb 2003 **ISSUE: I**

Jarred Glansbeek Managing Director

Jarred worked for RMB Asset Management for 9 years, and became the executive director responsible for the quantitative services of FirstRand's asset management divisions. He then set up Mercury Risk Managers, which became RisCura after a management buyout in 2000. He has significant experience in risk management, quantitative portfolio management as well as product and system development.

jarred on the business

2002 was an exciting expansive year. New clients came in steadily and existing clients stayed happy and loyal. We increased our staff and skills base significantly from 17 staff members at the end of 2001 to 35 at the end of 2002. We also developed some innovative products and services, and now offer a more comprehensive, holistic range of products to our clients. Our vision remains to create an entire process and infrastructure support, based on Global Best Practice, to facilitate decision-making in pension funds and other financial services businesses.

One of our goals this year is to communicate on a more formal level with clients about our business. As a result, every 3 months we will put pen to paper and email this newsletter out to you. We want to inform you about the business, new products and new people as well as highlight more generic issues that we think are important for you to consider. We will aim to inform, educate and inspire. Furthermore you will not receive this newsletter at quarter end when most of us are flooded with information, so look forward to getting it a month or so after quarter end.

"2002 was an exciting expansive year."

RisCura

good **thinking**

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An Update on Key Issues:

Keeping Up the Service Levels

For us to continue keeping clients and attracting new ones, the quality of our service is paramount. This was last year's big challenge, given the increased size of our client base. We met the challenge head on by employing additional staff and systemising as many aspects of the business as possible. We think the high levels of service offered to clients at the start of our business, as well as our value-for-money proposition, has been well retained.

Growing Bigger and Better - The RisCura Consulting Team

Our investment consulting business empowers pension funds and trustees to make the right decisions via skills and information transfer, as well as through technology support. Key to this is a well-staffed, highly skilled consulting team.

During 2002 we increased the size of our consulting team making us one of the largest teams in the market. The team is highly educated and from diverse backgrounds ensuring that there is a good cross section of skills and expertise in pension fund consulting, quantitative asset management, derivative management and stock broking.

The team is split between our Cape Town and Johannesburg offices ensuring that clients in both regions receive personal interaction and communication.

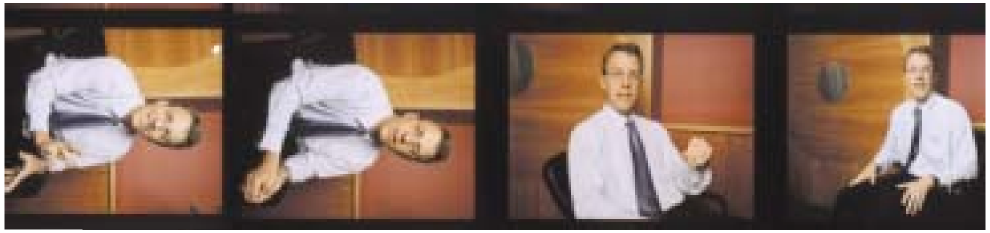
Our consulting services include:-

- Investment strategy consulting
- Optimal portfolio construction
- Performance and risk measurement
- Understanding multi-management issues
- Benchmarking
- Comprehensive asset liability modeling
- Unitisation of performance
- Compliance
- Pension fund regulation
- Pensioner outsourcing
- Technology issues
- Quantifying, managing and understanding risk

Empowerment and Independence

In 2002 we made a big drive to ensure that not only our staff and shareholders reflect the demographics of the broader South African population, but also to empower our stakeholders with training and education.

We have concluded the final purchase of shares from external shareholders and recently empowered staff with equity in the business. Previously disadvantaged staff members in particular, have been allocated equity well beyond what is expected by clients. We will continue to consider appropriate partners for our business based on their commitment to South Africa and our clients as well as their drive for excellence.



Research, Research, Research

A traditional asset consultant usually "learns" from the investment professionals and then passes this knowledge on to their pension fund clients. RisCura however provides advisory services to investment professionals and accordingly needs to have unique, value-add knowledge. Our reputation and business depends on us producing highly innovative mathematical, statistical, empirical and conceptual research. Our research team now consists of 7 members, 2 of which have PhD's in physics. We have also limited our research team's consulting involvement to ensure that they focus wholly on producing the best quality research.

Managing the Business

We are in the process of putting project management teams and processes in place within technology, research, consulting and reporting to ensure that deadlines and deliverables are met.

We have also formed a multi-skilled management committee to effectively run all areas of the business. This will ensure that there is a group of people, beyond a high level board of directors, who are aware of and can manage any opportunities and threats facing the company at all times.

Zero Tolerance for Error

Our business is founded on the provision of accurate information. Given this and the significant amount of data that crosses our desks, we recently put in place a well-defined, demanding set of checks and balances to help eliminate potential error. The benefits of this have already been seen in terms of output and efficiency.

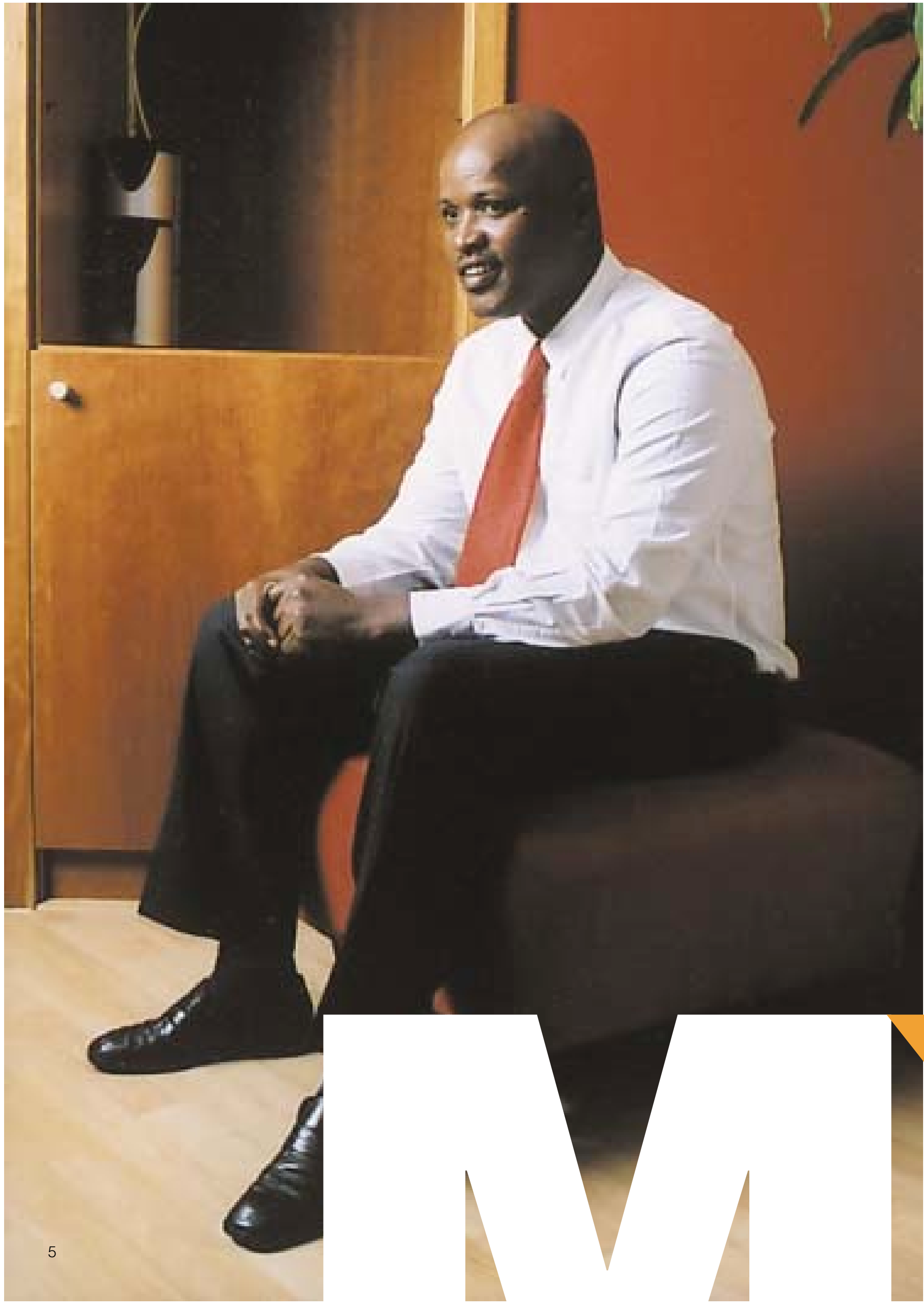
New Business

Jumpy markets and currencies, rocketing resource shares, a threat of war and dismal equity performance have contributed to a growing awareness of the need for proper risk management amongst parties managing cash flows, assets and liabilities.

Given RisCura's proprietary and unique approach to asset and liability modeling as well as our passion for risk management, we continue to make inroads into the pension fund business. 2002 brought success with a number of smaller and larger pension funds. The biggest mandate tendered for last year was Mines Pension Fund, which we were fortunate (and thrilled) to win.

In other areas of the business, our scrip lending clients continue to grow, as do our asset management clients. This advisory service to asset managers has been separated even further from the core pension fund business to avoid any conflicts of interest.

We look forward to working with you in 2003 and hope this year is a challenging and rewarding one for all of us.



profile

Mxolisi Mbekwa **(Nickname: MX)**

Director and Pension Fund Consultant

Education: Started a degree in Chemical Engineering but changed to a BComm in Quantitative Management which I am currently completing.

Experience: More than 8 years experience in pension fund consulting.

Family life: Engaged to Mandisa.

Passionate about: My family.

Dislike: Seeing children suffer at the hands of adults.

Spend my spare time: I try to spend as much time with Mandisa as I possibly can.

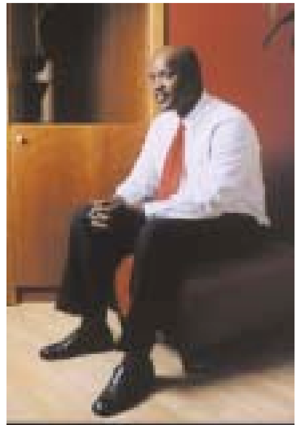
Favourite book: Ways of Dying by Zakes Mda.

Best thing about living in South Africa: The diversity of our people and cultures.

What motivates you? Making a contribution to my country's future.

Where do you see RisCura going? I see us taking a leading role in the asset liability consulting arena, due to our specialisation in client-focused investment strategies.

MX



transition managers - worth your while?

A proposed change to Regulation 28 states that each retirement fund must have its own investment strategy tailored to suit the needs and objectives of it's members rather than based on a pre-defined asset allocation rule (e.g. 75% invested in equities). This change is a shift away from the current "one size fits all" approach and recognises that each retirement fund (and it's member base) is unique.

A significant implication of this proposed change is that many funds will have to change part of their investment structure so as to comply with this requirement.

What is a Transition?

Portfolio transitions can be defined as the process of implementing change to a portfolio or fund structure. They generally occur as a result of a re-alignment or change in a fund's investment strategy and/or objectives.

Some of these changes may include:

- Changing a fund's investment mandate e.g. from balanced to specialist;
- Terminating or appointing investment managers to manage assets;
- Strategic changes to the overall asset allocation;
- Large contributions or withdrawals;
- Changing the fund structure from Defined Benefit to Defined Contribution;
- Changes due to corporate restructuring, fund mergers, etc.

A Costly Business

The main objective of any transition process should be to minimise any potential negative effects that the process may have on fund members and their benefits.

Ian Chaplin B Com (Hons) Financial Economics, Head of Transaction Services

Ian joined RisCura in January 2002 and heads up the transition and transaction as well as securities lending risk management divisions. Prior to joining RisCura, Ian was employed at Penryth and then at Morgan Stanley in London as a Portfolio Analyst. He also worked for Investec Asset Management, London, as a Portfolio Administrator.

Excessive costs are one such negative effect. A typical fund can expect to pay anything between 2-4% of its total value for a transition. The impact of this can be significant. For example, a R250 million fund may pay between R5-10 million for a transition, with costs escalating further if not properly managed.

Before implementing any transition, a fund and it's trustees must take note of the potential costs and risks involved in the process. Incurring unnecessary costs could result in a loss in performance, which may take years to recover. It's therefore very important for trustees to control both explicit costs (such as brokerage fees) and implicit costs (such as opportunity, market impact and implementation costs).

There are a number of ways to manage costs and risks to the fund, and one increasingly popular way is to use a transition manager to assist with this process. A transition manager ensures that any changes to a fund's structure are implemented efficiently and cost effectively.

Although explicit costs (such as brokerage fees, taxes, custody and settlement fees) are important to manage, the majority of costs in a transition process are hidden. These offer the greatest potential for cost saving and include:-

Market Impact Costs - unfavourable movements in prices resulting from a counterparty's demand to be compensated for providing liquidity.

Market Exposure Costs - unfavourable movements in prices in the residual vs. target portfolio.

Opportunity Costs - unfavourable movements in prices while waiting to execute an order or the remainder thereof, due to concern over potential market impact.

Other advantages of using a transition manager include:-

Risk Management - the transition manager will develop all necessary risk procedures and internal processes to minimise the risk of direct or indirect loss to the fund. The transition manager will also be accountable for any negligence or losses.

Expertise in Managing Transitions - a transition manager has developed specialist skills in this area with strong experience in managing transitions from a total fund perspective.

Systems - most transition managers make use of a range of information, risk, performance measurement and cost attribution systems all tailored to a specific transition process. These systems are proprietary in nature and the transition manager uses economies of scale to make these available to clients at low cost.

Good Relationships - A major influence on the effectiveness of any transition is how the fund, asset managers and stock brokers work together to achieve the transition objectives. The transition manager is independent of all parties involved in the process and generally, due to past transitions, has solid relationships with all parties.

For more information on transition management, contact Ian Chaplin on 021 683 7111, or Niël van der Merwe on 011 706 6322.

understanding risk

Prasheen Singh
B Bus Sc (Quantitative Management) - (Hons in Statistics); M.Sc. (Financial Mathematics)
Research Analyst

Prasheen joined RisCura in March 2000 straight after completing her undergraduate degree. She is extensively involved in research and has a strong understanding of both the financial and quantitative elements of the business.

Risk is one of the most important things to consider when investing money. It is the uncertainty between what you expect to happen (in investments, in love and in life) and what really happens.

The ultimate risk for a pension fund trustee is that you are unable to pay members' benefits. In managing this risk, you will need to consider 4 key sources of risk that can materially affect your fund's ability to match its liabilities.

Market Risk

When you put money into a market, there is uncertainty as to the direction in which the market could move (up or down) and this uncertainty is market risk. Some markets are more risky than others. For example, the equity market carries more risk than the bond or money market.

The more risk you take on, the greater the chance of generating high returns, but at the same time, the greater the possibility that you will lose all or some of your investment.

Liquidity Risk

This is the risk that you cannot buy or sell an asset when you want to at the current market price, because there is no supply or demand. If you own an illiquid (hard to sell or hard to buy) asset, and you need to sell it to, for example, pay members' benefits, you may not be able to, or you may need to make the sale price a lot lower than anticipated. Similarly if you want to buy an illiquid asset that you think will generate good returns, again you may not be able to, or you may have to pay a higher price than expected. Highly tradeable stocks such as stocks in the FTSE/JSE Top 40 Index have low liquidity risk while stocks that don't trade as much such as small and mid-cap stocks, have higher liquidity risk. Liquidity risk also arises when you want to buy or sell unusually large volumes of a stock, relative to what is usually traded in the market.

Credit Risk

When you obtain a bond to buy a house, the bank that you borrow the money from is taking on 'credit risk'. This is the risk that you may default on the loan by failing to repay the interest and borrowed capital in a timely manner. Regarding bonds, governments are unlikely to default on interest and capital payments and therefore government bonds have low credit risk. Corporates on the other hand do go bankrupt and are more likely to default on repayments. Corporate bonds therefore have higher credit risk.

Manager Risk

Remember the idiom "Don't put all your eggs in one basket"? Manager risk relates to the uncertainty that the fund manager(s) with whom you invest your money, does not perform as expected. If you have all your money with one manager, your manager risk is substantially higher than if your investments are spread over a range of managers. Manager risk also relates to investment styles. Certain managers' investment styles outperform over periods of time due to unpredictable market and economic factors. If you expose your investment to one type of manager's style, the risk of underperformance is higher than if you diversify the investment over a range of managers' styles.

There are numerous other sources of risk, for instance, currency risk, inflation risk, style risk, benchmark risk, operational risk, organisational risk and pension conversion risk. Next quarter, we will look at key risk terms such as risk reward trade-off, risk free return and risk adjusted returns.

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