ROLE OF THE UNIONS IN THE
S.A. RETIREMENT FUND INDUSTRY

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fifth quadrant

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1. PROJECT BRIEF

1.1 Terms of Reference

1.1.1 Fifth Quadrant has been engaged by NALEDI to provide advice on the status of union pension and provident funds and the actual and potential role of the unions in the SA retirement fund industry. The Terms of Reference for this project are as follows:

"1. Provide a quantitative description of the industry (number and types of funds, types and sizes of assets, trends, etc.).

"2. Discuss the influence of worker trustees over funds and assets management (discuss election of trustees, training of trustees, client mandates / service level agreements, de facto fund-asset manager power / control relationship).

"3. Discuss corporate (company / conglomerate) influence over fund strategies, such as through common networks / conflict of interest, linked business, inherent biases, etc.

"4. Discuss the actual practice of funds (fund administration, social and non-social investment strategies pursued, and proxy voting policies re companies in which funds are invested).

"5. Provide an assessment of the national policy and regulatory environment: industry products (including insured benefits, death benefits, etc.), new policies and regulation that could be looked into, the role of the FSB and other governance structures (such as the Pension Funds Adjudicator), etc.

"6. Provide an assessment of union impact on pension fund policy and practice.

"7. Highlight strategic issues that the union movement could seek to address over the short-, medium-, and long-term."

1.1.2 This document seeks to deal in detail with these issues. We look forward to further discussion with NALEDI on the issues raised.

2. THE S.A. RETIREMENT FUND INDUSTRY

2.1 Sources of information

2.1.1 The main source of industry information used for this report are:

- The Financial Services Board's annual report for 2001 (summary information on the retirement fund industry);
- The latest quarterly bulletin from the SA Reserve Bank (summary information);
- The 31.3.2001 financial statements of the Government Employees Pension Fund;
- Questionnaire responses submitted to Fifth Quadrant by leading institutional asset managers;
- The 2002 Sanlam Survey of Retirement Benefits in SA. (This survey covers some 150 funds, which is only 1% of the SA retirement fund industry, but we believe the information contained does illustrate general trends. The funds surveyed are generally quite small, with a median asset size of about R50m.)

2.2 Size and composition of the industry

2.2.1 Most S.A. retirement funds (with some notable exceptions) are regulated by the Financial Services Board, and the FSB's annual reports contain summary information on the industry.

2.2.2 The FSB's 2001 Annual Report is the latest one available. This contains statistics for the year 2000 (and the previous two years) – delays in reporting mean that more up-to-date information is not yet available. However, it appears that the picture does not change dramatically from year to year, and therefore the 2000 figures can be regarded as representative of the current state of the industry.

2.2.3 The FSB classifies funds into 5 categories:

- **"Self-administered" funds.** These are typically the larger funds which are subject to audit. The FSB comments that "*the largest 100 self-administered funds represent 36,6% of the total assets of all pension funds*", i.e. some R250 billion out of total industry assets of some R700 billion (2000 figures).

- **"Underwritten" funds.** These are funds managed in terms of insurance arrangements and not subject to audit. Typically these are smaller employer-sponsored funds, although the growing umbrella fund industry also largely falls into this category (since most umbrella funds are sponsored by insurance companies). The total assets of this category are some R100 billion, but there is an enormous number of separate funds in the category and therefore this asset base is highly fragmented.
- **"Official funds".** This category includes the Government Employees Pension Fund and a few other (much smaller) State funds. The GEPF is the dominant fund in this category, with assets in 2000 of some R200 billion.
- **Industrial funds not regulated by the FSB.** A handful of "industrial" funds (funds established for specific industries in terms of apartheid-era industrial legislation) fall into this category, but based on the FSB's statistics they are insignificant in terms of asset size and can therefore be ignored.
- **Parastatal funds.** The Telkom, Transnet and Post Office funds are also not regulated by the FSB, again for historical reasons. These funds are quite significant in terms of size, with combined assets of around R50bn.

2.2.4 The SA Reserve Bank publishes quarterly bulletins which also include some statistics on the retirement fund industry. The December 2002 bulletin includes summary figures up to Q2 2002. These broadly confirm the picture contained in the FSB report, and suggest that the industry has grown in asset size by some 20% over the 18 months from 31.12.2000 to mid-2002, i.e. from some R700bn in total to some **R850bn** in total.

2.2.5 The FSB report suggests at the end of 2000 there were some **7 million in-service retirement fund members** (employee members) and some **1,3 million pensioners**. There will be some "double counting" in this figure, because in some cases employees are members of more than one fund (e.g. pension/provident split structures). The total fund membership appears to have fallen quite significantly over the last few years, which may partly reflect a decline in formal employment, but it may simply arise from problems with data collection.

2.2.6 The FSB's classification is not useful either in indicating the breakdown of funds by **economic sector** (i.e. the sector/s from which fund membership is drawn), or in identifying **union-sponsored and "negotiated" funds**, within the "private funds" category.

2.2.7 What is clear from the available data is that, on the one hand, there is tremendous fragmentation in the industry (with **over 15 000 registered retirement funds** in S.A., each governed by its own legally constituted Trustee Board), while on the other hand there is an enormous **concentration** of assets and membership in a relatively small number of very large funds. For this reason, any stakeholder group (such as the union movement) seeking to influence the behaviour of funds *other than by legislation* would be best advised to concentrate its efforts on the larger funds.

2.2.8 The table overleaf indicates the larger funds that we are aware of, grouped by economic sector. We do not have up-to-date asset values for many of these funds, but it is likely that, collectively, they make up at least 50% of the total retirement fund industry, by assets.

2.2.9 The overall extent of **union influence** in these funds is unknown to us and will clearly vary considerably from fund to fund, and to some extent between different economic sectors. A small number of these funds are union-sponsored (e.g. the Mineworkers and SAMWU Provident Funds). In other cases, such as that of the Metal and Engineering Industries funds (which are multi-employer umbrella funds), the role of the unions is known to be substantial. It should not be difficult for COSATU, through its affiliated unions, to establish the situation applying to specific funds on this list.

Larger SA retirement funds (by sector)	Assets (Rbn)	DB or DC?
Public Service		
Government Employees PF	R230bn	DB
Associated Institutions PF	R9bn	DB
Municipalities		
Joint Municipal Pension Fund	-	DB
Cape Joint Pension Fund	R5bn	Both
Cape Municipal Pension Fund	R4bn	Both
Johannesburg Municipal PF	-	DB
Durban Municipal PF	R5bn	Both
Natal Joint retirement fund	R4bn?	-
Municipal Employees PF	-	-
SALA Pension Fund	R3bn	DB
Parastatals		
Transnet Pensioner Fund	R15-20bn?	DB
Transnet Pension Fund	R3bn	DB
Transnet Retirement Fund	R13bn	DC
Eskom Pension Fund	R20bn	DB
Telkom Retirement Fund	-	Both?
Post Office pension fund	R9bn?	DB?
Denel retirement funds (2)	R5bn	1 DB, 1 DC
Mining industry		
Mine Employees Pension Fund	R12bn	DC
Sentinel Retirement Fund	R19bn	DC
Mineworkers Provident Fund	R6bn	DC
Anglo-American retirement funds	-	Both
De Beers Pension Fund	R5bn	DB
Financial Services industry		
FNB Group pension fund	-	-
Standard Bank Retirement Fund	R8bn	DC
ABSA Group Pension Fund	-	-
Old Mutual staff retirement funds	R6bn?	1 DB, 1 DC
SANLAM staff pension fund	-	-
Nedcor Pension Fund	R3bn	Both
Other industries		
ISCOR retirement funds	R13bn	Both
Engineering Industries & Metal Industries retirement funds	R35bn	DB
Murray & Roberts Retirement Fund	R3bn	DC
AECI Pension Fund	R5bn	DB
Printing Industry Pension Fund	-	-
SASOL Pension Fund	R8bn	DC
Malbak Group Pension Fund	-	-
Tongaat-Hulett Pension Fund	R3bn	DB
Unilever Pension Fund	R3bn	Both
Details of the oil industry funds (Shell & BP) are not known.		

2.3 Asset structure of funds

2.3.1 The South African Reserve Bank quarterly reports provide some detail of the overall breakdown by **type of investment** of the most significant groups of funds (the "official" funds, i.e. the GEPF, Transnet, Telkom and Post Office funds, and the "self-administered funds"). There are some problems with this data (e.g. the treatment of investments via insurance policies) but nonetheless it is possible to form an overall picture of sorts. The following table summarises the reported position as of Q2 2002.

	"Official funds"	**"Self-administered funds"**
Total assets reported on (Q2 2002):	R308bn	R404bn
Assets excluding insurance policies:	R308bn	R292bn
Types of asset (excluding insurance policies):		
Cash and near-cash	5%	10%
Govt bonds	42%	12%
Other bonds	15%	9%
Equities	36%	58%
Property	0,5%	4%
"Other"	2%	7,5%*
* Includes some unclassified foreign assets		

2.3.2 It is also instructive to consider **who manages the assets** on behalf of the retirement fund industry.

2.3.3 Based on returns supplied by various larger asset managers to Fifth Quadrant, the table overleaf allows one to construct a picture of the asset management industry in South Africa, and the part of this that relates to retirement funds.

The table shows total Retirement Fund assets of some R450bn (at the end of 2001). As noted above, the combined assets of the "official funds" and the "self-administered funds" are some R600bn, if assets invested in insurance policies are excluded. It is likely that the balance of some R150bn is largely represented by investments in the hands of the Public Investment Commissioners (at least R120bn) and the in-house asset managers of some of the largest retirement funds (ISCOR, Metal & Engineering Industries, Eskom, Mines funds).

Note that the column marked "Insurance funds" will also include large amounts of retirement fund assets, in respect of the FSB's "insured funds" category as well as the part of the assets of the "self-administered funds" which is invested in insurance policies.

Assets under management – Dec. '01 (R'bn)	**Retirement Funds**			**Insurance Funds**	**Unit Trusts**	**Other business***	**TOTAL (R'bn)**
	Balanced Mandates	Specialist Mandates	**Total**				
Allan Gray	20	8	**27**	2	2	4	**36**
African Harvest	3	8	**11**	0	1	0	**12**
Alliance Capital	1	2	**3**	0	0	0	**3**
BOE (Dec.2000)	10	2	**12**	2	3	0	**17**
Coronation	14	19	**34**	6	7	5	**52**
FTNIBI (May '01)	4	1	**5**	3	7	6	**21**
Futuregrowth	-	26	**26**	0	1	0	**27**
Investec	54	41	**95**	***	14	4	**113**
LIBAM**	Unknown	Unknown	**-**	Unknown	-	-	**-**
Metropolitan	8	1	**9**	18	1	3	**31**
Oasis	2	1	**3**	0	1	0	**4**
OMAM	16	19	**35**	165	11	42	**254**
Prescient	1	5	**6**	0	0	0	**6**
Prudential	2	14	**16**	0	1	0	**16**
RMBAM	25	30	**56**	51	8	8	**122**
SIM	66	20	**86**	84	10	5	**185**
SCMBAM**	17	7	**24**	4	19	5	**52**
Total (R'bn)	**244**	**202**	**446**	**335**	**86**	**81**	**949**

* "Other business" includes, for instance, private client accounts.

** LIBAM did not submit a return. Their retirement fund assets at the end of 2001 exceeded R6,5bn. LIBAM and SCMBAM have subsequently merged to form StanLib.

*** Investec's "Insurance Funds" are included under "Retirement Funds" assets.

2.3.4 Note that the **multi-managers** are excluded from this analysis. The largest multi-manager (Investment Solutions) manages retirement fund assets well in excess of R25bn. However, the management of these assets is in turn "sub-contracted" by the multi-manager to other managers such as those appearing in the above table.

3. INDUSTRY TRENDS

In this section, we highlight some of the major recent trends in the SA retirement fund industry, which we believe are of relevance to COSATU's objectives in respect of the industry.

3.1 "Privatisation" of pension provision

3.1.1 There are various possible models for pension provision, which apply in different societies and at different points in time. One such model, obviously, is that of **State pension provision**, whereby the State undertakes to meet the post-retirement income needs of some or all of its citizens.

3.1.2 State pensions may be funded or unfunded, the current State (minimum) old-age pension paid in South Africa being an example of the latter.

3.1.3 The current **GEPF** structure may be viewed as an example of a funded State pension system, where pensions are earnings- and service-related. The coverage of the system is restricted to public servants. Obviously there is no conceptual requirement that the system should be funded, or that pensions should be linked to pre-retirement earnings or service – these are, ultimately, political decisions.

3.1.4 **Employer-sponsored "balance-of-cost" Defined Benefit pension funds**, which historically were the dominant form of private-sector retirement income provision in SA, can be viewed as the **"corporatist" equivalent** of the GEPF structure. It is obviously no accident that the largest such schemes were those in the large parastatals such as Eskom, Transnet, Telkom and Iscor, as well as the industries such as mining which the pre-1994 SA Government regarded as of key strategic importance.

3.1.5 Again, there is no strict conceptual requirement that such private-sector schemes should be "funded", rather than operated on a "pay-as-you-go" basis, although one can make a good argument that "funded" private-sector schemes offer employees much better security than "pay-as-you-go" schemes in the event of long-term changes in the economic landscape (such as the decline of certain industries).

3.1.6 One can argue that an employee or pensioner member of a funded "balance-of-cost" Defined Benefit scheme has no particular interest in the investment strategy followed by the scheme, unless this is so obviously imprudent as to threaten the soundness of the scheme (especially if there is no "social guarantee" to fall back on, such as would probably apply to Public Service pensioners if the GEPF were to encounter financial difficulties).

3.1.7 However, over the last 10-15 years, the SA retirement fund industry has seen a massive swing away from Defined Benefit schemes to **Defined Contribution** schemes. Although this trend is by no means complete, with the GEPF and several other very large schemes remaining Defined Benefit, it has been widespread, especially in the private sector. Inevitably, all or most of the Union-sponsored and "negotiated" funds are Defined Contribution.

3.1.8 Of the larger funds listed in the table in section 2.2, we estimate that only some 40% are still "pure" Defined Benefit arrangements. About 60% are at least partly Defined Contribution. Several of the remaining Defined Benefit funds are known to be considering a conversion to Defined Contribution.

3.1.9 Of the 150 funds covered by the 2002 Sanlam Survey, only about 20% are Defined Benefit.

3.1.10 Essentially, a Defined Contribution scheme can be seen as a collection of **individual savings accounts**. (This is very clear in the case of those Defined Contribution funds that offer their members a choice of investment portfolios.) Viewed from this perspective, a Defined Contribution scheme is little more than a **tax-efficient legal structure to facilitate and encourage private saving**. The point can be made that Governments (such as the UK's Thatcher government in the 1980s) which were the most enthusiastic supporters of Defined Contribution retirement funding, were also those which viewed private saving as a fundamental cornerstone of the capitalist economic system.

3.1.11 The further conclusion can be drawn, that the Defined Contribution "system" requires employees to be "capitalists", *in their capacity as future pensioners*. To the extent that the interests of capitalists and workers do not coincide, this requirement may conflict with the interests of employees in their current capacity as workers.

3.1.12 To put the point more clearly: in their capacity as Defined Contribution fund members, i.e. as future pensioners, employees are investors in shares and other financial assets, and are thereby participants in the financial markets in which those assets are valued and traded. If these markets value profits (accruing to shareholders) more highly than jobs for workers, then there is a conflict between the interests of the employees as future pensioners and their interests as current workers. Our argument is that the move to Defined Contribution has created or exacerbated this conflict.

3.1.13 The conflict is not necessarily absent in the case of Defined Benefit schemes. It is worth commenting that, in our understanding, several of the remaining large Defined Benefit schemes are not true "balance-of-cost" arrangements (in which the sponsoring employer carries the financial risk), but "hybrid" structures in which the employer's contribution rate is **fixed** in terms of the Fund Rules.

This means that, if the investments perform poorly so that the fund goes into deficit, it is not automatically the case that the employer is required to increase contributions to restore the fund to financial soundness – unless the Trustees and members can *negotiate* an increase in contributions, fund benefits would have to be reduced. (It is not quite clear what effect the recent "surplus legislation" will have on such funds.)

3.2 Member investment choice

3.2.1 We commented briefly in the previous section that the trend to member investment choice was logically connected with the "individualisation" or "privatisation" of retirement provision.

3.2.2 Among Defined Contribution funds, especially private-sector employer-sponsored ones, there has been a fairly marked trend to member investment choice. One reason for this is that some private-sector employers view this as a feature that will make their funds attractive to employees – this is undoubtedly more prevalent where the workforce is more financially skilled, e.g. in the Financial Services sector (banks and insurers). Another reason, in some cases, is that this is a feature valued by senior management personally.

3.2.3 Of the approximately 115 Defined Contribution funds covered by the 2002 Sanlam Survey, about **35%** offer member investment choice. Sanlam comment that the percentage has not changed significantly since their previous survey (2000).

3.2.4 One consequence of member investment choice is that the pool of assets relating to the in-service members of the fund is **split** into a number of smaller pools (corresponding to the different investment portfolios offered to the members). This often has an impact on the fund's overall investment policy. The smaller size of the separate portfolios, together with the additional complexity of managing a number of portfolios where in the past there was only one, undoubtedly increases the willingness of Trustee boards to outsource the whole investment management process.

In our experience, it is quite common for the assets backing the various member-choice portfolios to be invested in **insurers' or multi-managers' pooled funds** (either market-linked or smoothed-bonus), whereas prior to the introduction of member investment choice the assets might (at least nominally) have been directly under the control of the Trustees.

3.2.5 Where the underlying assets (shares and bonds) are **directly owned** by the fund, and therefore (at least nominally) directly controlled by the Trustees, there is clearly scope for the Trustees to set detailed investment guidelines and to follow whatever investment policies (e.g. as regards shareholder activism) that they feel are appropriate and consistent with their fiduciary duties. Once the investment policy is changed from direct investment by the retirement scheme, to investment in a pooled fund via an insurance policy or (less commonly) a unit trust, the Trustees **lose control** of the underlying assets, and it becomes very difficult or impossible for them to influence the investment strategy of the insurer or unit trust management company.

3.3 Pensioner outsourcing

3.3.1 Many schemes, both Defined Contribution and Defined Benefit, that in the past used to pay pensions directly from their own assets, have subsequently **outsourced** the payment of pensions to an insurer.

3.3.2 This type of transaction can take several forms. At one extreme, there is a complete transfer of both assets and liabilities to the insurer – the retirement fund retains no liability for the payment of pensions. (In the case of most Defined Contribution pension schemes, and a few Defined Benefit ones, it is normal now for this transfer of the pension liability to take place *automatically* in the case of new retirals. At retirement, fund members are told that they must find a pension provider of their choice, after which the relevant assets will be transferred to the provider who will take full responsibility for the payment of the pension in future.)

3.3.3 In other cases, the retirement fund invests in an insurance policy, in terms of which the insurer has the primary liability for the payment of the pensions. Ultimately, however, the fund retains liability (e.g. should the insurer go bankrupt) – the fund usually also has the right to terminate the arrangement and replace it with another one (e.g. with a different insurer). However, under this arrangement the fund once again loses direct control of the underlying assets.

3.3.4 We understand that a small number of larger funds have simply outsourced the *administration* of pension payments to an insurer, while retaining control of the assets themselves. This is the other end of the spectrum (with no transfer of liability).

3.3.5 Such transactions are often carried out at the same time as restructuring exercises, e.g. Defined Benefit to Defined Contribution conversions. It is striking that nearly all the Defined Contribution funds covered by the 2002 Sanlam Survey state that, at retirement, members are required to buy a pension annuity in the member's own name (not the fund's name) – i.e., in the case of new retirals, the assets and liabilities leave the fund when the member retires.

3.3.6 The reasons why funds have engaged in outsourcing transactions are many and varied. For smaller funds, especially, there may be compelling arguments that outsourcing the liability reduces both cost and risk. However, once again the effect is to **place pools of assets outside the control of the Trustees or fund members**. (One should note that these are assets directly backing *pensions in payment*, and therefore different considerations might in any case apply to them, by comparison with the assets relating to in-service members, i.e. members in current employment.)

3.4 The rise of the multi-manager industry

3.4.1 The multi-manager asset management industry had its origins within the last ten years, in the Ginsburg, Malan & Carsons "Superflex" investment products and the Alexander Forbes "Investment Solutions" business, since merged as Investment Solutions.

3.4.2 The market penetration of the multi-manager concept has been fairly strong, although mostly among the small-to-medium retirement funds, where the multi-manager recipe appeals because the products are relatively cheap and also simple for trustees to understand and manage.

3.4.3 We are not certain how much of the total retirement fund "market" the multi-managers have captured, although. an indication can be found from the Fifth Quadrant Investment Survey. The latest Survey covers some R125bn of "balanced" retirement fund investments, which is about half of the total of such investments reported to us by the asset manager community. In addition, the multi-manager category of the Survey covers a further R34bn of assets in the multi-managers' pooled funds. Based on these figures, we think it is unlikely that the total retirement fund assets in the hands of the multi-managers exceed some R60-70bn. This is probably around 10% of the total industry (by assets), excluding the GEPF.

3.4.4 One should bear in mind that, for larger funds, the multi-manager concept is less appealing, because they already have the "economies of scale" which the multi-managers offer to the smaller funds. It is clear to us that the multi-managers have had little penetration among the larger funds.

3.4.5 Assets invested with a multi-manager are generally invested in insurance policies. This again means that the retirement fund does not control the underlying assets.

3.4.6 However, the multi-managers have probably done more to erode the market share of the traditional insurers' smoothed-bonus and other pooled funds (i.e. assets which were not directly owned by the retirement funds in any case), rather than reducing the pool of directly-owned assets. It is certainly our impression that the rise of the multi-manager industry has coincided with a decline in the popularity of the smoothed-bonus funds (the so-called "Guaranteed Funds"). It is also striking that the major insurers (Old Mutual, Sanlam, Liberty, and Momentum) have all hastened to set up their own multi-manager operations – this supports the idea that it is this part of the market that has lost most business to the multi-managers.

3.5 "Structured Products" and passive investment strategies

3.5.1 Some retirement funds have invested in so-called **"structured products"** which use derivatives for portfolio insurance. Often, these investments provide a capital guarantee combined with a market-related return (i.e. a market-related return with a minimum of 0%, and usually a maximum return or "cap" as well). They can therefore be seen as an alternative to the insurers' smoothed-bonus funds.

3.5.2 The market-related return provided by a "structured product" is almost always a *passive* investment return – i.e. the return on an index portfolio (such as the JSE ALSI-40 share index), rather than the return on an actively-managed portfolio.

3.5.3 In Europe and North America, there has been quite a strong trend to **passive investment** in recent years, and across the SA investment industry there has been growing interest in passive investment strategies, whether combined with derivatives or not. Many of the larger managers are trying to develop their expertise in managing index-tracking portfolios, and some smaller managers have specialised in this.

3.5.4 However, in our assessment both "structured products" and purely passive (index-tracking) strategies have not yet made much headway with SA retirement fund trustees. Certainly, the proportion of retirement fund assets which the managers reported to us as being passively managed at the end of 2001 was very small.

3.5.5 A decision by fund trustees to invest passively does mean that the trustees generally give up the freedom to channel investments towards or away from particular parts of the market. For instance, a passive investment philosophy would tend to conflict with a desire to avoid investment in certain companies, e.g. those involved in the arms, alcohol or tobacco industries. (There are ways of getting around this conflict, e.g. the construction of specialised indices, but these are complex and can be expensive.)

3.5.6 In theory, passive investment could be combined with "shareholder activism", although by investing passively one is committed to retaining the investment, and therefore one cannot use the threat of selling the share as a "weapon" in dealing with company management.

3.6 "Umbrella funds"

3.6.1 In the medical aid industry, over several years there has been a trend away from single-employer medical schemes towards the so-called "open schemes", commercially-operated multi-employer umbrella arrangements. **The same trend now seems to be developing, in the retirement fund industry.** As the regulation of retirement funds becomes more burdensome (and therefore more costly for funds), and as the trend to Defined Contribution and member investment choice makes scheme administration more expensive, so small- and medium-sized employers (especially) are more inclined to join multi-employer "umbrella" retirement funds, rather than set up their own schemes.

3.6.2 We think it is likely that, over time, larger organisations will also start to see the attraction of umbrella arrangements. (There are practical difficulties in winding up an existing scheme and replacing it with a new arrangement, so it will take a long time for this trend to become very significant.)

3.6.3 The commercially-operated "umbrella" retirement funds have generally been established and sponsored by an insurance company or similar financial services business. Governance of these funds, including the investment policy, is in the hands of a Board of Trustees which in the past has generally *not* been independent of the sponsoring company. (This may be changing, because the Financial Services Board is concerned that the same governance standards should apply to these funds as to all other registered retirement funds.) In addition, there is a strong tendency for the Trustees to invest the umbrella funds' assets in pooled vehicles (insurance company funds or unit trusts) where the control of the underlying assets rests with the insurer or the unit trust management company, and not with the Trustees.

3.6.4 Once again, the effect of this trend is to put a distance between the fund members and member trustees, and the underlying investments of the fund.

3.7 Improving governance standards

3.7.1 We have no doubt that the standard of retirement fund governance in South Africa has improved significantly over the last few years.

3.7.2 Undoubtedly, one major reason for this has been the requirement for funds to have representative trustee boards with 50% member representation.

3.7.3 In the regulatory environment, a major development has been the creation of the office of the Pension Funds Adjudicator. Our sense is that the standards set by the Adjudicator, combined with a more "interventionist" stance from the Financial Services Board, have also played a big role in improving the standard of retirement fund governance.

3.7.4 The Adjudicator is clearly of the view that the **primary duty of a Trustee Board is to safeguard the interests of fund members, *in their capacity as future pensioners***. In his rulings he has often referred to the critical social role filled by the retirement fund industry, in the absence of a more adequate level of retirement income provision by the State. It is also noteworthy that he regards this duty towards members (and pensioners) as taking precedence over any responsibilities that trustees may have towards other stakeholders (such as the employer).

3.7.5 As discussed in later sections of this report, it is our experience that Trustee Boards are generally taking their fiduciary duties to members very seriously.

3.7.6 One consequence of the volume of new legislation intended to ensure better governance and regulation of the retirement fund industry, is that Trustee agendas are getting longer and more "cluttered" with governance issues, some of which can be very time-consuming. (A good example is the burden imposed by Section 37C of the Pension Funds Act, which requires funds to follow an extremely onerous process in deciding how to allocate death-in-service benefits.) Our sense is that the amount of time Trustees have to spend on investment policy tends to be "squeezed" by the other demands on their attention, and that this may be a further reason why many Trustee boards are happy to outsource investment policy to an insurer or multi-manager. (This problem can be mitigated by the effective use of sub-committees.)

3.8 The "missing" trend: industry consolidation

3.8.1 It is surprising that there has been very little consolidation in the SA retirement fund industry (other than the still relatively small umbrella fund phenomenon). According to the FSB's latest annual report, there were still over 15 000 registered funds at the end of 2001, hardly less than in 1996.

3.8.2 The increasing and more effective regulation of the retirement fund industry undoubtedly means that the **direct cost** of operating a retirement fund is increasing. (There is a comment in the 2002 Sanlam Survey that there is a "detectable trend" towards higher administration costs for Defined Contribution funds.) We believe the **indirect costs**, measured in terms of the time commitment required from Trustees, are also increasing.

3.8.3 In the light of the upward pressure on costs and the increasing complexity of fund governance, we believe that **significant consolidation within the industry is long overdue**.

3.8.4 In Australia, there has been extensive consolidation and large union-sponsored or union-linked multi-employer "superannuation funds" appear to dominate the retirement fund landscape. It might be instructive to analyse the factors that have led to this difference between the Australian and South African retirement fund industries.

4. INFLUENCE OF "STAKEHOLDER GROUPS" IN FUND GOVERNANCE

The material in this section derives from interviews with senior Fifth Quadrant consultants, in which they were asked about their *practical experiences* with specific retirement funds. The Fifth Quadrant client base is skewed towards larger funds. There may be some "sample bias", e.g. towards corporate rather than union/negotiated and public-sector funds, and also because the way a trustee board functions can be influenced by the consultant (so, if Fifth Quadrant consultants have a "house style", the functioning of their client funds could be influenced by this). However, we feel the influence of consultants on trustee boards can be exaggerated, so we believe the views reported here should still be of use in forming an overall picture of the industry.

4.1 Worker Trustees, and Union influence over funds

4.1.1 It is clear that the legal requirement to have a representative trustee board, with at least 50% of trustees elected by fund members (including pensioners), has been taken seriously and implemented by nearly all funds. This is also borne out by the Sanlam Survey.

4.1.2 There is a small category of funds (State funds, the Telkom, Transnet and Post Office funds, and some "industrial" funds) which are not subject to the Pension Funds Act and to which this requirement therefore does not apply. With the exception of the GEPF, which is currently still controlled by the Dept of Finance, our sense however is that most of these funds have at least 50% worker representation.

4.1.3 There are varying practices for the **election of worker trustees**. In most cases there are requirements for nomination (e.g. a minimum number of members must nominate the candidate) followed by an "open" election covering the entire workforce – this can result in the election of union representatives where the union is well-organised and strongly represented. In some cases, where the unions are strongly represented among the fund membership, there are specific places on the trustee board reserved for representatives of union members – in other words, there is a "constituency" system whereby different worker trustees are elected/appointed by different groups within the workforce.

4.1.4 It should be noted that, in many organisations, there is a fairly obvious split of the workforce between union funds (or negotiated funds) and employer-sponsored funds, in terms of some form of "freedom of association" principle. Union members will tend to belong to the union funds, while non-unionised employees will belong to the employer-sponsored funds. As a result, union involvement in many employer-sponsored funds (which may be quite large in asset terms) is negligible.

4.1.5 The general view of Fifth Quadrant consultants is that worker trustees are **increasingly effective and diligent** in carrying out their fiduciary duties, with worker trustees having a real role in shaping fund policy at all levels. The level of **training** is adequate to good, although **investment issues** tended to be singled out as the area where worker trustees were least effective.

4.1.6 A very obvious reason why the effectiveness of worker trustees is improving, is that the requirement for member-elected trustees was introduced about 5 years ago and (with continuity of Board membership) there has now been a reasonable amount of time for worker trustees to become familiar with the pensions environment.

4.1.7 There was a general comment that **all trustees tend to take their fiduciary responsibilities increasingly seriously** – by "fiduciary responsibilities" we mean the duty to safeguard the interests of fund members *in their capacity as future pensioners.* We asked consultants whether, in their experience and judgment, trustees tended to behave as "stakeholder representatives" or as "fiduciaries". Generally, the answer was that **all trustees try to act in the best interests of fund members** and not to "push" specific stakeholder agendas. (Again we would add that this refers to members' interests *in their capacity as future pensioners*.)

4.1.8 Clearly, there were some exceptions. In some cases there are strategic issues (e.g. Defined Benefit to Defined Contribution conversion, or the "surplus legislation") where it is difficult and possibly inappropriate to exclude "stakeholder interests" from discussion. In a few cases consultants referred to a general tendency among union representatives to exercise a "block vote" (not just on strategic issues), and also to a tendency for both union and employer representatives to blur what the consultant would see as the necessary distinction between their union or company roles, and their non-partisan roles as trustees. From time to time it is clear that "block voting" by union representatives (or other stakeholder representatives) relates to union/stakeholder interests "behind the scenes", that are not discussed in the trustee meetings.

4.1.9 In one or two cases the comment was also made that, for worker trustees, trusteeship appeared to be seen as a bit of a "perk" (e.g. providing time out of the workplace, business travel, and expense claims). Especially on large boards, this means some trustees may behave as "passengers" who (in the consultant's eyes) make very little contribution to the governance of the fund. (In fairness we should add that we have also come across this phenomenon with employer trustees!)

4.2 Pensioner trustees

4.2.1 Although the legislation dealing with member representation is not very clear on this point, there is often provision for pensioners to have the right to elect one or more trustees, in the case of funds where there are significant numbers of pensioners.

4.2.2 Several consultants commented that pensioner trustees do tend to see themselves as "stakeholder representatives" rather than "fiduciaries", and are vigorous in promoting the specific interests of the pensioner members as a group.

4.3 Corporate influence over funds

4.3.1 We asked the consultants to assess how and to what extent "corporate interests" play a role in shaping Fund policy.

4.3.2 In many cases the comment was made that the **Employer** takes relatively little interest in the Fund, because he has little "skin in the game". This obviously applies specifically to **Defined Contribution funds** where the Employer's financial commitment to the fund is fixed in terms of the rules, as well as those Defined Benefit funds (referred to in paragraph 3.1.13) where the same thing applies.

4.3.3 In such cases, the Employer's interest is usually limited to ensuring that governance standards are high enough so that there is minimal risk of "reputational damage" to the Employer. (This is one reason why employers continue to seek representation on trustee boards of defined contribution funds, including negotiated funds. Another major reason is to ensure that the fund structure and practice stay aligned with the employer's HR policies.)

4.3.4 In **Defined Benefit** or "hybrid" funds where the Employer carries financial as well as reputational risk, the picture will obviously be different. The example was given of a company-sponsored "hybrid" DB/DC scheme in which the Employer has "pumped huge corporate resources" into the management of the Fund. The effect of this is that the employer trustees are able to set the agenda and dominate the debate at Trustee meetings, even though in this case there are union representatives on the trustee board and there is no alternative union fund for employees to join.

4.3.5 This illustrates a feature referred to by other consultants, that **if the Employer chooses to apply sufficient resources to the Fund** (i.e. the time and energy of senior managers, especially managers with a strong financial background), then the employer trustees will often have a **disproportionate influence** on the board.

4.3.6 This happens even in some Defined Contribution funds where the Employer does not have an obvious major stake in the Fund. The reason for this may be historical – e.g. the Finance Director has "always" been an employer trustee.

4.3.7 In the case of single-employer funds, even if there is a single strong Union, it is always questionable whether the Union will have the depth of resources to match the resources which the Employer can commit to the Fund (if the Employer so chooses). It is clear that the Unions are in a much stronger position in multi-employer funds (e.g. union funds and industrial funds) where the employers' energies are diffused, if the employers are in fact represented at all.

4.3.8 Although it is common for Funds to have equal employer / employee representation, in practice the operation of the Trustee Boards (in employer-sponsored funds) will often have a **subtle bias towards the employer trustees** - for example:-

- In our experience, member-elected trustees (specifically non-union trustees) are often somewhat **intimidated by "management"** and therefore tend to defer to the opinions of employer trustees.
- The **chairperson** of the Trustee Board is generally in a powerful position. Although the rules of many funds provide for the chair to rotate between employee and employer trustees, we are not convinced that this is universal. We suspect there are many cases where member-elected trustees are quite happy for a **management representative** to occupy the chair, in what they regard as a "company fund". (Again our assessment is that many member trustees, possibly including Union trustees, lack the confidence to take on this role.)
- Another "institutionally powerful" position is that of **Principal Officer**. The PO is the "chief bureaucrat" of the Fund and is normally not a trustee. Although in some cases the role of PO is outsourced to a service provider such as the Fund's administrator, our sense is that in many employer-sponsored funds the PO is **essentially a management appointee** (again with the willing agreement of the member trustees).
- A further reason why employer trustees tend to dominate relates to the **organisational structure and geographical dispersion** of many large companies. Employer trustees will tend to be head office staff; member trustees often work away from head office, e.g. in factories/warehouses etc. Trustee meetings will normally be held at head office, so member trustees will often have to travel to the meetings. We suspect this is one practical reason why attendance by member trustees is often lower than by employer trustees. (There may also be indirect pressures which, in some cases, make it more difficult for member trustees to take time away from the "shop floor", even though their role as member trustees is legitimate and at least formally acknowledged by company management.)

The above observations are connected to the general theme of **resources and capacity** – in many cases, the employer tends to have the advantage over the members (and unions) in terms of money, knowledge, time and skills.

4.4 Financial relationships between employers and service providers

4.4.1 In the past, it was certainly common for employer-sponsored funds to place business with entities related to the sponsoring employer in some way. This was certainly the case in the financial services sector (banking and insurance), but also more widely in industry via the corporate "empires" that developed in the apartheid era. The most obvious examples are companies like Old Mutual and Sanlam which undoubtedly each had a group of clients which one can term "family and friends" - e.g. Old Mutual controlled Safmarine and Nedcor, and therefore administered the Safmarine and Nedcor retirement funds; there are likely to be many similar examples. Southern Life was latterly controlled by Anglos and our sense is that they also had a privileged relationship with some Anglo group companies.

4.4.2 These relationships have definitely weakened in recent years, for a number of obvious reasons:

- The legal environment has changed, and the **legal separation** between Fund and Company is now clear (which was not always clearly seen, in the past). There is a wide understanding that Trustees are at risk if they put company interests ahead of member interests.
- The introduction of **member-elected trustees** has been a big factor.
- The corporate "empires" themselves have in many cases been **unbundled**, to quite a large extent. (As a single example known to us - when Old Mutual sold its interest in Safmarine, the Safmarine fund trustees were quick to break their ties to Old Mutual.)
- As funds have converted to **defined contribution**, the level of interest and involvement by company management (e.g. at director level) has definitely reduced - as noted above. Management is generally more inclined to leave the choice of service providers up to Trustee Boards.
- Within companies like Sanlam and Old Mutual, there is more of a sense that divisions like Pension Fund Administration (Employee Benefits) and Asset Management should "stand on their own two feet" and win business on merit, rather than through "friends and family".

4.4.3 However, it is very likely that there are cases where these relationships persist:

- In the **banking and insurance sectors**, it was very recently still the case that the staff pension funds were largely serviced by "in-house" or closely related service providers (asset managers and pension fund administrators).

- We are fairly sure that the same applies in other sectors, to some extent, where the big corporate "empires" still exist, although we only have anecdotal evidence of this.

As noted above, in most cases we believe these relationships are weakening - there is plenty of recent evidence of this.

4.4.4 In fairness we should also note that, based on anecdotal evidence, we have the impression that there are some Union-sponsored funds where choice of some service providers (e.g. asset manager) has been influenced by relationships between the Union and the service provider.

4.4.5 In many cases such relationships are fairly open and obvious and therefore, from a governance point of view, may not be all that problematic (in the sense that the possible "conflict of interest" is plain for all to see). More problematic cases are where the conflicts of interest, or possible conflicts, are hidden. The extreme is where business is placed (by a retirement fund) in response to financial inducements which many include outright bribery of Trustees. There will be other cases where there are **two-way business relationships** between service providers and retirement funds / fund sponsors (i.e. the sponsoring employers) - i.e. **situations where the service provider is both "supplier" and "client"**. It is not impossible that some service providers abuse their positions as "clients", in order to win business as "suppliers" - but note that we do not have any direct evidence for this.

4.5 Employer manipulation of defined benefit funds

4.5.1 Finally, it is certainly true that in the past, there were practices highlighted by the Pension Funds 2nd Amendment Act of 2001 (the "surplus legislation") whereby employers were able to get indirect financial benefits by manipulating Fund rules. These practices have now generally been deemed to be **"improper uses of surplus"** and should therefore have ceased.

4.5.2 Practices included the selective improvement of benefits for senior employees only, and granting of additional years of service to selected (senior) employees. One practice which the "surplus legislation" seems to have overlooked is the manipulation of the definition of "pensionable salary" in Fund rules - by changing the definition for selected senior employees, or granting excessive salary increases very close to retirement, it is theoretically possible to achieve a significant "transfer of wealth" to the individuals concerned.

4.5.3 Note that in many cases employers who engaged in these practices would argue that they were "acting in good faith" at a time when there was an untested consensus that the surplus in a defined benefit fund belonged to the employer. However, it is undoubtedly true that some employers (or in reality, senior managers or directors) deliberately set out to abuse Fund rules in order to gain personal advantage from the surplus.

4.5.4 With all stakeholders and service providers now highly sensitised to these issues, we do not believe that these practices remain a significant problem.

5. "SOCIAL RESPONSIBILITY" AS A FACTOR IN FUND PRACTICE

Again, the following discussion is based on the first-hand experience of Fifth Quadrant consultants.

5.1 Socially Responsible Investment (SRI)

5.1.1 We asked the consultants to consider the following questions, in relation to specific retirement funds known to them:

- Does the Fund have a formal investment strategy (i.e. an Investment Policy Statement)?
- Does this formally address Socially Responsible Investment (SRI) and, if so, in what way – what are the Fund's SRI objectives?
- Does the Fund actually have any SRI investments? (Give details.)
- If there is no policy on SRI and/or no actual SRI investments – why not?

5.1.2 Replies were mixed. Most funds have Investment Policy Statements (this is borne out by the Sanlam Survey). There was a **clear correlation between Union influence and the level of attention paid to SRI** – in Union/negotiated and industrial funds, SRI had almost always been considered and most of these funds had an allocation to SRI (although rarely more than 10%, and usually less). Conversely, in funds offering **member investment choice** (generally employer-sponsored funds), there was **no SRI**.

5.1.3 Several reasons were given for the lack of SRI. It was felt that some funds are **"too small"** to justify this. In the case of member-choice funds (and some others), the following comment was made several times by different consultants: "The trustees' intention was to try and get the best returns and match members' risk profiles. This basically negates the possibility of SRI, in the sense that SRI is, by nature, **more risky** than other investments." (In other words, SRI is seen as a "fringe" investment strategy that could conflict with trustees' fiduciary duties to members, if these are interpreted as maximising investment returns subject to suitable levels of risk.)

5.1.4 One could argue that this reflects a bias by the consultants, rather than by the trustees – this is probably a valid criticism. However, we do not believe that Fifth Quadrant clients are significantly different from the rest of the retirement fund industry, in this regard. (Interestingly, the Sanlam Survey includes extensive questions about funds' investment strategies, but there is no reference to SRI whatsoever.)

5.1.5 Other issues raised included Funds' **past bad experiences** with SRI vehicles. There was a perception that SRI vehicles had in the past often been "products" developed by financial services companies, and there were questions about whose interests these products had really served. Several Funds had had SRI investments in the past, but had terminated them, either because of bad performance, or because they were not seen as suited to the fund's new investment strategy (e.g. when introducing member investment choice). In the latter cases it is likely that under-performance was also a factor - if the performance had been excellent, the trustees would have tried to retain the investments in the new strategy.

One consultant commented that "trustees are keen if they see the **right SRI opportunity** – this means a vehicle (1) that is **economically sound**, and (2) that offers **genuine empowerment** or social transformation, not just enrichment for a few individuals."

5.1.6 Actual SRI by retirement funds was described as taking two forms – either **investment in socially-responsible vehicles** (like the Futuregrowth funds or the Community Growth unit trust), or the **allocation of assets to "empowerment" managers** (names mentioned include African Harvest, Kagiso and the former Prodigy Asset Management, as well as the Community Growth Fund, of which the management company is 50% owned by a union consortium).

Our view is that awarding conventional investment mandates to "empowerment" managers may be a worthwhile activity, but should not be classified as SRI (but this is just a question of labels).

Our sense is that trustees have not really explored the differences between the various activities which all fall under the general heading of SRI, e.g. the difference between **"ethical screening"** vehicles (such as the Community Growth Fund) and **"positive social impact"** strategies (such as some of the Futuregrowth funds) – although our clients do ask us to address this issue from time to time. One reason for this is the limited opportunities currently available to funds, as the number of significant SRI vehicles and managers has definitely dwindled over the last few years.

5.1.7 There was only one case where a consultant mentioned that Fund members had specifically raised the issue of SRI.

5.2 Proxy voting policies and "shareholder activism"

5.2.1 We asked consultants to consider the questions, "Have the Trustees ever debated proxy voting rules, and do their mandates with investment managers refer to these? If not, why not?"

5.2.2 The general response was that the Trustees have **not really applied their minds to their potential power as institutional shareholders**. Therefore, the current situation in most cases is that investment mandates delegate full responsibility to the asset manager.

Where this is explicitly covered by the investment mandate, the form of words used is along the following lines:

> "[The asset manager is authorised to] exercise any voting power that it may hold in respect of any shares or other investments held on behalf of the client (unless otherwise instructed by the client in writing), provided that the asset manager in so doing, and in deciding whether to exercise such power or whether to abstain from exercising it, shall always endeavour to act in the client's best interest."

5.2.3 It is clear that, especially for larger clients, proxy voting policies and "shareholder activism" are starting to come onto Trustee agendas. However, even when these issues are debated, the outcome may still be that the Trustees decide to continue delegating the responsibility to their asset managers (although some mandates are now starting to specify that the manager must provide details of his/her voting record on behalf of the client).

5.2.4 Reasons given for this outcome are that the fund is **too small** for the trustees to concern themselves with the issue – as a small shareholder, the "leverage" that the fund could exert by shareholder activism is negligible – and also that the issues raised are **too difficult** for the trustees to engage with – i.e. the amount of time which would be needed for the trustees to familiarise themselves with the issues is not justified.

5.2.5 We should also mention that, in our view, the possible benefits that investors can gain by shareholder activism are offset by significant problems, including the impact of the **"insider trading" laws** if the investor or the asset manager becomes too closely involved with company management. Our advice to clients is therefore to be quite cautious before embarking on a programme of shareholder activism.

5.3 Supplier selection

5.3.1 We asked the consultants to what extent **"empowerment" or other social responsibility criteria** are taken into account by funds, in their experience, in selecting suppliers such as administrators, auditors, actuaries and consultants, and asset managers.

5.3.2 There was consensus that in nearly all cases, **"empowerment" criteria are important in supplier selection, and becoming more so**. There is a **high level of awareness** of this issue among both employer and worker trustees.

5.3.3 In some cases, trustees have decided to adopt a specific policy of awarding an appointment to an "empowerment" candidate. This most commonly happens with asset managers, where there may be a decision (e.g.) to place 20% of the assets with "empowerment" managers (regardless of the type of investment mandate – i.e. this is by no means restricted to SRI mandates.) This is obviously because funds tend to use more than one asset manager, and there is a range of "empowerment" managers to choose from.

5.3.4 In other cases, "empowerment" is only one of a range of criteria taken into account when choosing the supplier. Our sense is that trustees are more reluctant to make "empowerment" a prerequisite when the choice of "empowerment" candidates is limited – e.g. in the selection of auditors. (Retirement fund auditing is dominated by the "big four" global accounting firms, and there seem to be few black audit firms operating in this market sector.)

5.3.5 Obviously, different funds have different views on what "empowerment" means (i.e. the importance of black ownership, as opposed to other measures of empowerment).

6. STRATEGIC ISSUES FACING THE UNION MOVEMENT

6.1 National policy and the regulatory environment

The following developments in the area of national policy and the regulatory environment are relevant:

6.1.1 Government policy on retirement funding.

Given the "industry trends" referred to in section 3 above, a key question is to what extent future Government policy will encourage (or at least allow) the continued "privatisation" of pension provision that we identified in section 3.1 – for instance, does Government have any plans to convert the GEPF to Defined Contribution (as was rumoured a couple of years ago).

6.1.2 Taylor/Masutha Committee.

The Committee of Inquiry into a Comprehensive System of Social Security for South Africa (the "Taylor Committee", subsequently the "Masutha Committee") was appointed in 2000 and reported during 2002. Its recommendations referred to the retirement fund industry and covered the following areas, among others:

- Compulsory minimum contributions;
- Compulsory preservation;
- Minimum disability and death (survivors') benefits;
- Governance and fiduciary standards;
- Investment strategies, including SRI, offshore investment, and proxy voting;
- Taxation.

6.1.3 Role of the Adjudicator and FSB in reinforcing the concept of trustees' "fiduciary duties".

We have noted the role played by the Adjudicator and also the effect of generally tighter regulation of the industry, in reinforcing the concept of trustees' "fiduciary duties" (interpreted to mean the safeguarding of members' interests *in their capacity as future pensioners*). The FSB has recently published draft guidelines to help trustees interpret their "fiduciary duties", and to deal with conflicts of interest.

6.1.4 **The "Surplus Legislation"**.

The "surplus legislation" has highlighted the issue of "stakeholder interests" as potentially conflicting with trustees' fiduciary duties, and has laid down a framework for the trustees to deal with the conflict (in the specific context of surplus allocation). The legislation has also introduced a limited and specific definition of the trustees' duty to *former* members of a fund.

The surplus legislation will undoubtedly be an enormous drain on the time and energy of many trustee boards over the next two or three years (and also on that of the FSB).

6.1.5 **National Fund for unclaimed benefits**.

The FSB has started drafting legislation to set up a National Fund that will house the very substantial amount of unclaimed benefits presently lying dormant in many retirement funds.

6.1.6 **Re-drafting of the Pension Funds Act and Regulation 28**.

The FSB has also embarked on a complete revision of the Pension Funds Act, which was first enacted in 1956 and has had many piecemeal modifications since then.

A couple of years ago, there was extensive consultation resulting in a draft replacement of Regulation 28, the regulation which deals with the investment strategies of retirement funds. Our understanding is that the new Regulation has been "stalled" by National Treasury pending a "holistic" review of the investment regime applying to insurers and Unit Trusts, as well as to retirement funds.

6.1.7 **Regulation of umbrella funds**.

The FSB has indicated that it is reviewing the operation of commercially-operated "umbrella funds". Consultation documents have been published.

6.1.8 **"Prescribed investments" debate**.

There has been some public discussion about reviving the concept of "prescribed investments" for retirement funds, e.g. prescribed SRI or "empowerment" investments.

6.2 Strategic issues to be addressed by the union movement

We suggest the following as possible issues for the union movement to tackle:

6.2.1 The impact of the AIDS epidemic on retirement fund finances.

A key issue here is that, in Defined Contribution and other "fixed-cost" funds, as the impact of AIDS causes the cost of death-in-service benefits to rise, so trustees will have to decide whether to maintain the level of death benefits (with a reduction in the level of future retirement benefits), or reduce death benefits while retaining the same level of retirement funding.

This is a difficult issue, and we have a sense that many trustee boards have not properly considered how to deal with it.

6.2.2 Socially Responsible Investments.

We believe worker trustees should be fully involved in the development and implementation of *all* aspects of the investment philosophy and strategies in the Funds over which they have influence or control - SRI should be seen as but one element of the overall investment approach.

The union movement may wish to develop a common approach or philosophy on SRI, and indeed on investment strategies in general, and communicate this to worker trustees. (This could include consideration of whether it is appropriate for funds to **invest offshore**. We would also comment that SRI in the South African context needs careful definition and should be seen as potentially covering infrastructure development, venture capital and private equity, as well as public-private partnership initiatives.)

In the UK, the recent Myners Review of institutional investment recommended that, as a minimum, all retirement funds should be required to **formally consider** SRI, and **document** their SRI policies in their Investment Policy Statements. These policies should then be **communicated** to members.

We see this as a very desirable and obvious way to improve the quality of thinking and debate on SRI within trustee boards, and we believe it should be introduced as a requirement when Regulation 28 is replaced.

The union movement may also wish to consider engaging with the asset management / investment consulting industry to sponsor **further SRI initiatives** (similar to the Community Growth Fund, but with different investment objectives), and not simply delegate this to the fund management industry or investment consultants. A further lever of influence over fund managers could be in the **definition and construction of investment mandates**, typically the exclusive domain of consultants and managers at present (informed by the agreed investment philosophy of the client funds).

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6.2.3 **Shareholder activism**.

We are aware that COSATU is already considering ways in which the power of retirement funds as institutional investors could be harnessed to further its social objectives.

While we agree that it is relevant and legitimate for the union movement to consider this issue, we do believe that there are a number of practical and philosophical difficulties that will have to be addressed – we have suggested some of these in this report.

6.2.4 **Future of Defined Benefit funds**.

As noted in this report, despite the strong trend to Defined Contribution over the last 15 years, there is still a number of very large Defined Benefit funds (including the GEPF). We are aware that, in several cases, the sponsoring employers are keen to convert these funds to Defined Contribution – the "surplus legislation" will have increased employers' desire to escape from any open-ended Defined Benefit liabilities. The union movement may wish to formalise its policies on this issue.

6.2.5 **Consolidation of the retirement fund industry**.

We have suggested that, in our view, consolidation of the industry is long overdue. (The Taylor Committee report also commented on this.) The unions may well wish to encourage this trend. Given limited union resources, it makes sense to concentrate on a smaller number of large funds, rather than trying to deal with the industry in its current fragmented state.

A related issue is **retirement fund coverage** - our sense that there must still be groups of workers in formal employment, plus large numbers in semi-formal (e.g. contract, part-time) and informal employment, who do not have the opportunity for retirement fund membership. (The Smith and Taylor Committees apparently both concluded that only some 80% of workers in formal employment are retirement fund members.) The union movement may well wish to tackle this issue. We would comment that a key objective of any structure set up to fill this need should be **cost-effectiveness**.

6.2.6 **Regulation and governance of Funds falling outside the scope of the Pension Funds Act**.

We have indicated that a number of large Funds (most notably the GEPF) are not regulated by the Pension Funds Act. The union movement may wish to consider whether the governance arrangements of these funds are appropriate. The Government has recently indicated its desire to create a proper Trustee Board for the GEPF (with worker representation).

6.2.7 **Surplus legislation: unclaimed benefits**.

The surplus legislation provides for former members of funds to have "first claim" on surplus. There will be huge practical difficulties in tracing former members who are entitled to benefits in terms of surplus apportionment schemes. The union movement may wish to consider how it can assist with this.