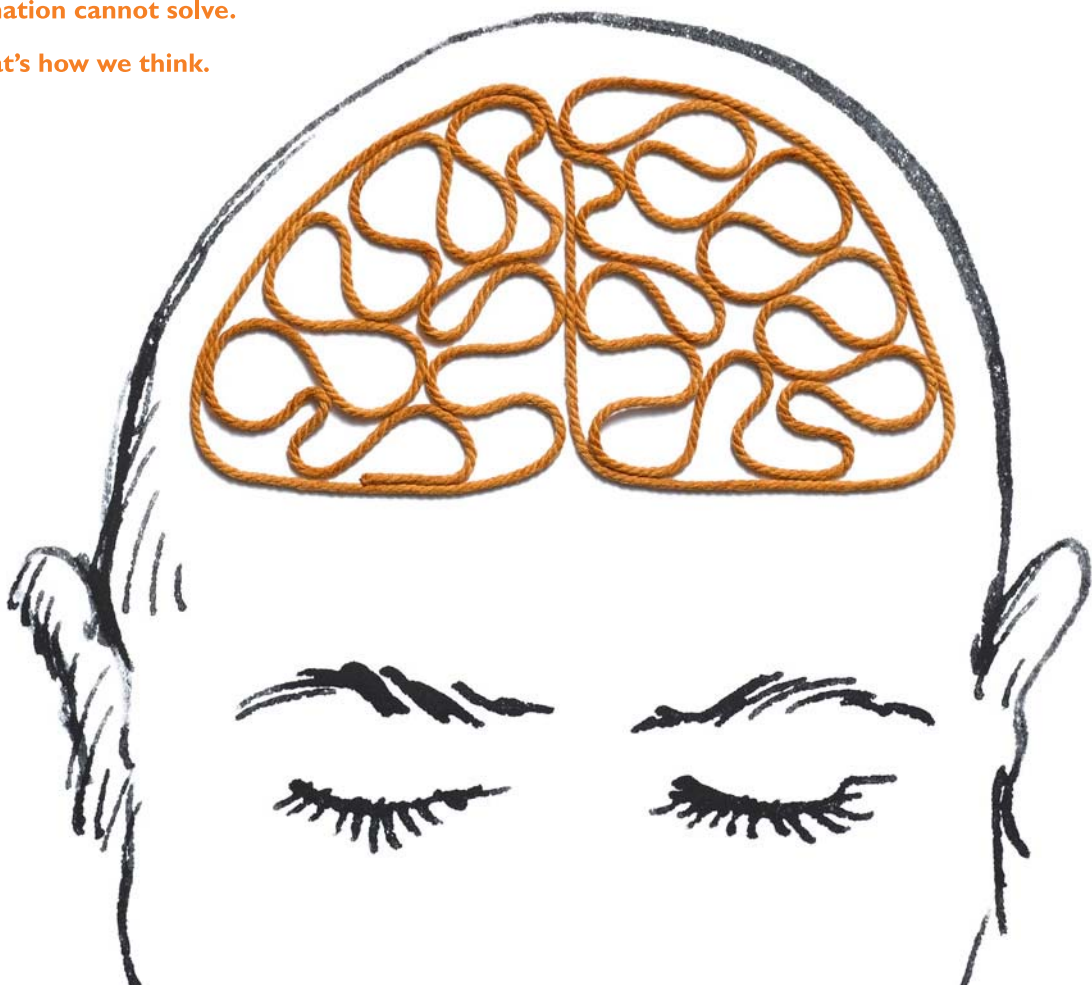


There is no problem that
considered thought, intelligence,
applied knowledge
and imagination cannot solve.

Well, that's how we think.



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JUNE 2007



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Goedkoop is duurkoop¹

Are Investment Consultants worthy of their fees?

By Prasheen Singh, Senior Consultant

RisCura is often asked to pitch to retirement funds that are considering using the services of an investment consultant. Small funds in particular; see investment consultants as an expensive luxury, given the high fixed costs of administering and managing a retirement fund. The Afrikaans idiom "goedkoop is duurkoop" comes to mind. Boards of Trustees that don't use the services of an investment consultant must evaluate whether a short-term fee saving won't result in higher long-term costs and risks for the fund. Good investment consultants should more than pay for themselves via improved fund returns and well-managed risk.

INVESTMENT CONSULTANTS ARE SKILLED EXPERTS

An investment consultant's entire business is focused on the investment and risk issues facing retirement funds. They employ people with specialist investment and risk qualifications, they develop systems that focus on streamlining investment decision-making and risk management, and they create tried and tested processes to ensure the sound governance of funds. They have significant experience in dealing with funds and leverage off this experience to save their retirement fund clients both costs and time.

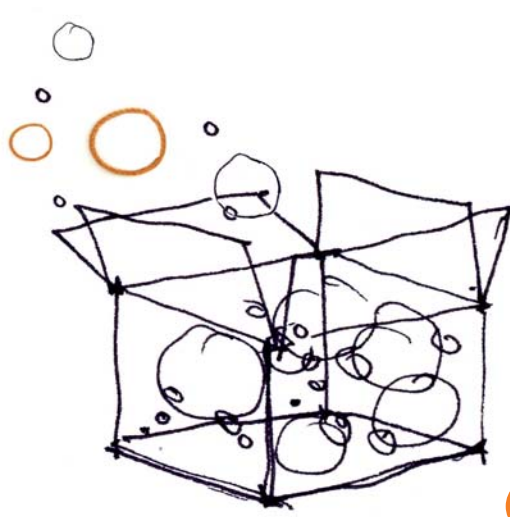
This experience includes:-

- knowledge of mistakes made by similar Boards of Trustees;
- understanding different fund liabilities and how best to construct investment strategies to match these liabilities;
- intensive knowledge of investment managers and available products in the market;
- how to negotiate the best fee structures with managers/product providers; and
- how to monitor managers' performance and risk so that it matches the fund's objectives.

Investment consultants also help to reduce the administration and workload for Trustees who often have other jobs and time pressures. Implemented consulting, which is a consulting model we address later on in this newsletter, helps to implement the fund's investment decisions cost effectively and timeously. This allows a Board to focus on more strategic fund decisions, and can often result in a huge cost saving for the fund.

The Myners Review of 2004, a document codifying global best practise for retirement funds, states that "decisions should only be taken by those with the right skills and expertise and Boards of Trustees should ensure they have access to appropriate skills and resources". A good investment consultant will have the right skills and resources to facilitate a fund's decision-making by ensuring they under-

¹ Penny wise, pound foolish.



stand and are aware of important issues. Independence is a key factor here - independent consultants are more likely to provide objective input to a retirement fund's decision-making, rather than push products for one of their associated businesses.

UNDERSTANDING THE PRICE

Most investment consultants charge a transparent fee that is calculated as a percentage of fund assets. This is generally a much lower fee than that charged by asset managers. A classic and much cited article published in the Financial Analysts Journal in 1986 found that 93.6% of the final performance of pension funds was determined by their investment policy and asset allocation. The study was based on 91 large corporate pension funds from 1974 - 1983. Over the same period, the range of performance added by active management (i.e. selection of asset managers) was 6%. The conclusion was that while both asset allocation and manager selection had a meaningful impact on fund performance, the former is of vital importance.²

Investment consultants play a significant role in advising on the investment policy and asset allocation strategy for a fund, and their recommendations are a major driver of a fund's long-term performance.

IT'S ALL RELATIVE

Since 2002, the average annual return of a balanced retirement fund has been 26.59%³. Most investment consultants charge a fee of between 0.05% - 0.10%

of assets depending on the fund size, which means that the average annual return will be between 26.49% - 26.54% - a small charge for a service that is the primary driver of long-term performance, helps Trustees meet their responsibilities and helps reduce their administrative burdens. It's also likely that an investment consultant will be able to save the fund costs in areas such as manager/product fees, which can often help compensate for their consulting fee.

CHOOSING THE BEST

Investment consultants tend to be split between those who compete on price, and those who compete on the value they add to a client's portfolio. The trade-off between the two depends on the needs and characteristics of the retirement fund.

A consulting company that competes on price is saying to a fund, "We will perform specific services for your fund and charge you as little as possible". A consulting company competing on value is saying, "We will add enormous value to your portfolio and expect to be compensated accordingly".

Consulting companies competing on value-add:-

- Must hire experienced investment professionals with considerable compensation levels and typically, they must be given substantial equity stakes in the company. Their staff will be highly educated with sound industry experience.

- Will customise their advice from asset allocation to manager selection to advice about other specific fund issues. These professionals do not use a "cookie cutter" approach.
- Are highly attentive to clients, proactively contacting clients and anticipating their needs. The client per consultant ratio for these companies is typically very low.
- Will quote a fee based on an estimate of the fund complexity and the extent of services/input that is required.

We believe the services of a good investment consultant can add measurable value to both small and large funds. An investment consultant's focus is on a fund's long-term horizons and well being. This long-term structuring is essential, and a mark of a well-governed fund.

For Trustees, it's not an expensive luxury to ensure your investment strategy is in line with your fund's needs, that you have the right products/managers in place to enhance your fund's returns, and to monitor the fund's performance and risk relative to its strategy on an ongoing basis. The right consultant in the end could prove to be your fund's greatest investment.

² "Determinants of Portfolio Performance" Brinson, Hood and Beebower, Financial Analysts Journal, (January/February 1995).

³ Based on the average annual return of a retirement fund since 2002 excluding fees.



Understanding Implemented Consulting

with **Mehluli Ncube**, Head of Implemented Consulting

What is implemented consulting?

An implemented consultant helps a fund effectively, timeously and cost efficiently implement its investment policy decisions. The implemented consultant is involved

in finding the right solutions for a fund, within the parameters set by the Trustees. Once the fund has selected the optimal solution, the consultant implements it. Traditional investment consulting is advisory only, and the Trustees remain responsible for making and implementing decisions. Implemented consulting recognises the potential inefficiencies of this for smaller funds that don't have dedicated investment staff and is therefore more active in facilitating and implementing decisions.

Why the need for implemented consulting?

Consultants and retirement funds put a large amount of effort into setting the fund's asset allocation policy, designing the asset class structure and researching/selecting asset managers. This is beneficial for a fund, but the hidden costs of poor implementation can significantly reduce the value this adds.

"Implementation leakage" is the risk of a fund losing performance due to the delay between agreeing with a consultant's recommendation and implementing it. For example, the consultant recommends that an underperforming manager be removed in favour of a better performing manager. A large retirement fund with a sophisticated investment committee and administration department could implement this decision quickly, allowing the fund to benefit immediately from a better performing manager. However, small and medium funds don't necessarily have the resources to quickly implement this decision, resulting in a potential performance drag.

How is it different to multi-management?

All fund's liabilities are different - something which multi-managers do not reflect in their portfolios. Implemented consultants customise solutions in line with a fund's specific needs. Multi-managers "own" all the fund's investment decisions

while implemented consulting is much more of a partnership between a Board of Trustees and the consultant who work together to find the right solutions for the fund. The consultant is not taking on the fund's assets or managing them independently of the fund - they are still principally providing advice. However, an implemented consultant takes the process one step further than a traditional consultant and implements this advice.

What do you mean by partnership?

We believe that a Board of Trustees should never hand over control of its investment strategy to an external party. A partnership implies that a Board of Trustees is not relinquishing control of the fundamental decisions and will still have to sign off on these decisions. By taking the implementation burden away from funds, the Board of Trustees is more able to focus on the strategic management of the fund while the implemented consultant deals with the nuts and bolts. A Board of Trustees only hands over selected decisions to the implemented consultant, which means that the scope of services may differ from client to client.

What does the actual "implementation" involve?

Once the fund and the implemented consultant have come up with a strategy that best suits the fund profile, the implemented consultant will:-

- manage the portfolio construction process to ensure an optimal mix of managers;
- choose high conviction managers for the fund's approval;
- draw up mandates and negotiate fees;
- manage the transfer of assets;
- actively monitor and where necessary terminate managers; and
- rebalance the fund's asset allocation to keep in line with objectives.

All of this takes place in partnership with the Trustees, but is efficiently executed and managed by the implemented consultant. Once the strategy is in place, the implemented consultant monitors and oversees the fund's investment strategy on a day-to-day basis, keeping the Trustees informed and up-to-date, but substantially reducing their administrative tasks.

What is the cost of such a service?

An implemented consultant puts their money where their mouth is. They carry some of the risk of performance and service delivery by charging a percentage of assets. This fee can be structured so that it's dependent on how the fund performs relative to its defined objectives. In this case, should the fund outperform, the implemented consultant is compensated according to this added value. This means that the initial cost to the fund is low, which makes it very affordable for small and medium funds.

Summarise the benefits for Boards of Trustees

- **Cost effective** - both in terms of the fee structure and the fact that the implemented consultant can leverage asset size and number of clients to generate economies of scale for clients.
- **Access to highly specialist solutions** - small and medium funds often can't afford the services of a specialist investment consultant. Given an implemented consultant's very accessible fee structure, these funds will now have access to the experience, skills, processes and solutions of a specialist investment consultant.
- **Highly customised** - funds get individual attention and solutions. They are not buying an "off-the-shelf" product but a customised investment solution.

- **Much lower administration burden -** Trustees have the comfort of knowing that the fund's day-to-day management issues are being taken care of, without relinquishing control of the fund and the decision-making. The level of decision "outsourcing" is defined by the client.



For more information on RisCura's Implemented Consulting solution, please call Mehluli or Fulu on (011) 214 9800 or email: mncube@riscura.com or fmakwetla@riscura.com

Summary Of The Q&A Document by Treasury on the controversial Social Security and Retirement Reform Proposal

This is a summary of the Q&A document taken from the website www.treasury.gov.za

It does not represent the views of RisCura. RisCura is currently engaging with industry players and clients to comment on the proposed reforms which will be forwarded to government.

In February 2007, Government proposed a mandatory earnings-related social welfare system informed by the principles of social solidarity. This proposal will form the basis for consultation with the organised business sector, trade unions and other stakeholders this year.

WHY DO WE NEED A SOCIAL SECURITY SYSTEM?

It's partly about redistribution - that a society should jointly share in a basic safety net that protects everyone against poverty. It's also about contributory insurance - ensuring that everyone participates in an agreed social insurance arrangement to protect household incomes in the event of death, disability or unemployment. All contributors will be entitled to benefit from the fund, governed through standard rules and

implemented through a common administrative platform.

SA HAS A WELL-ESTABLISHED RETIREMENT INDUSTRY. WHAT IS WRONG WITH THIS ARRANGEMENT?

Many South Africans do not save or leave it too late in their careers to save enough for retirement. This is partly because many working people cash in their pension when they change jobs or have informal, irregular employment, which makes it difficult to save. Our retirement industry therefore does not adequately meet everyone's needs.

The problem of retirement saving is closely related to other aspects of social insurance. Some people cash in their savings when they lose their jobs because unem-

ployment benefits are insufficient. Some people draw on savings to meet medical costs in the event of ill health etc.

These vulnerabilities can be addressed in an integrated way by a social security system which can provide affordable basic benefits for everyone.

WILL THIS REPLACE THE SOCIAL ASSISTANCE GRANTS?

The assistance grants are an important part of South Africa's social assistance system. Studies show that social grants contribute significantly to reducing poverty. The social assistance grants (including the child support grant and disability grant) will remain in place, as they provide a basic safety net protecting the poor. These grants are paid for out of general revenue.

The social assistance safety net is a redistributive arrangement and an important expression of social solidarity. As a society we also need to encourage saving and basic social insurance, which are the goals of an earnings-related contributory arrangement. Society as a whole is better off if everybody contributes to saving and social insurance arrangements. For these arrangements to be fair, basic minimum standards of social insurance need to be compulsory.

ISN'T THIS JUST GOING TO BE ANOTHER TAX?

It's proposed that everyone in formal employment will pay a social security contribution of 13 - 18% of their earnings, up to an agreed threshold (still to be decided). This will include the present UIF and will also finance an individual savings account for retirement, death and disability benefits. It is in effect, a standardised insurance contribution, collected by SARS as part of the Standard Income Tax on Employees (SITE), but it will pay

for benefits that belong to each individual contributor.

The social security tax will be capped, similar to the present UIF scheme - everyone contributes and is entitled to claim benefits, but up to an agreed threshold. Above the threshold, employees will be able to choose between further contributions to the social security scheme, or participation in an alternative retirement fund.

DOES THIS REPLACE EXISTING PENSION AND PROVIDENT FUNDS?

Once the social security system is in place, everybody will be a member of the social security scheme and many employees will also be members of occupational pension schemes or individual retirement funds (such as retirement annuities).

There will be transition arrangements to allow existing pension and provident funds to adapt to the new dispensation. Many will continue as supplementary occupational schemes, but an option to transfer accumulated funds and benefits into the social security scheme on behalf of members will also be provided.

WHO WILL MANAGE THE SOCIAL SECURITY FUND AND ADMINISTER BENEFITS?

This still has to be decided. Social security funds and benefits administration are usually managed by government and governed by law. But there are examples of countries that have opted for competitive provision of services by the private sector, subject to agreed product standards and a regulatory framework.

WILL THERE STILL BE LUMP-SUM BENEFITS?

The social security arrangement is about income security, and is not intended to fund lump-sums at retirement. In general,

the aim of the retirement policy is to encourage saving for post-retirement income ("annuities"). But it is recognised that lump-sum payments are a well-established part of the South African retirement system, and in some instances they meet needs that an annuity income cannot. Supplementary occupational and individual retirement funds will continue to allow for moderate lump-sum payments, but with the bias in tax treatment continuing to favour conversion of accumulated funds into income.

IS THE GOVERNMENT PLANNING TO TAKE AWAY THE TAX DEDUCTIBILITY OF PENSION CONTRIBUTIONS?

No, the tax system will continue to reward retirement saving. However, the present limits to the deductibility of pension and other contributions are under review. It is unsatisfactory that the tax system continues to provide an effective 40% marginal subsidy for this particular form of saving, without a cap. This is disproportionate from a retirement policy point of view, and has distorting effects on saving and investment decisions. Treasury is currently looking at international practices with a view to identifying options for reform. There is also the unsatisfactory tax treatment of lump-sum benefits at present, including complex formulas and thresholds that have not been adjusted for a long time. Proposals for changes will be tabled this year.

For further Q&A and more detail on the questions, please go to:

<http://www.treasury.gov.za/documents/budget/2007/Q&A>



Profile:

Clinton Pillay

Head of Pension Fund Reporting

What role do you have at RisCura:

Head of pension fund reporting - in conjunction with our reporting team I ensure that all our pension fund clients are provided with accurate and timely reports.

Qualifications and experience: BSc; BCom(Hons) UCT. I am currently study-

ing towards my Masters degree in Finance at the University of Cape Town. After my undergraduate degree, I participated in the graduate training programme at JP Morgan Investment Services before joining RisCura in 2004.

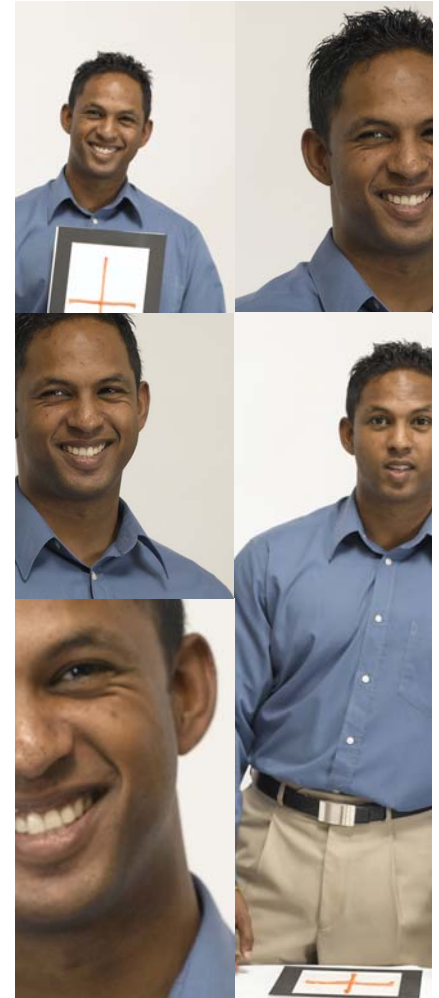
Day to day my job involves: Importing all the asset manager portfolios on our system, running exceptions on the portfolios and liaising with asset managers if there are any discrepancies. I also perform portfolio audits and create monthly investment reports that are sent to our pension fund clients.

Working at RisCura is about: Consistently being challenged and working with like-minded, clever people. RisCura provides a relaxed and flexible environment with exposure to every aspect of the financial services industry.

The person I most admire is: My dad. He is truly an extraordinary person with amazing qualities and I've learnt so much on a personal, spiritual and humanitarian level from him.

The best book I've ever read: A Brief History of Time by Stephen Hawking. It explores the authors' ideas about space, time, black holes and the universe in which we live.

On weekends I love to: Drive. I thoroughly enjoy driving my car - it relaxes me! I am particularly passionate about advanced driving and BMW M-series cars. I also love to hike in the mountains.



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