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## Good governance in plain English: A review of PFI 30

**By Claire Rentzke, Consultant**

Many of the latest scandals in the retirement fund industry like Fidentia, bulking etc. have stemmed from a failure in governance. The Financial Services Board (FSB) believes these scandals could have been avoided if strong, accountable Boards of Trustees had been in place.

In June this year, the FSB issued a Circular, PFI 30, outlining the principles of good governance for retirement funds. Their key intention is to better align trustees to their fiduciary duties and reduce any potential conflicts of interest. PFI 30 lays out a thorough list of requirements that Boards of Trustees will be obliged to implement.

Implementing these guidelines will increase Trustees' responsibilities significantly but the goals of PFI 30 are positive - put members' long-term interests first. PFI 30 has also coincided with changes that are being made to Regulation 28, and the two will dovetail well to create a more transparent, member-focused retirement industry.

### Some key points

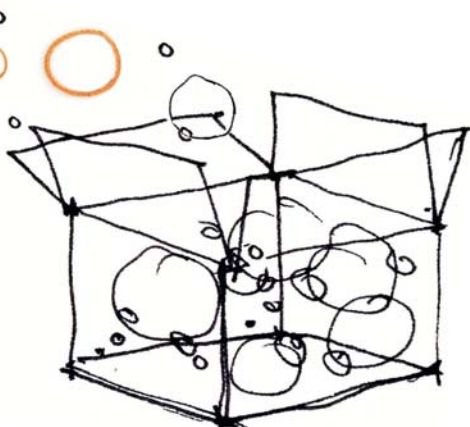
1. The FSB defines the purpose of good governance as follows:-
  - benefits promised in terms of fund rules are delivered;
  - appropriate balance between optimal investments and risk taken;

- process followed to deliver benefits is credible and worthy of members' trust.

2. Trustees must put in place:-
  - a documented code of conduct (including an explicit policy on gifts and resolving conflicts of interest);
  - an investment policy statement;
  - a communications policy;
  - a performance appraisal system for Trustees.

All these documents will have to be available for inspection by the FSB.


3. Trustees must maintain an up-to-date understanding of risk management, investment risks and strategies, benefit structures, legal issues, regulatory and compliance requirements, taxation as well as actuarial and reform issues.
4. Trustee training is essential and the costs should be borne by the fund.
5. Boards are free to engage experts, and are compelled to do so in areas where they may lack expertise, but remain responsible for all decisions. They must develop a methodology to assess whether consultants and service providers are giving appropriate advice.
6. Funds should include a policy on socially responsible investments (SRI) in their investment policy statement.



# The 12 Principles

Principles	Key points	How an investment consultant can help
<p><b>1: Roles and responsibilities</b></p>	<ul style="list-style-type: none"> <li>• Board of Trustees to be elected by fund members and accountable to them for fund administration and fund performance.</li> <li>• Trustees can be held personally liable if they don't adhere to good governance.</li> <li>• Board can delegate responsibilities to Board committees and service providers but delegation does not relieve Board of its accountability.</li> <li>• Chairperson must proactively lead Board - manage all Board meetings, ensure that the Board's performance is reviewed, raise areas of concern and monitor the fund's operations.</li> <li>• Principal Officer should not be the Chairperson and is not required to be a member of the Board. He/she ensures the Board's decisions are executed, and fund complies with applicable laws and regulations.</li> <li>• Conflicts of interest must be avoided and where they do occur should be quickly and satisfactorily resolved.</li> </ul>	<ul style="list-style-type: none"> <li>• Assist with prudent investment of fund's assets.</li> <li>• Help raise and address areas of concern - "ears and eyes" in the market.</li> <li>• Keep fund up-to-date on investment regulation changes.</li> <li>• Consultant to make fees fully transparent to fund and provide updated "declaration of conflict of interests".</li> </ul>
<p><b>2: Board composition and competency and use of sub-committees</b></p>	<ul style="list-style-type: none"> <li>• Board members to have sufficient capacity to handle responsibilities diligently and thoroughly.</li> <li>• Employers must ensure that skills needed for a Board of Trustees are represented. If necessary, to appoint people not employed by the company.</li> <li>• Sub-committees (audit and administration, investment, legal, communication and death benefits) may be established to oversee specific functions of the Board. Each sub-committee to have a written mandate.</li> </ul>	
<p><b>3: Board orientation and education</b></p>	<ul style="list-style-type: none"> <li>• New Board members to receive training to equip them to carry out their responsibilities.</li> <li>• Board should receive ongoing training on new retirement matters and have/maintain understanding of risk management, investment strategies, benefit structures, laws, regulations and actuarial issues.</li> <li>• Training to be at the fund's expense.</li> </ul>	<ul style="list-style-type: none"> <li>• Provide fund specific training to ensure Trustees understand issues relating to the fund's objectives and investment strategy.</li> </ul>
<p><b>4: Board assessment and breach of code of conduct</b></p>	<ul style="list-style-type: none"> <li>• Boards to have documented code of conduct, including an explicit policy on gifts.</li> <li>• Board, Principal Officer and sub-committees should undergo an annual performance review.</li> <li>• If Board member breaches fund's code of conduct, Board should take appropriate action to preserve the fund's integrity.</li> </ul>	

Principles	Key points	How an investment consultant can help
5: Internal controls	<ul style="list-style-type: none"> <li>Board's primary role is to administer all matters related to the fund's business.</li> <li>Board must ensure compliance with all relevant laws.</li> <li>There must be clear identification and assignment of operational responsibilities - use of appropriately skilled individuals or licensed administrators.</li> <li>Board required to ensure regular assessment of the performance, fee basis, costs and systems of the fund and all service providers.</li> </ul>	<ul style="list-style-type: none"> <li>Help fund with administration - secretariat duty.</li> <li>Provide transparent information on performance, fees and systems.</li> <li>Provide regular investment performance assessment and impact of costs on fund.</li> </ul>
6: Expert advisors	<ul style="list-style-type: none"> <li>Board can make use of approved advisors where they lack the necessary skills to manage fund's day-to-day operations. All advice supplied to the fund should be sourced from independent, licensed service providers.</li> <li>Appointed service providers should be independent and evaluated on their skill, competence, track record and fee structure amongst others.</li> </ul>	<ul style="list-style-type: none"> <li>Consultant to be registered with the FSB and independent from employer and other service providers.</li> </ul>
7: Risk management	<ul style="list-style-type: none"> <li>Risk management is a vital part of the governance of the fund. Funds need a risk management policy (reviewed annually), to identify, assess and reduce impact of the risks facing the fund. These risks are not limited to financial risks.</li> </ul>	<ul style="list-style-type: none"> <li>Assist with drawing up investment risk management policy. Consultant should have a thorough understanding of risk issues.</li> </ul>
8: The investment performance of the Fund's assets	<ul style="list-style-type: none"> <li>The proper management of fund assets is a critically important component of fund governance.</li> <li>Contracts should exist between fund and investment managers that outline performance requirements.</li> <li>Fund must have an investment policy statement that is communicated to all stakeholders, reviewed annually and provides information on the investment of fund's assets.</li> <li>Investment policy statement should define the fund's socially responsible investments.</li> </ul>	<ul style="list-style-type: none"> <li>Help draw up investment policy statement that is based on fund's unique needs and communication around this. Review this statement annually.</li> <li>Help define fund's SRI policy.</li> </ul>
9: Communication and access to information	<ul style="list-style-type: none"> <li>Board members should have unfettered access to all relevant information.</li> <li>Fund information is confidential and may not be released without proper reason.</li> <li>All relevant information to be communicated to members in a fair, transparent and accountable way.</li> </ul>	<ul style="list-style-type: none"> <li>Consultants' member communication departments to provide advice on how best to communicate complex issues to members.</li> </ul>

Principles	Key points	How an investment consultant can help
I0: Members and beneficiaries	<ul style="list-style-type: none"> <li>• Communication policy should be drawn up to ensure members have regular access to all relevant information (performance, costs etc).</li> <li>• Board to ensure that relevant aspects of the fund's operations are communicated to members to assist in decision-making.</li> <li>• All communication from members should be responded to promptly and thoroughly.</li> </ul>	<ul style="list-style-type: none"> <li>• Communication departments to do member communication programs and assist funds with carrying out communication policy.</li> </ul>
I1: Employer and sponsor	<ul style="list-style-type: none"> <li>• Board owes the employer and sponsor duty of good faith and the relationship should be marked by independence and co-operation.</li> <li>• Channel of communication to be established between the Board and employer through the chairperson.</li> </ul>	
I2: Regulatory authorities	<ul style="list-style-type: none"> <li>• Fund must comply at all times with the requirements of any regulatory authority.</li> <li>• Any complaints by Regulatory Authority should be treated seriously.</li> </ul>	<ul style="list-style-type: none"> <li>• Monitor fund compliance and notify the fund of any new regulations and where gaps exist.</li> </ul>
 <ul style="list-style-type: none"> <li>✓ Board to familiarise itself with the 12 principles and their requirements.</li> <li>✓ Board to put in place an evaluation process to see which principles are in place and where there is a shortfall.</li> <li>✓ Board to construct project plan for filling the gaps.</li> <li>✓ Where necessary, Board to evaluate service providers in the areas of investment, legal and communication to ensure compliance.</li> </ul>		

# What you need to know about the new Regulation 28

By Abi-gail Ryan,  
Head of Compliance

## Problems with current Regulation 28

- Does not allow for fund/member/liability specifics, which could result in the asset guidelines being inappropriate.
- Asset restrictions are bypassed through the use of insurance products and other complicated structures.
- Too much leeway for inappropriate investment strategies.
- No clear way to measure whether Trustees are fulfilling their fiduciary duty.
- Does not cater for new, complicated investment products.

## Goals of new legislation

- Holistic approach, which considers fund specific circumstances, individual member investment choice, accommodates pooled investments and flexible allowance for rapid new product development.
- Due diligence and risk management instilled as key factors.
- Prescribed process for fund to follow when investing rather than preset asset limits.
- Asset limits to be set by funds themselves after due process.
- Need for compliance officer to monitor adherence to the fund's strategy and report annually to Registrar.

## Trustee responsibility

- Trustees remain responsible for decision-making in their funds.
- Where knowledge gaps exist, trustees must employ expert skills.
- Trustees may spend more time and money understanding the unique characteristics of their funds and coming up with the right solutions.
- Process to be followed that gives rise to an investment strategy specific to a fund and the appointment of asset managers who will implement this strategy.

- Annual disclosure of actual or potential conflicts of interest by Trustees to Registrar.

## The issue of costs

- Costs may increase but benefit is improved governance in the long-term.
- Investment consultants to be selected on the quality of their consulting rather than their price.
- Smaller funds invested in pooled portfolios have less stringent requirements and therefore less costs.

## The use of experts

- If trustees lack investment expertise and knowledge, they are required to seek expert advice in drafting investment strategies;
- Factors to consider when choosing managers to implement investment strategies include:-
  - Track record and experience relating to assets in the mandate;
  - Investment style and philosophy adopted;
- Trustees to monitor investment managers' compliance with mandates.

# Making a change in your Fund? Use a transition specialist.

As Board of Trustees, you've decided to make asset allocation changes to your fund and have appointed some new managers. Now you have to move the fund's assets out of the old asset structure and managers into the new ones. You don't want to pay unnecessary fees and you've heard the potential risks can be big. Consider using a specialist transition manager.

## Q&A with Guy Allan - Head of RisCura's specialist transition management business

### Q1 What does a specialist transition manager do?

We co-ordinate and manage the process of reallocating assets, which can be costly and risky, not to mention admin intensive.

We partner with a fund and provide a plan for executing the transition based on the fund's needs, we co-ordinate all the parties (fund, custodian, managers, brokers, etc.) to ensure an efficient process, and most importantly we manage costs and risks throughout the process.

Our primary goal is to make sure the transition is executed at minimal cost and low risk. We keep the fund informed throughout the process and provide transparency.



### Q2 Why can't the asset managers do this?

A lot of funds have multiple transitions where a range of asset managers are being changed or multiple markets are being traded in, and if there is no proper communication or co-ordination, this can result in a huge cost escalation - shares being sold and rebought, which increases trading costs, the fund not benefiting from market movements as portfolios are converted to other asset classes etc.

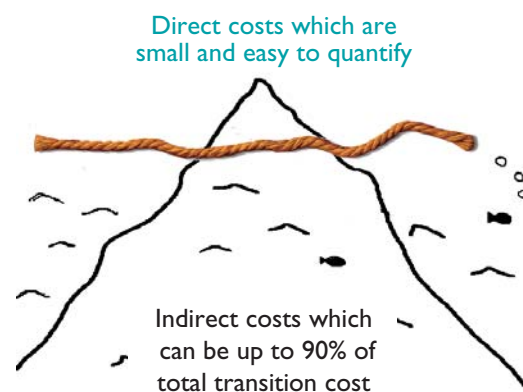
Also, when multiple brokers enter the market on behalf of multiple managers, the effect on the market/share prices is far greater than if one controlled entry point is used. For example, if two managers both sold Anglo shares into the market, the market would react far more prejudicially than if one central point handled the share trades.

Transition managers alleviate this risk as well as prevent situations where managers trade between each other in the market, when a simple scrip transfer between managers could be done.

A disciplined, integrated process managed by an independent party who can oversee multiple parties and has experience in trading across multiple markets, will help to reduce unnecessary costs and make sure the fund is not exposed to undue risks.

### Q3 What kind of costs are you talking about?

Although it's a commonly used image, I love the one of the ice-berg because it so aptly describes the explicit and implicit costs of a transition.





The explicit costs, such as commissions and taxes, are easy to quantify. However, our research shows that indirect costs make up between 65%-90% of the total transition cost. These include market impact, bid-ask spread differences, liquidity and opportunity (the cost of mistiming the execution of a trade) costs. This is where a specialist transition manager is very skilled and can make a big difference.

**Q4 On what basis should I evaluate the different transition managers? What skills are important?**

In my view, experience in trading, strong risk management background to manage and monitor risks, understanding of quantitative techniques to determine optimal

trading, knowledge of the stockbrokers and their core skills, experience in derivative-based hedging which can help to protect fund values, project management and administrative skills and good legal acumen.

**Q5 What is RisCura offering my fund that other competitors don't?**

We have been doing transition for over 6 years and have transitioned over R90 billion (traded value) worth of equities and bonds over the last 5 years.

Our team is highly skilled with experience in portfolio management, risk assessment and trading - our team has over 26 years of combined experience in trading and transition management.

We have strong relationships with all parties involved in the transition process including custodians, stockbrokers and asset managers, which enables a seamless execution process.

We are wholly independent. This means we will always select the best brokers based on the goals and needs of the transition and are not forced to use an in-house trading team.

Lastly, we have no conflicts of interest - we are paid directly by the fund and earn no kick backs on any of the trades.

## Managing a transition: Comparing your transition options

	Fund	Investment manager	Stockbroker	Transition manager
<b>Costs</b>	<ul style="list-style-type: none"> <li>Manages explicit costs such as brokerage and taxes, but generally not aware of, and no strategies in place, to manage implicit costs.</li> </ul>	<ul style="list-style-type: none"> <li>Usually requests a "performance holiday" while effecting a transition.</li> <li>Costs incurred by the manager for the transition are not reported or analysed.</li> <li>Not in line with Global Best Practice as manager's performance should be monitored at all times.</li> </ul>	<ul style="list-style-type: none"> <li>Must ensure trades are carried out at optimal costs and that individual trades are finessed in terms of timing, liquidity, spread and impact costs.</li> </ul>	<ul style="list-style-type: none"> <li>Distinguishes between implicit and explicit costs.</li> <li>Costs reduced by using specialist strategies and brokers.</li> <li>Constructs a strategy of transactions across a number of brokers which one broker cannot achieve alone.</li> </ul>
<b>Experience</b>	<ul style="list-style-type: none"> <li>Transitions are done infrequently and funds mostly lack suitable skills and experience.</li> </ul>	<ul style="list-style-type: none"> <li>Focused on individual portfolios and therefore cannot manage an overall fund transition taking into account overall asset allocation and benchmark issues.</li> </ul>	<ul style="list-style-type: none"> <li>Limited experience in dealing with large transitions.</li> <li>No specialist function exists to manage the entire transition project.</li> </ul>	<ul style="list-style-type: none"> <li>Specialist consultancy with highly developed skills and systems built through experience.</li> </ul>
<b>Relationships</b>	<ul style="list-style-type: none"> <li>May experience difficulties co-ordinating all parties effectively to achieve overall objectives.</li> </ul>	<ul style="list-style-type: none"> <li>Termination of an investment manager by a fund may have a negative impact on their efficiency regarding trading, settlement and other administrative issues.</li> </ul>	<ul style="list-style-type: none"> <li>Does not have a direct relationship with pension funds making it difficult for them to understand the fund, transition objectives, investment strategy or manager selection process.</li> </ul>	<ul style="list-style-type: none"> <li>Independent of all parties and has ongoing relationships with them (even outgoing managers).</li> </ul>



# Profile

## Kaajal Ethwar

### Reporting team

**Job description:** Risk analyst. I am responsible for analysing a client's portfolio with regards to asset allocation, performance measurement and benchmarking. I also generate the risk and performance reports for clients. My role demands a high level of attention to detail and can be very stressful - especially at quarter end!

**Qualifications and experience:** I completed my BCom at the University of Kwazulu Natal and joined RisCura in 2005 straight from university.

**RisCura is:** a friendly, dynamic place to work. Every day I am learning, growing and working with a really great team.

**The person I most admire is:** my dad. He is amazing and I draw strength and inspiration from him.

**The best book I've ever read is:** Who moved my cheese? by Dr Spencer Johnson.

**On weekends I love to:** relax and spend time with friends.

**My life philosophy is:** every cloud has a silver lining.

**Tea or coffee?** Tea

**Speak out or keep quiet?** Speak out

**Get out or stay in?** Get out in summer and stay in during winter.

**If I could change one thing in South Africa** it would be poverty.

**I am grateful for** waking up every morning and appreciating life.



good thinking

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