

APRIL 2019

# PENSION FUNDS AND CLIMATE RISK

**WHY PENSION FUNDS MUST  
INVEST RESPONSIBLY FOR  
CLIMATE RESILIENCE**

Legal opinion on the duty of the boards of South African pension funds to take climate change into account when making investment decisions



FASKEN



JUST SHARE  
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# THIS LEGAL OPINION WAS COMMISSIONED BY CLIENTEARTH AND JUST SHARE NPC.

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ClientEarth is a non-profit environmental law organisation based in London, Brussels, Berlin, Madrid, Warsaw, New York and Beijing. We are environmental lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

ClientEarth's Climate Finance Project conducts research into the legal implications of climate change-related financial risk for a wide spectrum of market participants including companies, investors (including pension funds and banks), company directors and regulators. We also engage with and conduct advocacy with these stakeholders in relation to the specific and the systemic risks of climate change.

**[www.clientearth.org](http://www.clientearth.org)**

Contact: Danielle Lawson, Lawyer, Climate Programme  
[DLawson@clientearth.org](mailto:DLawson@clientearth.org)



**JUST SHARE**

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Just Share NPC is a South African non-profit shareholder activism and responsible investment organisation, promoting the use of investor power for a fairer South Africa. We use advocacy, engagement and activism to support active ownership and responsible investment which drives good corporate citizenship. We work with institutional and retail investors, regulators, companies and civil society.

South Africa is the most unequal society in the world. This inequality manifests itself in incomes, wealth, health, education, crime, and pollution and environmental degradation. Just Share's work is aimed at driving the investment industry to do much more to effectively address inequality. Climate change will disproportionately affect those who are already the most vulnerable members of our society, which means that it will exacerbate inequality, and create further obstacles to achieving an inclusive, sustainable economy. Tackling climate change should therefore be a key priority for investors.

**[www.justshare.org.za](http://www.justshare.org.za)**

Contact: Tracey Davies, Executive Director  
[tdavies@justshare.org.za](mailto:tdavies@justshare.org.za)



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## EXECUTIVE SUMMARY

As far back as 2011, the South African Government recognised the potentially catastrophic impacts that climate change could have on South Africa in the medium to long-term. The *Climate Change Response White Paper*<sup>1</sup> stated that:

*“Even under emission scenarios that are more conservative than current international emission trends, it has been predicted that by mid-century the South African coast will warm by around 1 to 2°C and the interior by around 2 to 3°C. By 2100, warming is projected to reach around 3 to 4°C along the coast, and 6 to 7°C in the interior. With such temperature increases, life as we know it will change completely...”*

In the same year, Regulation 28 of the Pension Funds Act, 1956 (PFA) was published, requiring pension fund trustees to consider environmental, social and governance factors when making investment decisions.

ClientEarth and Just Share NPC commissioned Fasken to provide a legal opinion (the “legal opinion”) on the question of whether the boards of pension or provident funds (hereafter referred to as “boards”) are required under South African law to take into account climate-related risks and opportunities when making investment-related decisions on behalf of their funds.

The answer is an unequivocal “yes”, both for funds regulated by the PFA and for those, like the Government Employees Pension Fund (GEPF), that are not.

The opinion, prepared by top pension lawyer Rosemary Hunter, finds that a failure to consider material financial risks arising from climate change would likely amount to a breach of duty by the board of a pension fund, under both the common law principles and Regulation 28 of the PFA.

### **Pension Funds governed by Regulation 28**

Regulation 28 sets out a number of principles which must at all times be applied by a fund and its board. One of these principles is that, *“before making an investment in and while invested in an asset, [the board must] consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an environmental, social and governance character”*<sup>2</sup>.

This principle must also be adhered to by anyone to whom any investment-related powers and functions of the fund are delegated, for example asset managers and asset consultants.

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<sup>1</sup> Published by the Department of Environmental Affairs. A copy of the white paper may be found at [https://www.environment.gov.za/sites/default/files/legislations/national\\_climatechange\\_response\\_whitepaper.pdf](https://www.environment.gov.za/sites/default/files/legislations/national_climatechange_response_whitepaper.pdf)

<sup>2</sup> Regulation 28 (2)(c)(ix)



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Climate change is a material financial risk. Climate change risk must therefore be considered before making an investment in and while invested in an asset.

## **Pension Funds not governed by Regulation 28**

There are some pension funds in South Africa that are not subject to the PFA, because they have been established by statutes other than the PFA, and because their liabilities either have been or are now underwritten by the State. The largest of these is the GEPF, which is also the largest overall fund in South Africa by asset value.

The legal opinion is clear that these funds are also required by common law principles to take into account any factor which may materially affect the sustainable long-term performance of the fund, including those of an environmental, social and governance character. In other words, funds not regulated by the PFA must also consider the risks associated with climate change when making investment-related decisions.

## **Key findings of the legal opinion**

- The boards of South African pension funds must exercise the powers of the fund in the best interests of the fund, which means for the sole purpose of fulfilling its objects over the long term. Decisions relating to the investment of the fund's assets must therefore be taken with due regard for the risks, both long-term and short-term, associated with those investments. These include climate-related risks.
- Pension funds which are well managed, and which conduct their investment activities in a manner designed to ensure their long-term sustainability, will serve the best interests of both the fund's current members, those who may become their members in the future, and the dependents of current and future members, viewed as a whole.
- A pension fund's dependence on its board for the proper exercise of the fund's powers and fulfilment of its duties means that the board and each of its members occupies a position of trust, and owes a fiduciary duty to the fund when acting in that capacity. In other words, board members owe the duties of good faith, care and diligence to the fund.
- Pension fund trustees derive their powers from legislation, including the Constitution, and the rules of the fund. They do not derive them from any "mandate" given by those who elected or appointed them.
- In exercising the powers of a fund, the board must protect the existing rights of the fund's members, but it is not entitled to advance their interests if this would be inconsistent with its fiduciary duty to the fund. The interests of the fund's members and their dependents, and future members of the fund, must be viewed as a whole and treated as subordinate to those of the fund itself, particularly as they may not always coincide.
- This means that, although it may be to the advantage of some of a fund's current members for it to take certain actions in the short-term, if it is evident from information before the board that



it would not be in the long-term interests of the fund for it to take such actions, then the board must not take those actions on its behalf. Instead it must ensure that it follows the course of action best aligned with the long-term interests of the fund.

- If the board fails to properly consider relevant information, or, having considered it, fails to give it appropriate weight when making decisions, then it will be acting in breach of its duty to act in the fund's best interests.
- A failure to take into account risks associated with factors such as climate change, which may be relevant to the likely long-term performance of a specific investment, or the fund's investments as a whole, is likely to amount to a breach of the duty of care and diligence.
- Each board member must apply his or her mind to the issues before the board, including the likely environmental, social and governance (ESG) risks associated with any particular investment. A board member may not leave this to other board members or delegate the duty to third parties. He or she cannot remain ignorant when compliance with these duties means that he or she must seek information, nor can he or she blindly accept information and advice from third parties.
- Board members must therefore take all reasonable steps to acquire the information in relation to the risks associated with climate change as they may require, in order to make informed decisions when taking such risks into account when exercising the fund's investment powers.
- The board of a fund is entitled to appoint appropriately qualified and authorised third party investment managers to exercise some or all of the fund's investment powers. However, in order to comply with its legal obligations, the board must still:
  - ensure that the terms of appointment bind the investment manager to comply with the fund's investment policy statement and legal duties, including its policies in relation to the application of ESG factors to the assessment of investments; and
  - monitor and supervise the conduct by such investment managers of their functions and the fulfilment of their duties.
- If necessary, the board should make it a condition of its appointment of an investment manager that the manager procures the approval of the FSCA of the conclusion of an agreement between them on terms incorporating such duties.
- If a fund suffers financial loss as a result of negligent failure by one or more board members to act with due care and diligence in the formulation of the fund's investment policies and strategies, and/or the implementation of those policies and strategies (including in the mandating of third party investment managers to exercise powers on behalf of the fund), those board members may be held liable to compensate the fund for its loss.
- As the management of investments ordinarily entails the exercise of discretion, and the fund will be dependent on any appointed investment manager for the proper exercise of that discretion,



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such investment manager occupies a position of trust in relation to the fund. As such, the common law imposes on the investment manager a duty to exercise the powers delegated to it in good faith, with due care and diligence, and in the best interests of the fund. This includes the evaluation of investments taking into account the risks associated with climate change.

- The investment manager must not place itself in a position in which its duty to the fund conflicts with or is inconsistent with the direct or indirect interests of the investment manager.

In light of these findings, the opinion also recommends that the 2007 non-binding guidance note from the Registrar of Pension funds (PF 130), which, inter alia, states that “the primary obligation of [a fund’s investments] is to provide optimum returns for its beneficiaries” should be withdrawn.

The legal opinion was commissioned in order to support the boards of South African pension funds in the exercise of their fiduciary duties: we hope that it will assist boards to build climate competence, so that they can carry out their functions in a way that contributes to the future resilience and prosperity of South Africa.

OPINION

Rosemary Hunter
Phone: +27 11 586 6032
Fax: +27 11 586 6121
rhunter@fasken.com

To: Just Share NPC & ClientEarth
From: Rosemary Hunter/315416.00001
Date: 4 April 2019
Subject: The duty of the board of a pension fund to take climate change into account when making investment decisions

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## INTRODUCTION

1. In its 2011 *Climate Change Response White Paper*,<sup>3</sup> the South African Government noted that—

‘Should multi-lateral international action not effectively limit the average global temperature increase to below 2°C above pre-industrial levels, the potential impacts on South Africa in the medium to long-term are significant and potentially catastrophic. Even under emission scenarios that are more conservative than current international emission trends, it has been predicted that by mid-century the South African coast will warm by around 1 to 2°C and the interior by around 2 to 3°C. By 2100, warming is projected to reach around 3 to 4°C along the coast, and 6 to 7°C in the interior. With such temperature increases, life as we know it will change completely: parts of the country will be much drier and increased evaporation will ensure an overall decrease in water availability. This will significantly affect human health, agriculture, other water-intensive economic sectors such as the mining and electricity-generation sectors as well as the environment in general. Increased occurrence and severity of veld and forest fires; extreme weather events; and floods and droughts will also have significant impacts. Sea-level rise will negatively impact the coast and coastal infrastructure. Mass extinctions of endemic plant and animal species will greatly reduce South Africa’s biodiversity with consequent impacts on eco-system services.’
2. More recently Justice Owen Rogers of the Western Cape division of the High Court said in his judgment in *WWF South Africa v Minister of Agriculture, Forestry and Fisheries & others*<sup>4</sup>:

‘Conservation and sustainable development, which are placed to the fore by s 24 of the Constitution<sup>5</sup> ... , are not only, or even primarily, important because of the pleasure humans derive from healthy and biodiverse ecologies. Many people in the past, the present and the future have depended, do depend or will depend for their economic wellbeing on exploiting renewable resources. To enable them to do so, and thus to preserve food security and avoid poverty, one cannot allow the resource of the many to be exhausted for the benefit of the few.’
3. It is in this context that we have been asked to advise ClientEarth<sup>6</sup> and Just Share NPC<sup>7</sup> whether the board of a pension or provident fund is required under South African law to take into account climate-related risks and opportunities when making investment-related decisions on behalf of the fund.<sup>8</sup>

<sup>3</sup> Published by the Department of Environmental Affairs. A copy of the white paper may be found at [https://www.environment.gov.za/sites/default/files/legislations/national\\_climatechange\\_response\\_whitepaper.pdf](https://www.environment.gov.za/sites/default/files/legislations/national_climatechange_response_whitepaper.pdf).

<sup>4</sup> [2018] ZAWCHC 127 at para 91.

<sup>5</sup> Section 24 of the Constitution of the Republic of South Africa (the Constitution) says:

**‘Environment**

Everyone has the right –

- (a) to an environment that is not harmful to their health or well-being; and
- (b) to have the environment protected, for the benefit of present and future generations, through reasonable legislative and other measures that –
  - (i) prevent pollution and ecological degradation;
  - (ii) promote conservation; and
  - (iii) secure ecologically sustainable development and use of natural resources while promoting justifiable economic and social development.’

<sup>6</sup> ClientEarth is an international not-for-profit organisation that works to protect the environment through research and policy work, advocacy and litigation. See [www.clientearth.org](http://www.clientearth.org).

<sup>7</sup> Just Share is a non-profit shareholder activism and responsible investment organization that promotes the use of shareholder power for a fairer South Africa. See [www.justshare.org.za](http://www.justshare.org.za).

<sup>8</sup> Climate-related risks can broadly be grouped into the following categories:

- Physical risks: the impacts today on insurance liabilities and the value of financial assets that arise from climate- and weather-related events, such as floods and storms that damage property or disrupt trade; and
- Transition risks: the financial risks which could result from the process of adjustment towards a lower-carbon economy. Changes in policy, technology and physical risks could prompt a reassessment of the value of a large range of assets as



4. In South Africa, for funds subject to regulation and supervision in terms of the Pension Funds Act, 1956 (the PFA), it has been clear since Regulation 28 was published in 2011 that, should these factors have a material impact on the fund, the answer is ‘yes’.<sup>9</sup>

5. In particular, Regulation 28 requires the board of a fund-

‘before making an investment in and while invested in an asset, [to] consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an environmental, social and governance nature’

and to ensure that anyone to whom investment-related powers and functions of the fund are delegated does the same.

6. There are a few pension funds in South Africa that are not subject to regulation and supervision in terms of the PFA<sup>10</sup> because:

6.1 they have been established and are specifically referred to in statutes other than the PFA and

6.2 the liabilities of most, if not all, either have been or are now underwritten by the State.

7. One of these funds is the Government Employees Pension Fund (GEPF), the largest fund in South Africa by asset value.<sup>11</sup>

8. In our opinion these funds are likewise required by common law principles to take into account the risks associated with climate change when making investment-related decisions. These common law

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costs and opportunities become apparent.

<sup>9</sup> In regulation 28(2)(c)(ix) and (d) respectively. In para 14.8 of annexure B to his 2007 non-binding guidance note, *PF 130*, the then registrar of pension funds said, amongst other things:

‘The issue of socially responsible investment often raises the question of whether such investments offer the best returns on investment. However, there are various ways to achieve such investments. The first is to invest in companies that meet certain prescribed criteria, whilst the other is through shareholder activism, to influence the behaviour of companies in which funds are already invested to encourage them to meet corporate governance and good citizenship best practice standards.

The primary obligation of [a fund’s investments] is to provide optimum returns for its beneficiaries. However, once these returns have been met, funds should consider socially responsible investments. Boards of funds should consider how shareholder activism can be applied to promote good governance and citizenship in companies where the funds are already invested. Such activities may actually enhance the performance of companies and therefore returns to the fund....’.

As this guidance is inconsistent with both the legal principles canvassed in this memorandum and with Regulation 28(2)(c) and (d), it should be withdrawn by the FSCA.

<sup>10</sup> Funds not subject to the PFA include-

<b>Name of Fund</b>	<b>Name of statute in terms of which it was established</b>
Associated Institutions Pension Fund	Associated Institutions Pension Fund Act, 1963
Associated Institutions Provident Fund	Associated Institutions Provident Fund Act, 1971
Closed Pension Fund	Closed Pension Fund Act, 1993
Government Employees Pension Fund	Government Employees Pension Law, 1996
Members of Statutory Bodies Pension Scheme	Members of Statutory Bodies Pension Act, 1969
Post Office Retirement Fund	Post and Telecommunication-Related Matters Act, 1958
SA Public Library Provident Fund	SA Public Library (Pensions and Provident Fund) Act, 1924
Temporary Employees Pension Fund	Temporary Employees Pension Fund Act, 1981
Telkom Pension Fund	Post and Telecommunication-Related Matters Act, 1958
Transnet Retirement Fund	Transnet Pension Funds Act, 1990
Transnet Second Defined Benefit Fund	Transnet Pension Funds Act, 1990
Transport Pension Fund (formerly known as the Transnet Pension Fund)	Transnet Pension Funds Act, 1990

While they are not required by law to do so, some of the boards of these funds have chosen to conduct those funds’ investment activities in compliance with PFA Regulation 28.

<sup>11</sup> As at March 2018 it reportedly had assets with an aggregate value of approximately R1.8 trillion. See: [http://www.gepf.co.za/uploads/annualReportsUploads/AR\\_2018\\_\(20181128\)\\_Final\\_Submitted-min.pdf](http://www.gepf.co.za/uploads/annualReportsUploads/AR_2018_(20181128)_Final_Submitted-min.pdf)

principles apply to all pension funds, and those making decisions on their behalf, irrespective of whether they are subject to the PFA.

9. The reason for this is that the board of a pension fund must exercise the pension fund's powers in its best interests, which means for the sole purpose of fulfilling its objects – the payment of benefits provided for in its rules – over the long term. If the fund is to fulfil its objects in the long term, decisions in relation to the investment of the fund's assets must be taken with due regard for the risks, both long-term and short-term, associated with various kinds of investments. These include climate-related risks.<sup>12</sup>
10. Pension funds that are well managed and which conduct their investment activities in a manner designed to ensure their long-term sustainability will thereby serve the best interests of both the fund's current members, those who may become their members in the future and the dependants of current and future members, viewed as a whole.
11. In this opinion we explain the common law principles on which these views are based. If and to the extent that these principles are codified by legislative provisions and/or supported by-
  - 11.1 guidance from a regulator, such as *PF 130*, which was issued by the registrar of pension funds,<sup>13</sup> and/or
  - 11.2 guidance from other bodies such as-
    - 11.2.1 the *Principles for Responsible Investment* published in 2006<sup>14</sup> and to which investors (including the GEPF<sup>15</sup>), the Transnet Retirement Fund<sup>16</sup> and other funds) have voluntarily

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<sup>12</sup> A member of an Australian 'super fund' has recently launched litigation against the fund, claiming that its trustees have failed to comply with their fiduciary duties by not taking proper account of climate change risk when making investment decisions. See <https://www.smh.com.au/business/consumer-affairs/super-fund-alleged-to-have-breached-duties-over-climate-change-risk-20181002-p507a3.html>.

<sup>13</sup> See summary of relevant provisions in Annexure 2.

<sup>14</sup> The *Principles for Responsible Investment* were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General and the *Principles* were published by the United Nations Environment Programme (UNEP) Finance Initiative and the United Nations Global Compact in 2006. Subscribers to the principles make the following commitments in relation to environmental, social and governance (ESG) factors relevant to investment decision-making:

'As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).

We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

'Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.

Principle 6: We will each report on our activities and progress towards implementing the Principles.'

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.'

<sup>15</sup> And its investment manager, the Public Investment Corporation.

<sup>16</sup> See

subscribed; and/or

- 11.2.2 the *Code for Responsible Investing in South Africa* (CRISA) published by the Institute of Directors in 2011;<sup>17</sup> or
  - 11.2.3 the *Report on Corporate Governance for South Africa (King IV)* published by the Institute of Directors in 2016, we will refer to those as well.
12. As pension funds, provident funds, retirement annuity funds, beneficiary funds and unclaimed benefit funds all fall within the scope of the term ‘pension fund’ as defined in the PFA,<sup>18</sup> in this opinion, a reference to a ‘pension fund’ or ‘fund’ includes-
- 12.1 a reference to a provident fund (that is, a fund that pays benefits in the form of lump sums, rather than pensions);<sup>19</sup>
  - 12.2 a fund, such as a beneficiary fund and an unclaimed benefit fund, that does not provide for the payment of benefits on retirement at a future date.
13. The different types of funds falling within the scope of ‘pension funds’ as defined in the PFA are described in Annexure 1 to this opinion.

#### **REGULATORY FRAMEWORK FOR FUNDS SUBJECT TO THE PENSION FUNDS ACT**

14. Almost all retirement fund plans are subject to regulation and supervision in terms of the PFA.
15. The primary regulatory authorities are-
- 15.1 the South African Revenue Service, which enforces compliance by employers, funds and their members with tax laws; and
  - 15.2 the Financial Sector Conduct Authority (FSCA) and the Prudential Authority (PA).
16. The latter two were established on 1 April 2018 under the Financial Sector Regulation Act, 2017 (the FSR Act) to supervise and enforce compliance with laws relating to the financial soundness of financial institutions and the fair treatment of financial sector customers. For period of at least three years from 1 April 2018 the FSCA will be exercising the powers of the PA in relation to the prudential

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<https://www.unpri.org/searchresults?qkeyword=South+Africa&PageSize=10&parametrics=WVSECTION%7CSignatories&cmd=ReplaceKeyword&val=South+Africa>.

<sup>17</sup> By the Institute of Directors for Southern Africa. See Annexure 3. A copy of the code may be found at

<https://www.iodsa.co.za/page/CRISACode>.

<sup>18</sup> See the following definitions in section 1 of the PFA.

“pension fund” means a pension fund organization.’

“pension fund organisation” means-

- (a) any association of persons established with the object of providing annuities or lump sum payments for members or former members of such association upon their reaching retirement dates, or for the dependants of such members or former members upon the death of such members; or
- (b) any business carried on under a scheme or arrangement established with the object of providing annuities or lump sum payments for persons who belong or belonged to the class of persons for whose benefit that scheme or arrangement has been established, when they reach their retirement dates or for dependants of such persons upon the death of those persons; or
- (c) any association of persons or business carried on under a scheme or arrangement established with the object of receiving, administering, investing and paying benefits, that became payable in terms of the employment of a member on behalf of beneficiaries, payable on the death of more than one member of one or more pension funds.’

<sup>19</sup> For descriptions of the various kinds of ‘pension fund’, see Annexure 1.

supervision of pension funds, in addition to its own ‘market conduct’ powers in relation to such funds.

17. The FSCA is authorised in terms of the PFA to exercise wide-ranging powers. These include the following:
- 17.1 powers to prescribe requirements with which pension funds subject to the PFA must comply;<sup>20</sup>
  - 17.2 licensing and registration powers and functions;<sup>21</sup>
  - 17.3 prudential supervision powers and functions;<sup>22</sup> and
  - 17.4 general supervision powers and functions.<sup>23</sup>

## **THE PURPOSE OF A PENSION FUND AND THE NATURE OF ITS INTERESTS**

### **Pension funds are unique not-for profit savings vehicles in the form of legal entities**

18. Pension funds are special purpose, ‘not-for-profit’,<sup>24</sup> legal entities<sup>25</sup> through which their members, and/or their employers, if applicable,<sup>26</sup> make provision for the payment of benefits determined in terms of the rules of the fund<sup>27</sup> to those members after their retirement and, if the rules of the fund so provide,

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<sup>20</sup> The FSCA is authorised to prescribe requirements, both substantive and procedural, with which retirement funds and other regulated entities and persons must comply in addition to those prescribed by the minister of finance by regulation. These requirements include:

- the licensing conditions for funds, fund administrators and custodians of fund assets;
- the information required to be given to fund members;
- the information to be supplied by an employer to a fund, together with the contributions paid by the employer to it;
- the minimum rates at which interest must be paid to funds in respect of arrear contributions;
- the regulatory reporting requirements; and
- the criteria by which the ‘financial soundness’ of a fund will be measured.

<sup>21</sup> The FSCA has the powers under the PFA to:

- license retirement funds and fund administrators to conduct business as such;
- approve or reject rule amendments;
- exempt funds from ‘full compliance’ with specific provisions of the PFA; and
- require those he or she considers not ‘fit and proper’ to act as trustees or principal officers of funds to vacate their offices.

<sup>22</sup> The FSCA is empowered in terms of the PFA to monitor and supervise compliance by the board of a fund with its duties to ensure that the fund is, remains, or, within a reasonable period of time, becomes financially sound and complies with investment regulations. The registrar does this by, amongst other things, reviewing annual financial statements and reports on triennial actuarial valuations, approving or rejecting schemes for the transfers of assets and liabilities between funds and other entities, and supervising the winding up of a part or the whole of the business of a fund.

<sup>23</sup> The FSCA conducts compliance visits and investigations, including those prompted by whistle-blowing reports made by members of the public or in compliance with statutory duties imposed on board members, administrators and others. If irregularities are detected, the FSCA may issue directives compelling non-compliant persons or entities to act or refrain from acting in specified ways, impose administrative penalties, withdraw licenses and require persons to vacate specified positions in relation to regulated entities and/or apply to a court for orders placing regulated entities under statutory management, curatorship or in liquidation.

<sup>24</sup> Olivier, MP *et al Social Security: A Legal Analysis* 1<sup>st</sup> ed, Butterworths Durban 2003 at p 261. This means that it must be run for the benefit of its members, and not for the purpose of generating profits for suppliers of goods and services to the fund, even if one of those suppliers established the fund for that purpose (that is, its ‘sponsor’) and has the power to appoint one or more of the members of its board.

<sup>25</sup> Pension funds registered in terms of the Pension Funds Act, 1956 (the PFA) become legal entities on registration, if they were not already. Funds established in terms of specific status derive their status as legal entities from provisions for it in those statutes or in the rules of the funds.

<sup>26</sup> That is, if the fund is an occupational retirement fund to which the members are required to belong in terms of their conditions of employment.

<sup>27</sup> Which rules are its ‘constitution.’ *Tek Corporation Provident Fund & others v Lorentz* 1999 (4) SA 884 (SCA) at 898G-899A.

to the dependants and/or nominees of fund members<sup>28</sup> following the deaths of such members.<sup>29</sup>

19. A fund is a legal entity separate from its members, any employer that participates in it, any union to which its members may belong and any person or entity that administers the fund, underwrites its liabilities, manages its investments or provides other products or services to it. It is capable of owning assets and of suing and being sued in its own name.

**The best interests of a fund lie in the effective and cost-efficient fulfilment of its objects over the long term**

20. Importantly, a fund has its own interests – the delivery and payment of appropriate (‘fit for purpose’), ‘value for money’<sup>30</sup> benefits to members and beneficiaries as a whole, including future members and beneficiaries,<sup>31</sup> in an effective and cost-efficient manner and *over the long term*.<sup>32</sup>
21. As the South African Parliament has recognised,<sup>33</sup> the protection and advancement of these interests

<sup>28</sup> That is, ‘beneficiaries’ as defined in section 1 of the PFA.

<sup>29</sup> *Joint Municipal Pension Fund & another v Grobler & others* 2007 (5) SA 629 (SCA) at para 13. That is the only ‘business’ which a pension fund as defined in section 1 of the PFA may conduct. See s 10 of the PFA. Commenting on the definition of the term ‘business of a medical scheme’ in section 1 of the Medical Schemes Act, 1998, the Constitutional Court in its judgment in *Genesis Medical Scheme v Registrar of Medical Schemes & another* [2017] ZACC 16 said at para 24:

‘This definition is striking in three respects. First, a medical scheme is not supposed to be profit-directed (and multiple memberships are proscribed). And it is subject to rigorous statutory and institutional control. But the statute nonetheless sees it as a “business”. Why? Because, by elementary entrepreneurial principle, a scheme must survive on what it gets in. And the statute requires that it balances its books while doing so. It demands that schemes keep afloat in a fraught, competitive insurance, reinsurance and healthcare market. To keep afloat means keeping solvent – and this inevitably demands a sensible, practical, realistic, business-based approach to managing and accounting for both assets and liabilities.’

<sup>30</sup> It is not the function of the board of a fund to try to get the employer to pay more in contributions to the fund so that it can pay benefits of higher value. That would be the job of trade unions. The board must ensure that the fund uses the contributions paid to it to produce benefits of reasonable value to all of its members over the long term. See extract from judgment in *Genesis Medical Scheme v Registrar of Medical Schemes & another* [2017] ZACC 16 in footnote 29 above.

In regard to the use of such contributions to provide ‘value for money benefits’, see *Edge & others v Pensions Ombudsman & another* [1999] 4 All ER 546 (CA) at p 566 and *Nolan v Kerry (Canada) Inc.* [2002] 2 SCC at para 59. There is no clear basis for determining what constitutes ‘value for money’ in any circumstances. The UK Pensions Regulator has provided some guidance on the matter to workplace pension funds on the issue saying, amongst other things, that ‘...charges and transaction costs are likely to represent good value for members where the combination of costs and what is provided for the costs is appropriate for the scheme membership as a whole, and when compared to other options available in the market.’ See <http://www.thepensionsregulator.gov.uk/codes/code-governance-administration-occupational-dc-trust-based-schemes.aspx#s22009> at para 115.

<sup>31</sup> See *Buschau v Rogers Communications Inc.* [2006] SCJ No at para 34.

<sup>32</sup> *Merchant Navy Ratings Pension Fund Trustees v Stena Lines Ltd & others* [2015] EWHC 448 (Ch) at para 228. This approach is endorsed by King IV which says

‘For a retirement fund, it is especially critical that a long-term view is taken of the fund’s performance in the interests of its members.’

See the retirement funds ‘sector supplement’ of King IV under ‘Principle 4: The board should appreciate that the fund’s core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process.’

<sup>33</sup> To encourage members of the public to save for retirement, Parliament has provided in the Income Tax Act, 1962, for the generous tax treatment of contributions to pension funds and benefits payable by them to encourage investments in such funds. In effect, then, the State is a co-investor in each such fund. See, for example, National Treasury’s 2012 discussion paper *Improving tax incentives for retirement savings* at [http://www.treasury.gov.za/comm\\_media/press/2012/Improving%20tax%20incentives%20for%20retirement%20savings.pdf](http://www.treasury.gov.za/comm_media/press/2012/Improving%20tax%20incentives%20for%20retirement%20savings.pdf) at pp 6 and 11. These incentives are in the form of allowable deductions of contributions to pension funds from taxable income and the generous tax treatment of benefits paid by pension and provident funds. It may be reasonably assumed that the facts that-

- South Africa boasts one of the highest rates of fund membership amongst formal sector employees in the world;
- the financial sector is one of the most resilient in the country (see media presentation by Stats SA on [http://www.statssa.gov.za/?page\\_id=1854&PPN=P0441](http://www.statssa.gov.za/?page_id=1854&PPN=P0441)) are attributable, at least in part, to these incentives.

Unless an employer and its employees (or defined categories of its employees) fall within the scope of sectoral

also serve the public interest.<sup>34</sup>

**THE FUND'S POWERS MUST BE EXERCISED BY ITS BOARD FOR THE SOLE PURPOSE OF ENSURING THAT IT CAN FULFIL ITS OBJECTS EFFECTIVELY AND COST-EFFICIENTLY OVER THE LONG TERM**

**The dependence of a fund on its human 'directing mind and will' means that the board must exercise the fund's powers as it would if it could**

22. As a legal entity, a pension fund needs a 'directing mind and will' to exercise its powers in the fulfilment of the objects of the fund.<sup>35</sup> In South Africa that directing mind and will takes the form of the board of the fund – colloquially referred to as the fund's 'board of trustees' although pension funds are not trusts.
23. A fund's dependence on its board for the proper exercise of the fund's powers and fulfilment of its duties means that the board and each of its members occupies a position of trust<sup>36</sup> and thus owes a fiduciary duty – that is, among other things, a duty of loyalty to the fund when acting in that capacity.<sup>37</sup>
24. Members of the board are not the agents or 'representatives' of those who elected or appointed them in the sense that they are required to exercise the fund's powers in accordance with any mandate given by such persons or bodies.<sup>38</sup> They do not derive those powers from those persons.<sup>39</sup> Instead, the capacity of the fund and the powers of its board are derived from, and limited by, governing

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determinations published by the Minister of Labour in terms of the Basic Conditions of Employment Act or bargaining council agreements concluded in terms of the Labour Relations Act, 1995, the employer is not required to enrol its employees in a pension fund. Many do, however, because, provided that they make membership of such funds compulsory for all their employees, or for all their employees falling within categories defined in the funds' rules, the employers' contributions to the funds are deductible from their own incomes and the employees' contributions are deductible from theirs for tax purposes. This makes employee remuneration in this form tax-effective.

Furthermore, recognising the broader social purposes served by pension funds and that it is in the public interest that they be operated fairly, properly and successfully, Parliament in 1956 enacted the PFA and in it gave extensive powers of regulation and supervision to the registrar. *Financial Services Board & another v de Wet (in his capacity as liquidator of the Pepkor Pension Fund & others* [2002] 4 BPLR 3259 (C) at para 175, *Pepkor Retirement Fund & another v Financial Services Board & another* 2003 (6) SA 38 (SCA) at para 14. See also *Executive Officer of the Financial Services Board v Dynamic Wealth Ltd & others* [2012] 1 All SA 135 (SCA) at para 1. Since its establishment on 1 April 2018, these powers have been required to be exercised by the Financial Sector Conduct Authority. In particular, from that date all references in the PFA to 'the registrar' have been replaced by references to the 'Authority' or FSCA.

<sup>34</sup> See also *Monsanto Canada Inc v Ontario (Superintendent of Financial Services)* 2004 SCC 54, [2004] 3 S.C.R. 152 at para 14 and *Independent Trustee Services Ltd v Hope & others* [2009] EWHC 2810 (Ch) at pp 116 to 118.

<sup>35</sup> *Mostert NO v Old Mutual Life Assurance Company (SA) Ltd* [2001] 2 All SA 465 (C) at 480, *Minister of Water Affairs & Forestry & others v Durr & others* 2006 (6) SA 587 (SCA) at 603 and *S v Coetzee & others* 1997 (1) SACR 379 (CC) t para 128.

<sup>36</sup> *Johannesburg Municipal Pension Fund & another v NBC Employee Benefits (Pty) Ltd & another* [2001] ZAGPHC 2 at 10. See also *Phillips v Fieldstone* 2004 (3) SA 465 (SCA) at p 478.

<sup>37</sup> *Robinson v Randfontein Estates Goldmining Company Ltd* 1921 AD 168 at 177–8 (*Robinson v Randfontein Estates*); *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 (2) SA 54 (T); and *Cyberscene Lt v I-Kiosk Internet and Information (Pty) Ltd* 2000 (3) SA 806 (C) at 814. In relation to the fiduciary duty owed by the directors of a company to the company, see also, for example, *Da Silva v CH Chemicals (Pty) Ltd* [2009] 1 All SA 216 (SCA) at para 8, *Afrisure CC & another v Watson NO & another* 2009 (2) SA 127 (SCA) at paras 54 to 56 and s 2 of the Financial Institutions (Protection of Funds) Act, 2001.

<sup>38</sup> *Fisheries Development Corporation v Jorgenson; Fisheries Development Corporation v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163; *Sage Holdings Ltd v The Unisec Group* 1982 (1) SA 337 (W) at 353–4; *Blackwell v Moray* (1991) 5 ACSR 255 SC (NSW) at 270–1.

<sup>39</sup> Instead they derive their powers from the 'trust instrument' (*Hoosen NO & others v Deedat & others* (1999) 4 All SA 139 (A) at para 21) such as, in the case of a trustees of a trust, the trust deed, or, in the case of the board of a fund, from the fund's rules.

legislation<sup>40</sup> and the rules of the fund.<sup>41</sup>

25. As the board's powers are derivative in nature, it is required to exercise only such powers as have been properly conferred on it, in good faith, that is, for the sole purpose of fulfilling the objects of the fund<sup>42</sup> and, in the case of a specific power, for the purposes for which it was specifically given<sup>43</sup> and in the manner in which the fund, as owner of the powers, would have exercised them if it had been able to exercise them itself.<sup>44</sup>

### The fund's interests override the interests of individual stakeholders

26. While, in the exercise of the fund's powers, its board must protect the existing rights of the fund's members in terms of the currently registered rules of the fund<sup>45</sup> and must take into account their interests and those of their dependants and employers,<sup>46</sup> creditors (including those who have provided products and services to the fund in terms of agreements with it<sup>47</sup>) and other stakeholders, it is not entitled to advance their interests if this would be inconsistent with its fiduciary duty to the fund.<sup>48</sup>
27. The members of a fund, and the dependants and nominees of those members (that is, their 'beneficiaries'<sup>49</sup>) self-evidently have rights in relation to the fund to the extent that they are, or will

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<sup>40</sup> *ABSA Bank Ltd v SACCAWU National Provident Fund (under curatorship)* [2011] JOL 27997 (SCA) at paras 27 to 31. If a board member fails to do this, he or she will not be capable of being exempted in terms of section 7F of the PFA from joint and several liabilities with other members of the board for any losses suffered by the fund as a result.

<sup>41</sup> *Tek Corporation Provident Fund & others v Lorentz* 1999 (4) SA 884 (SCA) at 898 H–I.

<sup>42</sup> *Minister of Defence and Military Veterans v Motau & others* [2014] ZACC 18 at para 54 and *South African Association of Retired Persons & others v Transnet Ltd & others* [1999] 4 All SA 25 (W) at p 55.

<sup>43</sup> *South African Association of Retired Persons & others v Transnet Ltd & others ibid* and *Cowan & others v Scargill & others* [1984] 2 All ER 750 (Ch) Megarry V-C at 761. For example, the board cannot use the fund's powers for the purpose of increasing the amounts of remuneration payable by a participating employer to members of the fund employed by it in the form of contributions or other amounts payable to the fund. *Barnardo's v Buckinghamshire* [2016] EWCA Civ 1064 at para 35. Compare, however, *British Airways Plc v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) at para 377.

<sup>44</sup> See Miller, P. 'Justifying Fiduciary Remedies' (2013) 63 *University of Toronto Law Journal*. Accessed on <https://www.utpjournals.press/doi/abs/10.3138/utlj.1.128> on 2 November 2012 at pp 53 - 55. If the retirement fund were a trust, the powers that its board would exercise would be powers that are 'owned' by the members but which they either cannot, or which they have chosen not, to exercise themselves. The duty to exercise powers for the sole purpose of fulfilling the objects of the fund is not a duty to achieve the best outcome. A trustee is not required to be prescient: *Re Chapman* [1896] 2 Ch 763 at 778; *De Bruyne v Equitable Life Assurance Society of the US* 920 F.2d 457 (7th Cir. 1990) at 465; *Nestle v National Westminster Bank Plc* [1994] 1 WLR 1260 at 1282.

<sup>45</sup> S 7C(2)(a) of the PFA.

<sup>46</sup> *Tek Corporation Provident Fund & others v Lorentz* 1999 (4) SA 884 (SCA) at para 24. See also *Edge & others v Pensions Ombudsman & another* [1999] 4 All ER 546 (CA), 2000 Ch 603 at 623. *International Power v Healy* [2001] UKHL 20 at para 16, *Stevens v Bell: Re Airways Pension Scheme* [2001] All ER (D) 193, upheld by the Court of Appeal [2002] EWCA Civ 672.

<sup>47</sup> Other creditors may include the former spouses of former members whom shares of members' 'pension interests' as defined in the Divorce Act, 1979, have been allocated in terms of divorce orders, the SA Revenue Service (SARS) in respect of tax deducted from benefits and payable to SARS, and the FSCA in respect of fees and/or penalties payable to it in terms of applicable legislation.

<sup>48</sup> Section 7C(2) of the PFA says, amongst other things, that the board has 'a fiduciary duty to members and beneficiaries in respect of accrued benefits' and 'any amount accrued to provide a benefit'. The Supreme Court of Appeal has, however, correctly said this must be 'understood in the context of', and thus subordinate to, 'steps taken in the direction, control and oversight of the fund', that is in fulfilment of the principal object of the board set out in section 7C(1). See *City of Johannesburg v South African Local Authorities Pension Fund & others* [2015] ZASCA 4 at para 13, *Merchant Navy Ratings Pension Fund Trustees v Stena Lines Ltd & others* [2015] EWHC 448 (Ch) at para 212, Pollard, D. *The Shortform Best Interests Duty: Mad, Bad and Dangerous to Know*, a paper presented by David Pollard, a leading English pension lawyer, at a seminar of the UK Association of Pension Lawyers in November 2017, a copy of which can be found at <http://www.wilberforce.co.uk/wp-content/uploads/2018/02/The-Shortform-Best-Interests-Duty-Mad-Bad-and-Dangerous-to-Know-text-from-a-Brewers-Hall-seminar-by-David-Pollard.pdf>.

<sup>49</sup> See the definition of the term 'beneficiary' in s 1 of the PFA.

become, entitled to benefits payable in terms of its rules<sup>50</sup> and may have interests in the affairs of the fund and derive some advantage from it in ways not specifically provided for in the rules.<sup>51</sup> However, the interests of-

27.1 the fund's members and their dependants; and

27.2 future members of the fund,

must be viewed as a whole and treated as subordinate to those of the fund itself, particularly as they may not always coincide.<sup>52</sup>

28. It follows from this that, although it may be to the advantage of some or all of a fund's current members for it to take certain actions in the short-term, if it is evident from the information before it (or which, in the exercise of due care, the board would have ensured was before it<sup>53</sup>), that it would not be in the long-term interests of the fund for it to continue such actions, then the board of the fund must ensure that it follows the course of action best aligned with the long-term interests of the fund.
29. If the board fails to properly consider relevant information in this way, or having considered it, fails to take appropriate actions then it will be acting in breach of its duty to act in the fund's best interests.

#### **BOARD'S DUTY TO EXERCISE THE FUND'S INVESTMENT POWERS IN GOOD FAITH AND WITH CARE AND DILIGENCE**

30. It is implicit in the fiduciary duty owed by each board member to the fund that the board member owes

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<sup>50</sup> S 13 of the PFA and *Tek Corporation Provident Fund & another v Lorentz* [1999] 4 All SA 297 (A) at para 15.

<sup>51</sup> See, for example, *Entrust Pension Ltd v Prospect Hospice Ltd & another* [2012] EWHC 1666 (Ch) at para 72.

<sup>52</sup> The duties of the governing body of a financial institution such a pension fund, medical scheme or collective investment scheme is analogous to that of the board of a company, which are described by the authors of Cilliers & Benade *Corporate Law* 3 ed (Durban: Butterworths 2000) at 148–9 as follows:

'When it is said that a director must act in good faith towards the company and for the advancement of the company's interests, this implies that the members as a group will derive their benefit from the wellbeing of the company. In this sense a fiduciary duty rests on the directors to promote the interest of the members. However, no fiduciary relationship exists between a director and individual members of a company. It is a matter of impossibility for a director to maintain a fiduciary relationship towards both the company and the individual members. The interests of the member and the company may diverge with the result that a director would be in an untenable position if he were to observe fiduciary duties towards both.'

See also *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 All ER 1126 at 1134A–B, in which Lord Wilberforce remarked that the phrases such as 'bona fide in the best interests of the company as a whole', 'if they do anything more than restate the general principle applicable to fiduciary powers, at best serve, negatively, to exclude from the area of validity cases where the directors are acting sectionally or partially, improperly favouring one section of shareholders against another'. This view of the position in company law is echoed by Meskin et al *Henochsberg on the Companies Act* at 467, at which the authors say:

'The "interests" [of the company, in which the board must act] are only those of the company itself as a corporate entity and those of its members as such as a body (*Alexander v Automatic Telephone Co* [1900] 2 Ch 56 (CA) at 67, 72; *Coronation Syndicate Ltd v Lillienfeld* 1903 TS 489 at 497; *Parke v Daily News Ltd* [1962] Ch 927 at 963; [1962] 2 All ER 929 at 948) including, possibly, future members (*Gaiman v National Association for Mental Health* [1971] Ch 317 at 330; [1970] 2 All ER 362 at 374; see further the article by RC Beuthin in 1969 *SALJ* 155; the article by L Hodes in 1983 *SALJ* 468).'

<sup>53</sup> See para 49.



the duties of good faith, care and diligence<sup>54</sup> to the fund, for the latter are elements of the former.<sup>55</sup> These duties, however, also exist independently of the fiduciary duty<sup>56</sup> and, if breached, will found a claim by the fund for compensation for the loss, if any, sustained by it as a result.<sup>57</sup> Such a claim may be framed in common law terms or, if the claim is made as a complaint to the pension funds adjudicator in terms of the PFA, as ‘maladministration’ as contemplated in the definition of ‘complaint’.<sup>58</sup>

31. The duty of the members of the board of a fund to act in good faith means that they must act with ‘an entire absence of indirect motive, with honesty of intention and with a fair consideration of the subject’.<sup>59</sup> The courts’ understanding of what the right reasons may be will be shaped by the ‘legal convictions of the community’.<sup>60</sup>

32. More specifically, the duties of good faith, care and diligence owed by a board of a fund mean that, when exercising its power or discretion, the board must-

32.1 exercise the power or discretion granted to it only for its proper purpose;<sup>61</sup>

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<sup>54</sup> In South African law, a duty of care is said to exist when-

- ‘a reasonable man in the position of the defendant would have (a) foreseen the possibility of the harm occurring to the plaintiff; and (b) taken steps to guard against its occurrence. (*Peri-Urban Areas Health Board v Munarin* 1965 (3) SA 367 (A) at 373F–G; *Langley Fox Building Partnership (Pty) Ltd v De Valence* 1991 (1) SA 1 (A) at 12.)’

and

- ‘the moral convictions of society are such as to demand that the defendant’s failure to take steps to guard against its occurrence ought to be regarded as unlawful and that the damage suffered by the plaintiff ought to be made good by the defendant (*Coronation Brick (Pty) Ltd v Strachan Construction Co (Pty) Ltd* 1982 (4) SA 371 (C) at 384D; *Minister van Polisie v Ewels* 1975 (3) SA 590 (A) at 597A).’

The boards of funds subject to the PFA are bound by s 7C of that act which requires the board to, amongst other things, ‘act with due care, diligence and good faith’, ‘avoid conflicts of interest’, act with impartiality in respect of all members and beneficiaries and ‘act independently’ (or, more properly, exercise an independent discretion). Similar wording can be found in the rule 4.1.19 of the rules of the GEPP published in terms of the Government Employees Pension Law and is likely to be found in the rules or governing statutes of other funds not subject to the PFA.

<sup>55</sup> *Fisheries Development Corporation of SA Ltd v Jorgenson* 1980 (4) SA 156 (W) at 165–6.

<sup>56</sup> See, for example-

- Section 7C(2) of the PFA which requires the board of a fund, when directing, controlling and overseeing the operations of the fund, to ... (b) act with due care, diligence and good faith’;
- rule 4.1.19 of the rules of the GEPP which requires each member of the board of the fund to ‘act at all times with due care and diligence and in good faith’; and
- equivalent provisions in the governing statutes and/or rules of other funds not subject to regulation and supervision in terms of the PFA.

<sup>57</sup> Provided all the elements of Aquilian liability are satisfied, that is-

- the defendant owed the plaintiff a duty of care;
- in breach of that duty the defendant acted in a manner which was wrongful and negligent; and
- the plaintiff has suffered damages as a result of the plaintiff’s wrongful and negligent act or omission.

*Cathkin Park Hotel & others v JD Makesch Architects & others* 1993 (2) SA 98 (W). See also paras 67 and 68 below

<sup>58</sup> The term ‘complaint’ is defined in s 1 of the PFA as-

‘complaint of a complainant relating to the administration of a fund, the investment of its funds or the interpretation and application of its rules, and alleging -

- (a) that a decision of the fund or any person purportedly taken in terms of the rules was in excess of the powers of that fund or person, or an improper exercise of its powers;
  - (b) that the complainant has sustained or may sustain prejudice in consequence of the maladministration of the fund by the fund or any person, whether by act or omission;
  - (c) that a dispute of fact or law has arisen in relation to a fund between the fund or any person and the complainant;
- or
- (d) that an employer who participates in a fund has not fulfilled its duties in terms of the rules of the fund; but shall not include a complaint which does not relate to a specific complainant.’

<sup>59</sup> *Wilson v Law Debenture Trust Corporation* [1995] 2 All ER 337.

<sup>60</sup> See *obiter* statement by Davis J in *Mort NO v Henry Shields-Chiat* 2001 (1) SA 464 (C) at 474J – 475F, a statement endorsed by the SCA in its judgment in *Brisley v Drostky* 2002 (4) SA 1 (SCA) at para 22.

<sup>61</sup> *South African Association of Retired Persons & others v Transnet Ltd & others* [1999] 4 All SA 25 (W) at p55.

- 32.2 give due consideration to all those facts and considerations which are relevant to its decision;<sup>62</sup> (which in some circumstances may require it first to take all reasonable steps to acquire information in relation to such facts and circumstances<sup>63</sup>) and disregard those facts and circumstances that are irrelevant to the issue at hand;<sup>64</sup>
- 32.3 free itself from bias<sup>65</sup> and refrain from fettering its discretion;<sup>66</sup>
- 32.4 take a decision that is reasonable<sup>67</sup> in the sense that it is justifiable on the basis of the reasons given for it and the means contemplated in it are proportional to the objectives sought to be achieved by it;<sup>68</sup> and
- 32.5 if asked for them, provide reasons for its decision.<sup>69</sup>
33. By accepting appointment to the board of a fund, the members of the board together undertake to manage the investment of its assets<sup>70</sup> and, in the exercise of its powers to do so, the board has ‘*the duty to take such care as an ordinary prudent [person] would take if he [or she] were required to make an investment for other people for whom he [or she] felt morally bound to provide*’.<sup>71</sup> This is described as the ‘prudent investor rule’.
34. The prudent investor rule does not require that the board of a fund must make only those investments that are devoid of all risk<sup>72</sup> or that it believes will yield the most profitable returns.<sup>73</sup> Instead, it

<sup>62</sup> *Guarnieri v Fundsatwork Umbrella Pension Fund & others* [2018] ZAGPPHC 579 at para 44.

<sup>63</sup> See statement in *Fisheries Development Corporation of SA Ltd v Jorgensen and Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & others* 1980 (4) SA 156 (W), Margo J said at 166D-E, which statement was endorsed by the appeal court in *Howard v Herrigal* [1991] 2 All SA 113 (A) at para 127.

<sup>64</sup> *Government Employees Pension Fund v Buitendag & others* [2006] 4 BPLR 284 (SCA) at para 14 and *South African Association of Retired Persons & others v Transnet Ltd & others* (supra) at 55.

<sup>65</sup> *Guarnier & others v FundsAtWork Umbrella Pension Fund & others* [2018] ZAGPPHC 579 at paras 30 and 39.

<sup>66</sup> *Gerson v Mondi Pension Fund & others* 2013(6) SA 162 (GSJ) at pars 14, 15 & 28.

<sup>67</sup> Or what has been described as ‘within the judgment of a fair-minded person’. See *Nedcor Bank Ltd v SDR Investment Holdings (Pty) Ltd & others* 2008 (3) SA 544 (SCA) at 548B.

<sup>68</sup> *Sentinel Retirement Fund v C V Bold & others* (80105/2015) [2017] ZAGPPHC 83 at paras 31 to 39. The SCA held in *NBS Boland Bank Ltd v One Berg River Drive CC & others; Deeb & another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd* 1999 (4) SA 928 (SCA) that ‘it is a rule of our common law that unless a contractual discretionary power was clearly intended to be completely unfettered, an exercise of such discretion must be made arbitrio non viri’. In its judgment in *Juglal NO & another v Shoprite Checkers (Pty) Ltd t/a OK Franchise Division* 2004 (5) SA 248 (SCA) the court said at para 26 that this requirement to act arbitrio non viri obliges the decision maker to ‘act reasonably and to exercise a reasonable discretion’.

<sup>69</sup> See *Judicial Service Commission and another v Cape Bar Council and another* [2013] 1 All SA 40 (SCA) at para 44 at which Brand JA said:

‘As to rationality, I think it is rather cynical to say to an affected individual: you have a constitutional right to a rational decision but you are not entitled to know the reasons for that decision. How will the individual ever be able to rebut the defence by the decision-maker: “Trust me, I have good reasons, but I am not prepared to provide them”?’.

The same must be true of reasonableness.

<sup>70</sup> See *Ex Parte Bellingham* 1936 CPD 515 and 517, *Johnsson v Estate Johnsson* 1945 NPD 66 and *Ex Parte Knight* 1946 CPD 800 and 814.

<sup>71</sup> *Sackville West v Nourse & another* 1925 AD 516 at p 536.

<sup>72</sup> *Administrator, Estate Richards v Nichol & another* [1998] 4 All SA 555 (A); 1998] JOL 3833 (A) at pp 13-15.

<sup>73</sup> See, for example, the judgment of Lord Murray in *Martin v City of Edinburgh District Council* [1988] SLT 329 in which he said:

‘I cannot conceive that trustees have an unqualified duty simply to invest trust funds in the most profitable investment available. To accept that without qualification would, in my view, involve substituting the discretion of financial advisors for the discretion of trustees.’

In its judgment in *Withers v Teachers’ Retirement System of the City of New York* 447 F.Supp 1248 (1978), the New York district court said –

‘In the area of investment decisions, the obligation to exercise prudence is essentially an obligation to give primacy to the preservation of the trust estate and the procurement of a reasonable income while avoiding undue investment risks ... and to make independent inquiry into the merits of particular investments rather than to rely wholly on the advice of others.’

contemplates a ‘qualitative’ approach to investments which means that the characteristics of the investor and the purposes for which its investments are to be made must be considered. In particular, the fund must make investments that are ‘fit for purpose’ in that they are considered in their mix to be appropriate for the purposes of ensuring that the fund is able to achieve its objects by meeting its liabilities as and when they arise over the long term.<sup>74</sup>

35. To do this, the board of a fund must formulate, adopt, document and implement appropriate investment policies and strategies.

#### **In the formulation of the fund’s investment policies and strategies**

36. In 2007, long before the current version of PFA Regulation 28 was published in 2011, the then registrar of pension funds (since replaced by the FSCA) issued *PF 130*, a non-binding guidance circular in which he sought to provide advice to boards on matters relating to the governance of their funds.<sup>75</sup> In it he said, amongst other things, that every fund should have an investment policy statement (IPS), which should be conveyed to stakeholders and asset managers<sup>76</sup> and reviewed each year when the financial statements of the fund are considered.<sup>77</sup>

37. In 2011 more guidance in this regard was given to funds in the form of the CRISA principles,<sup>78</sup> the first of which was that-

‘An investor should incorporate sustainability considerations, including environmental, social and governance, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.’<sup>79</sup>

38. This guidance was later supported by *King IV* Principle 3, expressed in the retirement fund sector

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[Emphasis added]. See also the judgment of the court in *Board of Trustees v City of Baltimore* 562 A.2d 720 (Md 1989) at 737, *Anderson v Mortell*, 722 F. Supp 462 at 470 (N D Illinois 1989) which said ‘a fiduciary has no duty to “achieve the highest possible price” on the sale of securities’; *Ershick v United Missouri Bank* 12 Employee Benefits Cas (BNA) 1848 (10<sup>th</sup> Cir 1991), and *Donovan v Walton* 609 F. Supp 1221 at 1226 (DC Fla 1985). Unfortunately, in para 14.8 of annexure B to his non-binding guidance note, *CPF 130*, the then registrar of pension funds said that the primary objective of the investment activities of the board of a fund is ‘to provide optimum returns for [the fund’s] beneficiaries’. If it is only the current beneficiaries that are contemplated in this statement, this advice is incorrect and should be withdrawn.

<sup>74</sup> Or, as PFA Regulation 28(2)(c)(iv) puts it, ‘are appropriate for its liabilities’.

<sup>75</sup> See circular issued on 11 June 2007 at [ftp://ftp.fsb.co.za/public/pension/circular/PF1302.pdf](http://ftp.fsb.co.za/public/pension/circular/PF1302.pdf).

<sup>76</sup> Annexure B to *PF 130* at paras 9. and 20.

<sup>77</sup> *PF 130* at para 51. The matters which he said should be canvassed in the investment policy statement are summarised in Annexure 2 to this memorandum.

If the board of a fund does not include amongst its members anyone with the investment expertise necessary for this purpose, the board must get advice from an appropriately qualified and licensed investment consultant. The board will violate the duty of care that it owes to the fund if it fails to obtain the advice of someone who has such expertise. *Cowan v Scargill* [1984] 2 All ER 750 at 762 and *Jones v AMP Perpetual Trustee Company NZ Limited* [1994] 1 NZLR 690, 1993 NZLR Lexis 614 at 619–20.

S 7D (1) (e) of the PFA helpfully provides that the board of a fund must ‘obtain expert advice on matters where board members may lack sufficient expertise.’ Nonetheless, a fund may not delegate to a consultant with the required expertise the power and authority to formulate these investment policies and strategies on behalf of the fund as these are functions that are a part of the ‘core business’ of the board and so the law requires them to be fulfilled by the board itself. Ellison, *R Pension Fund Investment Law* Tottel Publishing Ltd, West Sussex 2008 at para 9.3.

A body’s directing mind and will may not delegate to a third party a power | to exercise a general discretion which the law vests in that body or which it can reasonably be expected to exercise itself. Cameron et al *Honoré’s South African Law of Trusts* op cit at 327. On the other hand the board may appoint an independent expert to conduct a risk assessment exercise in relation to the fund’s investments with specific reference to governance structures, mandates, terms of reference and such like. In 2007 the then registrar of pension funds advised that a fund should appoint such an expert to conduct this assessment exercise. See Para 15 of Annexure B to *PF 130*.

<sup>78</sup> Referred to in para 11.2.2 above.

<sup>79</sup> *CRISA* at p 3. *CRISA* provides guidance on the application of each of its five principles. See annexure 4 to this memorandum.

supplement as follows:

‘Principle 3: The board [of the fund] should ensure that the fund is and is seen to be a responsible corporate citizen’.<sup>80</sup>

39. Since Regulation 28 came into effect on 1 January 2012, every fund subject to regulation and supervision in terms of the PFA has been required by law to have an ‘investment policy statement’ (IPS) as defined,<sup>81</sup> that is, ‘a document which describes the fund’s investment philosophy as determined by its liability profile and risk appetite’ and which ‘addresses the principles’ referred to in Regulation 28(2).<sup>82</sup> One of these principles is that, before the fund invests in an asset and during the subsistence of such investment, the fund’s board must consider any factor which may materially affect the long term performance of the investment, including, but not limited to, environmental, social and governance factors (the ESG principle).<sup>83</sup>
40. The fund is then required to review its IPS at intervals not exceeding twelve months.<sup>84</sup>
41. Regulation 28 does not explicitly require a fund to comply with its own IPS. This requirement, however, must be implicit in the regulation, or the requirement that a fund have an IPS would be meaningless.<sup>85</sup>
42. Funds not subject to Regulation 28 maybe required by their own governing statutes or rules to put in place investment policies. For example, the GEPF, which is not subject to the PFA, is required in terms of its own governing statute to determine, in consultation with the Minister of Finance, the investment policy of the fund<sup>86</sup> but neither the Government Employees Pension Law, 1996 nor the rules of the fund require it to disclose its investment polic[ies] to its members or the public. Nonetheless by becoming a signatory to the *Principles for Responsible Investment*, the GEPF has undertaken both to take into account environmental, social and governance factors when making investment-related decisions, and to report on its progress towards achieving compliance with the

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<sup>80</sup> See *King IV* at p 97.

<sup>81</sup> See definition of the term ‘investment policy statement’ in Regulation 28. Note that the definition of the term ‘prescribed’ in the Regulation allows the FSCA to determine the additional conditions by publishing a notice on the FSCA website.

<sup>82</sup> See definition of the term ‘investment policy statement’ in Regulation 28. Note that the definition of the term ‘prescribed’ in the Regulation allows the FSCA to determine the additional conditions by publishing a notice on the FSCA website.

<sup>83</sup> Regulation 28(2)(c)(ix).

<sup>84</sup> Regulation 28(2)(b). In para 51 of his 2007 guidance *PF 130* the registrar recommended that funds review their investment policy statements each year when they considered the funds’ annual financial statements.

<sup>85</sup> In its judgment in *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] 2 All SA 262 (SCA) at para 18 the supreme court of appeal set out the principles to be applied in the interpretation of statutory instruments as follows:

‘The present state of the law can be expressed as follows. Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusiness like results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or business like for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation. In a contractual context it is to make a contract for the parties other than the one they in fact made. The “inevitable point of departure is the language of the provision itself”, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.’

This exposition has been endorsed by the Constitutional Court in *Kubanya v Standard Bank of South Africa Ltd (Socio-Economic Rights Institute of South Africa as amicus curiae)* 2014 (4) BCLR 400 (CC) at para 78 and in numerous subsequent judgments.

<sup>86</sup> See section 6(7) of the Government Employees Pension Law, 1996.

Principles.<sup>87</sup> The same is true of the Transnet Retirement Fund which is likewise not subject to the PFA.

43. In March 2018 the then registrar of pension funds published for public comment a draft directive entitled *Sustainability reporting and disclosure requirements*’ (the draft *Sustainability reporting directive*)<sup>88</sup> to be issued in terms of PFA Regulation 28(8) in which he set out his proposed requirements for reporting by funds subject to that act on their adherence to the ESG principle. If the FSCA publishes a directive in the form contemplated in the draft *Sustainability reporting directive*, a fund will be required by law to state in its IPS how its investment approach has been designed to ensure ‘the sustainable long-term performance of the fund’s assets’<sup>89</sup> including, in particular-
- 43.1 the criteria by which it will assess the ‘sustainability’ of an investment (‘sustainability criteria’<sup>90</sup>) which criteria must include-
    - 43.1.1 economic criteria;
    - 43.1.2 environmental, social and governance (ESG) criteria;<sup>91</sup> and
    - 43.1.3 criteria relating to the advancement of broad-based black economic empowerment;<sup>92</sup>
  - 43.2 its policy in regard to the application of its sustainability criteria when deciding on the acquisition of assets;<sup>93</sup>
  - 43.3 at what intervals it will evaluate its assets using its sustainability criteria;<sup>94</sup>
  - 43.4 its ‘active ownership policy’;<sup>95</sup> and
  - 43.5 if any of the fund’s assets are invested in portfolios in the construction of which no account is taken of ESG factors, why the fund considers such investments to be in the interests of the fund and what action, if any, the board intends to take to remedy or mitigate any prejudice or

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<sup>87</sup> See endnote 19.

<sup>88</sup> The content of which is set out in Annexure 7 to this opinion.

<sup>89</sup> Draft *Sustainability reporting directive* at clause 6.1.

<sup>90</sup> It is implicit in the requirement in clause 6.3 that a fund’s IPS must state ‘how regularly it measures the compliance of its assets with ... ESG factors and its ‘sustainability criteria’ that a fund must determine the criteria it will adopt for the purpose. In the draft *Sustainability reporting directive*, the term ‘sustainability’ is defined as-

‘the ability of an entity to conduct its operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs. Sustainability includes managing the impact that the business of an entity has on the life of the community, the broader South African economy and the natural environment in which it operates. It includes the converse, namely considering the effects that society, [the] economy and [the] environment have on business strategy. Sustainability includes economic and ESG considerations. “Sustainable” has a meaning consistent with this.’

<sup>91</sup> See definition of ‘sustainability’.

<sup>92</sup> Draft *sustainability reporting directive* at clause 6.3.

<sup>93</sup> Draft *sustainability reporting directive* at clause 6.2.

<sup>94</sup> Draft *sustainability reporting directive* at clause 6.3.

<sup>95</sup> The term ‘active ownership’ is defined in the draft *Sustainability reporting directive* as follows:

“active ownership” means the prudent fulfilment of responsibilities relating to the ownership of, or an interest in, an asset. These responsibilities include, but are not limited to:

- (a) guidelines to be applied for the identification of sustainability concerns in that asset;
- (b) mechanisms of intervention and engagement with the responsible persons in respect of the asset when concerns have been identified and the means of escalation of activities as a holder or owner of that asset if these concerns cannot be resolved; and
- (c) voting at shareholder meetings, or meetings of owners or holders of an asset, including the criteria that are used to reach voting decisions and for public disclosure of full voting records.

special risks associated with the investment;<sup>96</sup> and

- 43.6 the requirement that these matters be reflected in the terms on which the fund will delegate to third party investment managers the power and duty to manage assets of the fund.<sup>97</sup>
44. In the draft *Sustainability reporting directive*, the then registrar of pension funds also proposed that it be required that-
- 44.1 members of the fund must be given, on request and without charge, access to the fund's investment policy statement<sup>98</sup> or an abridged version of it, provided that, in the case of the latter, it includes the information contemplated in paragraphs 43.1 to 43.5;<sup>99</sup> and
- 44.2 if the fund has a website, such information must be published on it.<sup>100</sup>
45. These proposed disclosure requirements are consistent with *King IV*, which states that
- “the responsible investment code adopted by the institutional investor and the application of its principles and practices should be disclosed”<sup>101</sup>.
46. They are also consistent with *CRISA Principle 5* which is that-
- ‘Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.’<sup>102</sup>

#### **In the making of specific investment decisions and in monitoring the performance of investments**

47. The duty on the part of the board of a fund ‘to consider any factor which may materially affect the sustainable long term performance of the asset including those of an environmental, social and governance character’, both before making an investment and during the subsistence of the investment, has been made explicit in Regulation 28 for funds subject to the PFA<sup>103</sup> and, for the reasons given above, it is equally a duty of the board of a fund not subject to the PFA.<sup>104</sup>

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<sup>96</sup> *Draft sustainability reporting directive* at clause 7.

<sup>97</sup> *Draft sustainability reporting directive* at clause 6.5.

<sup>98</sup> *Draft sustainability reporting directive* at clause 8. In para 9 of Annexure B to *PF 130* the then registrar of pension funds recommended that funds convey their investment policy statements to both the funds' stakeholders and the funds' asset managers.

<sup>99</sup> *Draft sustainability reporting directive* at clause 8.

<sup>100</sup> *Draft sustainability reporting directive* at clause 9.

<sup>101</sup> Principle 17, Recommended Practice 35.

<sup>102</sup> See *CRISA* at p 3.

<sup>103</sup> See Regulation 28(2)(c) (ix). The preamble to Regulation 28 says the following, amongst other things, in its preamble: ‘A fund has a fiduciary duty to act in the best interests of its members whose benefits depend on the responsible management of fund assets. This duty supports the adoption of a responsible investment approach in deploying capital into markets that will earn adequate risk-adjusted returns suitable for a fund's specific member profile, liquidity needs and liabilities. Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund's assets, including factors of an environmental, social and governance character. This concept applies across all assets and categories of assets and should promote the interests of a fund in a stable and transparent environment.’

The preamble, is not, however, part of the Regulation. Instead it may be used in the interpretation of a provision in the Regulation the precise meaning of which is not evident in the words used. See *Bhyat v Commissioner for Immigration* 1932 AD 125 at 129; *Norden and another NNO v Bhanki and others* 1974 (4) SA 647 (A) at 654–655 and *National Director of Prosecutions v Seevnarayan* 2003 (2) 178 (C) at 194F–H.

<sup>104</sup> See also *King IV* which in its retirement funds sector supplement at p 102 includes in the principles to which it recommends that the boards of funds adhere:

48. Whether or not a specific investment can be said to have been prudent or made with care and diligence is a question that can only be decided on the basis of the specific facts and circumstances in which it was made.<sup>105</sup> However, a failure to take into account risks associated with factors such as climate change, which may be relevant to the likely long-term performance of the specific investment, or the fund's investments as a whole, is likely to amount to a breach of the duty of care and diligence.
49. The diligence required of a person who occupies a position of trust in relation to a fund, such as a member of its board, requires that person to engage properly with the affairs of the fund. While, if he or she acts as a fund's board member on a 'non-executive' or 'part-time' basis, the board member is not bound to give continuous attention to the affairs of the fund, he or she must apply his or her mind to the issues before the board. A board member is not entitled to leave this to other board members or third parties,<sup>106</sup> to remain ignorant when knowledge is required,<sup>107</sup> or to blindly accept information and advice.<sup>108</sup>
50. In the circumstances, members of the board of a fund must take all reasonable steps to acquire such information in relation to the risks associated with climate change as they may require in order to make informed decisions, taking such risks into account when exercising the fund's investment powers.

#### **In the delegation of investment powers and responsibilities to asset managers and the supervision of those asset managers**

51. If the board has delegated any of its investment functions to a licensed investment manager and has included in its mandate to that investment manager, the duty to comply with the fund's investment policies in the exercise of its delegated powers, then, unless there are indications that the investment manager is acting in breach of its contractual and fiduciary duties, the board members are entitled to trust that it will comply with them<sup>109</sup> and the fund may hold it accountable if it does not.
52. The board of a fund may not have the capacity<sup>110</sup> to manage the investment of the fund's assets itself. In such circumstances it is entitled to appoint one or more persons or organisations with such capacity to exercise some or all of the fund's investment powers and to fulfil some of the board's duties, including, if applicable, the powers and duties referred to in PFA Regulation 28.
53. There is nothing unlawful in this delegation of powers and duties provided that-

53.1 the appointee is authorised in terms of the Financial Advisory and Intermediary Services Act,

- 
- 'Principle 11: The board should govern risk in a way that supports the fund in setting and achieving its strategic objectives'; and
  - 'Principle 17: The board should ensure that responsible investment is practiced by the fund to promote the good governance and the creation of value by the companies in which it invests.'

<sup>105</sup> *Colonial Banking and Trust Co Ltd v Estate Hughes and others* 1932 AD 1 at 15–16; *Administrators, Estate Richards v Nichol & another* 1999 1 SA 551 (SCA) at p 560.

<sup>106</sup> *Drincqbier v Wood* [1899] 1 Ch 393 at 406 and *Adam & others v Dada & others* 1912 NPD 495 at 503. See also *Boyce NO v Bloem & others* [1960] 3 All SA 574 (T) at 579 and *Minister of Water Affairs & Forestry v Stilfontein Gold Mining Co Ltd* 2006 (5) SA 333 (W).

<sup>107</sup> See *Boyce NO v Bloem* (supra), in which the court said:

'It is no excuse for a person who, by virtue of his office, is required to make enquiry, to allege ignorance, and he who ought to know is just as much in *culpa* as he who knows, and he who neglects to know that which he ought to know is not to be excused...'

See also s 7D(e) of the PFA and the judgment of the Australian court in *Daniels v Anderson* (1995) 37 NSWLR 438.

<sup>108</sup> *Fisheries Development Corporation of SA Ltd v Jorgenson* 1980 (4) SA 156 (W) at 166.

<sup>109</sup> *Meskin et al Henochsberg on the Companies Act* op cit at 463, where the authors refer to *Re National Bank of Wales Ltd* [1899] 2 Ch 629 (CA) at 673, approved in *Dovey v Corey* [1901] AC 477 (HL) and *In re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 (CA) at 427–9.

<sup>110</sup> That is, the knowledge, skill, time and/or tools as well as the authorisation in terms of the Financial Advisory and Intermediary Services Act, 2002 (FAIS) to render advisory and/or intermediary services as defined in that act.

- 2002 (FAIS) to render ‘intermediary services’ as defined in that act;<sup>111</sup>
- 53.2 the rules of the fund expressly or impliedly permit such delegation;<sup>112</sup>
- 53.3 the delegation of responsibilities to the delegee does not amount to the board’s abdication of those responsibilities<sup>113</sup> or a breach of its duty of care;<sup>114</sup>
- 53.4 the person or body to whom the power and responsibility is delegated is suitably qualified to exercise the power;<sup>115</sup>
- 53.5 the power which is sought to be delegated is not a power to exercise a general discretion which the law vests in the board or which it can reasonably be expected to exercise itself;<sup>116</sup> and
- 53.6 the board monitors and supervises the conduct by the delegee of its functions and the fulfilment of its duties in terms of its delegated authority.<sup>117</sup>

<sup>111</sup> Section 1(1) of FAIS defines ‘intermediary service’ as follows –

“intermediary service” means, subject to subsection (3) (b), any act other than the furnishing of advice, performed by a person for or on behalf of a client or product supplier—

- (a) the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier; or
- (b) with a view to—
  - (i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested;
  - (ii) collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of a financial product; or
  - (iii) receiving, submitting or processing the claims of a client against a product supplier.’

Section 1(3)(b) then provides that-

‘intermediary service does not include—

- (i) the rendering by a bank, mutual bank or co-operative bank of a service contemplated in paragraph (b) (ii) of the definition of “intermediary service” where the bank, mutual bank or co-operative bank acts merely as a conduit between a client and another product supplier;<sup>111</sup>
- (ii) an intermediary service rendered by a product supplier—
  - (aa) who is authorised under a particular law to conduct business as a financial institution; and
  - (bb) where the rendering of such service is regulated by or under such law;
- (iii) any other service exempted from the provisions of this Act by the registrar by notice in the Gazette.’

<sup>112</sup> See *Kaplan & another NNO v Professional and Executive Retirement Fund & others* (supra), at which the court said that the power to delegate certain functions had to be implied in the rules of the fund in the circumstances.

<sup>113</sup> Regulation 28(2)(d) explicitly provides that ‘...the appointment of third parties to perform functions which are required to be performed in order to comply with the principles in [Regulation 28(2)(d)], the fund retains the responsibility for compliance with such principles.’

<sup>114</sup> *Administrators, Estate Richards v Nichol & another* 1999 (1) 551 (SCA) at 557.

<sup>115</sup> Cameron et al *Honoré’s South African Law of Trusts* 5<sup>th</sup> ed Juta & Co Cape Town 2002 at 326 state that :

‘It is not uncommon for a trustee to delegate the administration of the trust to another. This may be to a co-trustee, to a form in which the trustee is or is not a partner, to a relative, to a suitably qualified professional person or even to a management committee. Such a course is not improper as long as it amounts only to a delegation (the appointment of another, for which acts one will be responsible, to act on one’s behalf) and not to abdication (the appointment of another to act instead of oneself, so as to relieve oneself of responsibility)... [I]t does not relieve the trustee from the duty of supervising and checking the work of any non-trustee to whom the delegation may have been made. Indeed, the trustee retains office as trustee with primary responsibility to the beneficiaries under the trust and is accordingly at liberty at any time to revoke the delegation of the authority.’

The applicability of these principles to retirement funds was confirmed in *Johannesburg Municipal Pension Fund & another v NBC Employee Benefits (Pty) Ltd & another* [2001] ZAGPHC 2 at p 10. See also *Hoosen v Deedat* 1999 (4) SA 425 (SCA) at para 24.

<sup>116</sup> Cameron et al *Honoré’s South African Law of Trusts* op cit at 327.

<sup>117</sup> This duty is made explicit for funds subject to the PFA in Regulation 28(2)(c)(ii) which says that the board of a fund must ‘monitor compliance with [Regulation 28] by its advisors and service providers.’



54. To enable a fund which appoints a third party investment manager to exercise the fund's investment powers in relation to some or all of its investible assets to comply with these conditions, the fund's board must ensure that the terms of appointment bind the investment manager to comply with the fund's IPS – including, if applicable, its policies in regard to the application of ESG factors to the assessment of investments and the fund's 'active ownership policy'<sup>118</sup>- and to fulfil the duties of the fund's board in regard to the fund's investments, both at common law and in terms of applicable statutes.
55. It may not suit an investment manager to comply with these duties if the terms on which it is remunerated by the fund provide incentives for it to seek to achieve high returns on the fund's investments managed by it in the short- to medium-term, rather than sustainable returns over the long-term.<sup>119</sup> So it will be important for the board of the fund to be vigilant when concluding an agreement in terms of which an investment manager is appointed to manage investments on behalf of the fund and ensure that the agreement both requires the manager to exercise its delegated powers in the long-term interests of the fund in compliance with the fund's rules and its IPS, and provide for the remuneration of the investment manager on bases that promote such conduct.<sup>120</sup>
56. A fund may, however, face some resistance from its investment managers, some of whom may refer to their duties in terms of the *Code of Conduct for Discretionary Financial Services Providers*,<sup>121</sup> to

<sup>118</sup> See para 57 and following below.

<sup>119</sup> The *General Code of Conduct for Financial Services Providers and Representatives* published in terms of the Financial Advisory and Intermediary Services Act, 2002 in BN 80 of 8 August 2003 and as amended by Board Notice 58 of 2010 of 19 April 2010 requires a licensed financial services provider

- to 'avoid, and where this is not possible, to mitigate any conflict of interest between the provider and a client or the representative and a client' (para 3(1)(b)); and
- to disclose to its client, in writing and at 'the earliest reasonable opportunity' -
  - any 'conflict of interest in respect of that client' and the measures taken to avoid or mitigate it; and
  - any 'ownership interest' or 'financial interest' (other than an 'immaterial financial interest' as defined) that the provider may be or may become eligible for and the nature of any relationship or 'arrangement' that it has with a third party that 'gives rise to a conflict of interest' (para 3(1)(c)).

These provisions may not, however, provide the fund with sufficient protection and so it would be prudent for it to take advice from an independent expert on ways to minimise the risks associated with possible conflicts between the interests of its investment managers and their duties to the fund.

<sup>120</sup> As CRISA usefully says in Principle 4, a fund '*should recognise the circumstances and relationships that hold a potential for conflicts of interests and should pro-actively manage these when they occur.*' See annexure 4 to this memorandum for guidance given in CRISA for compliance with this principle.

<sup>121</sup> Published in the *Government Gazette* in terms of s 15 of FAIS in BN 79 of 8 August 2003 and amended thereafter (the *Discretionary FSP Code of Conduct*). See, in particular, clause 5(1) which says-

'A discretionary FSP must obtain a signed mandate from a client, before rendering any intermediary service to that client: Provided that the parties may agree to complete an electronic mandate in respect of which appropriate controls and personal identification procedures have been put in place that ensures security of information, and that the mandate records the arrangements made between the parties, and must—

- (a) authorise the discretionary FSP to act on behalf of the client, indicating whether the authorisation is given with full or specified limited discretion;
- (b) state the investment objectives of the client and whether there are any investment or jurisdiction restrictions that apply to the rendering of intermediary services in relation to the financial products involved;
- (c) contain a general statement pertaining to the risks associated with investing in local and foreign financial products, with particular reference to any currency risk;
- (d) ...
- (g) stipulate the basis on which, the manner in which and the intervals at which the client will remunerate the discretionary FSP for the rendering of intermediary services on the client's behalf: Provided that for the purposes of this paragraph it shall be deemed that the basis of the remuneration has not been stipulated if the remuneration must be calculated with reference to a source outside the mandate or if it is placed within the discretion of any person;
- (h) state whether the discretionary FSP receives commission, incentives, fee reductions or rebates from an administrative FSP or product supplier for placing a client's funds with them;
- (i) ...
- (k) stipulate whether the discretionary FSP may vote on behalf of its clients in respect of their financial products;
- (l) ...

ensure that, unless the FSCA otherwise agrees, the terms of its agreement with the fund are consistent with those in its ‘specimen mandate’ approved by the FSCA on application by the investment manager.<sup>122</sup> However, as few such ‘specimen mandates’ specifically require investment managers-

- 56.1 to exercise their delegated investment powers in a manner designed to promote the long-term sustainability of their institutional clients; and,
- 56.2 for that purpose, to take proper account of ESG factors including, in particular, the risks associated with climate change,

the board of a fund that seeks to comply with its duties described above may have to make it a condition of its appointment of an investment manager that it procures the approval of the FSCA of the conclusion of an agreement between them on terms incorporating such duties.

### **In the exercise of the fund’s ownership rights**

57. Rights attaching to ownership of financial instruments such as shares, bonds, claims in terms of the trust deeds or other constitutive documents of collective investment schemes and the like form part of the value attached to those financial instruments. In the circumstances, a failure by a pension fund to exercise such rights when it could have the effect of improving the sustainability of the investment, could amount to a violation of the duty of care owed by the board or anyone to whom proxy voting powers had been delegated to the fund.<sup>123</sup>

58. It is, no doubt, for this reason that *CRISA Principle 2* is that-

‘An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.’<sup>124</sup>

59. In the draft *Sustainability reporting directive* the then registrar of pension funds proposed that a fund be required to include in its IPS its ‘active ownership policy’.<sup>125</sup>

### **In the provision of investment choices to fund members**

60. In recent years an increasing number of funds, both stand-alone and umbrella funds, have offered their members choices in regard to the portfolios in which fund assets notionally held to provide for the

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<sup>122</sup> Clauses 5(2) and (3) of the Discretionary FSP Code of Conduct.

<sup>123</sup> In the English case of *Barlett v Barclays Bank Trust Co* [1980] 1 All ER (HL) the court said – ‘The prudent man of business will act in such a manner as is necessary to safeguard his investment. He will do this in two ways. If facts come to his knowledge which tell him that the company’s affairs are not being conducted as they should be, or which put him on enquiry, he will take appropriate action. Appropriate action will no doubt consist in the first instance of enquiry and consultation ... and in the last but more likely resort ... to replace one or more of the directors. What the prudent man of business will not do is content himself with the receipt of such information on the affairs of the company as a shareholder ordinarily receives at an annual general meeting. Since he has the power to do so, he will go further and see that he has sufficient information to enable him to make a responsible decision from time to time either to let matters proceed as they are proceeding, or to intervene if he is dissatisfied.’

In his 2007 circular *PF 130*, the then registrar advised the boards of funds to state in their investment policy statements whether the fund would exercise its rights (such as its voting rights) attached to its ownership of financial products such as shares and, if not, why not and if so, what its proxy voting policy was. Para 51 of *PF 130* and paras 16 and 17 of Annexure B to it. The registrar also said that the board of a fund *should* exercise such voting rights or require its asset manager(s) to exercise them on the fund’s behalf. Para 16 and 17 of Annexure B to *PF 130*.

<sup>124</sup> *CRISA* at p 3. See annexure 4 to this memorandum in which is set out the more detailed advice given in *CRISA* for the application of this principle.

<sup>125</sup> *Draft sustainability reporting directive* at clause 6.4. For the definition of ‘active ownership’ in that draft directive, see footnote 95.

fund's liabilities to and in respect of the members (their 'retirement savings') will be invested.<sup>126</sup> In doing so, however, the boards of the funds are still be required to ensure that providing such options is in the best interests of the fund overall, rather than the individual members.

61. At common law, the principles applicable to the delegation of investment powers to an investment manager set out in paragraph 53 are equally applicable to the delegation of investment powers by a fund to its members when it gives them the power to determine the portfolios in which their retirement savings will be invested.
62. The reason for this is that the assets representing a member's retirement savings are assets that nonetheless belong to the fund, not the member. Unless the original rules of the fund conferred on its members investment decision-making powers, giving such powers to members who do not have appropriate investment expertise may amount to an improper delegation of power by the board in violation of its duty of care.<sup>127</sup>
63. To avoid this risk, portfolios in which the retirement savings of members may be invested, whether at their election or by default, should be constructed and managed in compliance with the fund's overall investment policies and strategies, including policies designed to minimise risks associated with climate change.<sup>128</sup> This is so for all funds, including those subject to the PFA Regulation 37<sup>129</sup> in which the Minister of Finance has prescribed requirements in relation to default investment portfolios and which says, in particular, that such portfolios must be designed to be 'appropriate for the members who will be automatically enrolled in them'.<sup>130</sup>

#### **In the disclosure of investment information to the fund's stakeholders**

64. While the explicit legislative bases for a duty on the part of the board of a fund to disclose the fund's investment policies and strategies to its stakeholders (members, their adult dependants and participating employers) are very limited,<sup>131</sup> both the common law and applicable statutes have been

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<sup>126</sup> According to the Sanlam *Benchmark Survey* for 2018 (a copy of which may be found at [https://www.sanlam.co.za/institutional/retirement/benchmarksurvey/Documents/Benchmark-Combined\\_Research\\_Data.pdf](https://www.sanlam.co.za/institutional/retirement/benchmarksurvey/Documents/Benchmark-Combined_Research_Data.pdf)), 62% of the stand-alone funds and 64% of umbrella funds surveyed offered their members investment choice of this nature.

<sup>127</sup> See, for example, the determination of the adjudicator in *Twerefoo v Liberty Life Association of SA Ltd & others* [2000] 12 BPLR 1437 (PFA) in which he said at paragraph 53:

'However the trustees in my view cannot abdicate all responsibility for the investment performance once they have delegated this duty. They retain the residual duties as regards the investment of the fund's monies as one of the key operations of a fund, which the trustees must direct, control and oversee. Part of their duty of diligence, care and good faith involves a consideration of whether the person to whom the power of investment is delegated is a suitable person. Furthermore it must involve the duty to monitor the performance of the delegee.'

Note that a determination by the pension funds adjudicator does not constitute legal precedent. Nonetheless it may provide some guidance as to the likely approach of the adjudicator to similar problems in the future.

<sup>128</sup> In his 2007 non-binding guidance note, *PF 130*, the then registrar of pension funds said in para 52:

'Where a fund has member investment choice, the board is responsible for ensuring that the investment portfolios from which members may make their selection is appropriate for the profile of the fund membership; if there is a default portfolio, it must be reviewed regularly for appropriateness in relation to the membership profile of the fund.'

<sup>129</sup> See Annexure 5.

<sup>130</sup> See Regulation 37 set out in Annexure 6 to this memorandum.

<sup>131</sup> Section 7D(c) of the PFA requires the board of a fund subject to that act to-

'ensure that adequate and appropriate information is communicated to the members of the fund informing them of their rights, benefits and duties in terms of the rules of the fund'.

Section 35 of the PFA gives every member of a fund subject to that act a right to a copy of the fund's rules and its latest revenue account and balance sheet and the right to inspect the latest report on the fund's statutory actuarial valuation, if it is required by law to prepare one.

There are equivalent provisions in some of the statutes in terms of which funds not subject to the PFA have been established and/or the rules of those funds. See, for example,

- rule 11.5 of the rules of the Post Office Retirement Fund; and
- rule 19 of the GEPF rules. Section 10 of the Government Employees Pension Law, 1996, requires the GEPF to prepare

interpreted in favour of such ‘transparency’,<sup>132</sup> particularly in regard to information relevant to decisions that such stakeholders may need to take.<sup>133</sup>

65. Furthermore:

65.1 Each of those pension funds that are signatories to the *Principles for Responsible Investment* have thereby undertaken to ‘report on [its] activities and progress towards implementing the Principles’,<sup>134</sup>

65.2 Each fund that has adopted the CRISA principles has thereby undertaken to ‘be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments’,<sup>135</sup> and

65.3 In the draft *Sustainability reporting directive*, the then registrar of pension funds proposed that a fund subject to regulation and supervision in terms of the PFA be required-

65.3.1 to disclose in its annual financial statements and annual report or other appropriate form of communication to members the extent of its compliance with its IPS and any changes that have been made to its IPS; and

65.3.2 at intervals not exceeding 12 months, to furnish to-

65.3.2.1 a member on request; and

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and submit to the Minister of Finance each year an annual report including its annual financial statements and canvassing, amongst other things, ‘the state of affairs, the business and the financial position of the Fund and the degree in which the objects of the Fund have been furthered’ and ‘relevant performance information with regard to the economical, efficient and effective application of the resources of the Fund’. Rule 4.10 of the GEPF rules then requires that an annual report (which is presumably the same as that submitted to the Minister) be published in the Government Gazette and a copy made available to any member or other person with an interest in the fund on request but subject to payment of a fee relating to the cost of the fund’s production.

Of course every fund is bound by the Promotion of Access to Information Act, 2000. However, the right of access to information held by a pension fund is limited to such information as the applicant requires for the protection and enforcement of his or her own rights.

In his non-binding 2007 circular *PF 130* the then registrar advised funds

- to communicate with members in a way that is ‘appropriate, timely, accurate, complete, consistent, cost-effective, useful, comprehensible and accessible’. He also said that such communication ‘should be informative, transparent and fair and display accountability’ and should include information in respect of the operations, administration and investments of the fund’(see para 59); and
- to disclose their investment policy statements to their members, beneficiaries, investment managers and, as required, regulatory authorities and regularly to report to beneficiaries on ‘relevant performance, risk/return and fund matters especially relating to any changes, that the fund might deem appropriate (see annexure B to PF 130 at para 20).

*CRISA* Principle 5 says: ‘Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.’ See annexure 5 for more detailed advice in *CRISA* on how the principle should be applied.

<sup>132</sup> See, for example, *Nova Property Group Holdings Ltd & others v Cobbett & another (M and G Centre for Investigative Journalism NPC as amicus curiae)* [2016] 3 All SA 32 (SCA) in paras 16 to 18 in which the Supreme Court of Appeal made it clear that a corporate entity has very limited rights to privacy.

<sup>133</sup> In his determination in *Tatiya v Liquor and Catering* [1999] 11 BPLR 315 (PFA), the adjudicator said: ‘In other areas of administrative and employment law, the courts have consistently held that the duty to act in good faith incorporates the duty to disclose adequate relevant information. This is particularly so when individuals face an impending decision which may have adverse implications for them.’

See also the determinations in *Matsolo v Mine Employees’ Pension Fund* [2011] JOL 28032 (PFA) and *Da Silva Pinto v Sentinel Mining Industry Retirement Fund* [2011] 2 BPLR 157 (PFA).

<sup>134</sup> See Principle 6 set out in Annexure 3.

<sup>135</sup> *CRISA* also recommends that these disclosures be made public for easy access by stakeholders, including investee companies and beneficiaries. See annexure 4 for guidance by *CRISA* on how Principle 5 should be applied.

- 65.3.2.2 each participating employer and each union to which members of the fund belong, a copy of the fund's IPS and notice of any changes to it;<sup>136</sup> and
- 65.4 if, as is expected,<sup>137</sup> the FSCA issues a directive making compliance by funds subject to the PFA with *King IV* compulsory, then those funds may be required to comply with CRISA's disclosure principles which are incorporated in *King IV* by reference.<sup>138</sup>
66. If the board of a fund subject to regulation in terms of the PFA fails on request to disclose its IPS to its members, one or more of those members may submit a complaint to the pension funds adjudicator on the basis that the board's failure amounted to an 'improper exercise of its powers'.<sup>139</sup> A member of such a fund, or a fund not subject to the PFA, may, alternatively, apply for access to the IPS in terms of the Promotion of Access to Information Act, 2000 (PAIA). To succeed in such an application, however, the applicant would need to be able to demonstrate that he or she required such access for the 'exercise or protection' of his or her rights.<sup>140</sup> If the FSCA issues a directive in the terms contemplated in its draft *Sustainability reporting directive*, this may well be sufficient for the purpose.

### **POSSIBLE CONSEQUENCES OF A BREACH BY A FUND'S BOARD MEMBERS OF THEIR FIDUCIARY DUTIES OR DUTIES OF CARE AND DILIGENCE**

67. If a fund suffers financial loss as a result of the negligent failure by one or more members of the board of the fund to act with due care and diligence in the conduct of activities referred to below, that is-
- 67.1 the formulation of the fund's investment policies and strategies; and/or
- 67.2 the implementation of those policies and strategies, including in the mandating of third party investment managers to exercise investment powers on behalf of the fund in compliance with those policies and strategies,
- those board members may be held liable to compensate the fund for its loss<sup>141</sup> if and to the extent that it was not attributable to any such investment manager(s), and the fund acting through its board must seek to recover compensation from those board members.<sup>142</sup>
68. In such a case, the standard of care against which each board member's acts or omissions will be assessed will be the standard which could reasonably be expected of a person in a like position, with the knowledge, experience and expertise that the board member had,<sup>143</sup> or held out that he or she

<sup>136</sup> Draft *Sustainability reporting directive* at clauses 12 and 13.

<sup>137</sup> See para 80 below.

<sup>138</sup> *King IV* Retirement funds sector supplement at p 97.

<sup>139</sup> As contemplated in paragraph (a) of the definition of 'complaint' in s 1 of the PFA. See, for example, the recent determination of the pension funds adjudicator in *Matsheka & others v Mafikeng City Council Pension Fund & others* [2018] 1 BPLR 129 (PFA) at para 5.8 (disclosure of information relating to investment performance).

<sup>140</sup> Section 9(a)(ii) read with s 50(1)(a) of PAIA.

<sup>141</sup> *Jowell v Bramwell-Jones* 1998 (1) SA 836 at 894H–J and 895C.

<sup>142</sup> See, in relation to the obligation of the board of a company to act against one of its members which has caused the company loss, *Francis George Hill Family Trust v South African Reserve Bank & others* 1992 (3) SA 91 (A) at 97E–F.

<sup>143</sup> *Van Wyk v Lewis* 1924 AD 438, in which he said the following at p 444:

'It was pointed out by this court, in *Mitchell v Dixon* (1914 AD at 525) that a medical practitioner is not expected to bring to bear upon the case entrusted to him the highest possible degree of professional skill, but he is bound to employ reasonable skill and care. And in deciding what is reasonable the court will have regard to the general level of skill and diligence possessed and exercised at the time by the members of the branch of the profession to which the practitioner belongs. The evidence of qualified surgeons or physicians is of the greatest assistance in estimating that level... But (at 448) the decision of what is reasonable under the circumstances is for the court; it will pay high regard to the views of the profession, but it is not bound to adopt them.'

had,<sup>144</sup> and such knowledge and the expertise to which the board member had access.<sup>145</sup> If the fund is subject to regulation in terms of the PFA and a claim is made against a board member on the basis of his or her alleged breach of duties, the court will no doubt take these factors into account if asked to decide in terms of section 7F of the PFA<sup>146</sup> to relieve the board member from liability, in whole or in part.

69. If it can be shown that, by their acts or omissions the board members also acted in breach of their fiduciary duties (that is, their duties to be loyal to the fund), the fund may also be entitled to an order-

69.1 that those board members are required to-

69.1.1 refund to the fund remuneration paid by the fund to them for their work as board members;<sup>147</sup> and/or

69.1.2 'disgorge' (that is, pay to the fund) any 'secret profits' (that is, any unauthorised and undisclosed benefits) received by them in breach of the fiduciary duties;<sup>148</sup> and/or

69.2 interdicting the board members from engaging in or continuing the impugned conduct;<sup>149</sup> and/or

69.3 declaring a transaction concluded in breach of the duty voidable at the instance of the fund<sup>150</sup> for so long as full restitution is possible;<sup>151</sup> or

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<sup>144</sup> Citing with approval the extract from the judgment in *Mitchell v Dixon* 1914 AD at 525 referred to above, Schutz JA in *Durr v ABSA Bank Ltd & another* [1997] 3 All SA 1 (A) said in regard to the evaluation of the skill of a broker accused of negligence:

'What is actually needed is first to determine what skills the particular kind of broker needs to exhibit, which must depend in large part on what skills he is held out to possess. If this were not so then the reasoning advanced by the respondents would justify the neurosurgeon being judged by the standards of the general practitioner. That would be contrary to the reference by Innes CJ in *Van Wyk v Lewis* ... to the branch of the profession to which the practitioner belongs.'

<sup>145</sup> In its judgment in *Philotex (Pty) Ltd & others v Snyman & others* 1998 (2) SA 138 (A) at 148E, a case concerning apparently reckless decisions by directors of a company, many of whose duties are analogous to those of members of a fund's board of management in relation to a fund, the Appellate Division said the following:

'... [A]lthough the standard by which a director's conduct must be measured is an objective one ... regard should also be had to any additional knowledge, experience or qualification that the evidence reveals that director to possess and which is relevant to the question whether recklessness has been proved. So if director A, being, say, a farmer, did not know certain relevant facts which, by justified inference, would have been within the knowledge of his co-director B by reason of the latter's professional qualifications or experience, say, as a chartered accountant, then A's ignorance will be blameworthy if he ought reasonably to have sought B's advice, that is to say, not advice *qua* accountant but advice *qua* director having additional relevant knowledge. And B's position will be assessed, not just as a director-businessman, but as one having that extra knowledge. The enquiry will therefore be: what would the reasonable businessman, having that additional knowledge, or having ready access to that knowledge, have done in the circumstances?'

<sup>146</sup> Section 7F(1) says:

'In any proceedings against a board member in terms of this Act, other than for willful misconduct or willful breach of trust, the court may relieve the board member from any liability, either wholly or partly, on terms that the court considers just, if it appears to the court that—

(a) the board member has acted independently, honestly and reasonably; or

(b) having regard to all the circumstances of the case, including those connected with the appointment of the board member, it would be fair to excuse the board member.'

<sup>147</sup> See *Levin v Levy* 1917 TPD 702; *Gerry Bouwer Motors (Pty) Ltd v Preller* 1940 TPD 130.

<sup>148</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* (supra) at 77-78. In *Transvaal Cold Storage v Palmer* 1904 TS 4 Innes CJ said at 21:

'The doctrine of an agent's liability to account for profits does not rest upon the fact that he has prevented the principal from earning profits; but is based upon his duty in good faith to hand over to his employer every advantage directly or indirectly connected with the agency, save and excepting the remuneration agreed upon.'

<sup>149</sup> *Meskin et al Henochsberg on the Companies Act op cit* at 463.

<sup>150</sup> *Du Plessis NO v Phelps* (supra).

<sup>151</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* (supra) at 179, 200; *Gundelfinger v African Textile Manufacturers Ltd*

- 69.4 if full restitution is not possible, that the board members are liable, jointly and severally, to compensate the fund for any loss that it has suffered or will suffer as a result of the breach of their fiduciary duties.<sup>152</sup>

### **AN INVESTMENT MANAGER MUST EXERCISE THE FUND'S INVESTMENT POWERS DELEGATED TO IT IN THE BEST INTERESTS OF THE FUND AND WITH CARE AND DILIGENCE**

70. As the management of investments ordinarily entails the exercise of discretion,<sup>153</sup> and the fund will be dependent on the investment manager for the proper exercise of that discretion, the latter will occupy a position of trust in relation to the fund,<sup>154</sup> and the common law will automatically impose on the investment manager a duty of loyalty or fiduciary duty<sup>155</sup> to exercise the powers delegated to it-
- 70.1 in good faith (exercising the powers for their proper purposes and no other);
- 70.2 with due care and diligence<sup>156</sup> (including, in the evaluation of investments, taking into account the risks associated with climate change); and
- 70.3 in the best interests of the fund described in paragraph 20 above,<sup>157</sup>

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1939 AD 314 at 326.

<sup>152</sup> *Atlas Organic Fertilisers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd & others* 1981 (2) SA 173 (T) at 197F–H.

<sup>153</sup> The term ‘management of securities and funds’ is broadly defined in the Financial Markets Act 2012, as: –

- (a) to exercise discretion in buying and selling securities or in exercising any rights attached to those securities on behalf of another person;
- (b) the safeguarding of securities on behalf of another person; or
- (c) the safeguarding of another person’s funds intended for the purpose.’

<sup>154</sup> A position of trust is a position which by its nature, in relation to the person or organization in respect of whom the position exists, and the nature of the latter’s relation to the person in that position of trust, implies ‘as a matter of equity that confidence is reposed in him and his good faith is relied upon.’ Meskin et al *Henochsberg on the Companies Act* (Lexis Nexis on-line) para 208, citing as authority the judgments in *Robinson v Randfontein Estates* at 177–8; *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 (2) SA 54 (T); and *Cyberscene Lt v I-Kiosk Internet and Information (Pty) Ltd* 2000 (3) SA 806 (C) at 814.

<sup>155</sup> See *Robinson v Randfontein Estates Ibid*. A fiduciary relationship is one in which one party (‘the principal’) confers on another (‘the fiduciary’) a power or discretion which it may exercise unilaterally so as to affect the principal’s practical or legal interests. The right to exercise the power or discretion (which fiduciary power is properly understood as a means belonging exclusively to the beneficiary – See Miller, *Pop cit* at footnote 44 at p 56) is usually conferred on the fiduciary because the principal does not have the necessary skill, expertise or knowledge to exercise it itself. This inequality between them means that the principal is dependent on, and vulnerable in relation to, the exercise by the fiduciary of the discretion or power conferred on it. See *Phillips v Fieldstone* 2004 (3) SA 465 (SCA) at para 27. See also Miller, P at pp 42 – 45.

<sup>156</sup> An investment manager is a ‘Discretionary FSP’ as defined in authorised to conduct business in terms of FAIS is also bound by the *General Code of Conduct for Authorised Financial Services Providers and Representatives* published in terms of s 15 of FAISA in the *Government Gazette* in BN 80 of 8 August 2003 and amended thereafter (the *General Code of Conduct*).

<sup>157</sup> In relation to the management of the investments of a fund-

- registered in terms of the PFA, this is reinforced by the Financial Institutions (Protection of Funds) Act, 2001 (‘the FIA’) which says in s 2 that a ‘financial institution’ (the definition of which includes a pension fund registered in terms of the PFA but not any other) or an official, employee or agent of the financial institution who invests, controls, administers or alienates any of assets of the funds of the institution must, with regard to those assets, observe ‘utmost good faith’ and exercise proper care and diligence and may not make use of the assets in a manner calculated to gain directly or indirectly any improper advantage to any person to the prejudice of the financial institution concerned; and
- whether or not it is registered in terms of the PFA, this is reinforced by clause 2 of the *Discretionary FSP Code of Conduct* published in terms of s 15 of the Financial Advisory and Intermediary Services Act, 2002 (FAIS) in BN 79 of 9 August 2003 (the Code of Conduct). That clause says that a financial services provider (FSP) must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry. The term ‘client’ is defined in s 1 of FAIS as a specific person or group of persons, excluding the general public, who is or may become the subject to whom a financial service is rendered intentionally, or is the successor in title of such person or the beneficiary of such service.’

subject to the terms of its mandate.

71. Importantly, the investment manager must not place itself in a position in which-
- 71.1 its duty to the fund (to exercise its powers for the purpose of enabling the fund to fulfil its objects effectively and cost-efficiently over the long term);
- conflicts or is inconsistent with-
- 71.2 the direct or indirect interests of the investment manager in, for example, investment management fees based on returns earned on the assets managed by it over an inappropriately short period, or which provide incentives inconsistent with the fund's interests,<sup>158</sup>
- and it may not make a secret profit out of its work for the fund.<sup>159</sup>
72. As is captured in CRISA Principle 4-
- ‘An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these when they occur.’<sup>160</sup>

#### **POSSIBLE CONSEQUENCES OF A BREACH BY AN INVESTMENT MANAGER OF ITS DUTIES TO THE FUND**

73. A material breach by an investment manager of its duties towards the fund discussed above may have a number of possible consequences.
74. Such a breach may amount to a breach by the investment manager of an explicit or tacit term of its contract with the fund, even if the contract includes a provision in terms of which the fund has waived its rights in relation to such terms.<sup>161</sup> It may also justify the granting of an interdict against the investment manager against engaging in or continuing the impugned conduct<sup>162</sup> and, if the breach is material, the cancellation of the contract by the fund on notice to the investment manager. Such cancellation of the contract will not terminate any liability on the part of the investment manager for the payment of damages to the fund.<sup>163</sup>
75. The investment manager's liability for the payment of such damages may arise from loss sustained by the fund as a result of the wilful misconduct or negligence of the investment manager, and/or from a breach by the latter of its fiduciary duties to the former.<sup>164</sup> A material breach of fiduciary duties may

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<sup>158</sup> Clause 3(1)(b) of the FAIS *General Code of Conduct* states that an FSP –  
‘must avoid, and where this is not possible, mitigate, any conflict of interest between the provider and a client or the representative and a client.’

<sup>159</sup> *Robinson v Randfontein Estates* *Ibid*, *Mothew (t/a Stapley & Co) v Bristol and West Building Society* [1996] EWCA Civ 533, [1996] 4 All ER 698 at 711–12.

<sup>160</sup> See *CRISA* in Annexure 3.

<sup>161</sup> A statutory right may be renounced by the person for whose *benefit* it has been introduced (*Bezuidenhout v AA Mutual Insurance Association Ltd* 1978 (1) SA 703 (A) at 710A–D) provided that it was not also introduced in the public interest. See *South African Co-operative Citrus Exchange Ltd v Director-General Trade and Industry & another* 1997 (3) SA 236 (SCA) at 242G and following. Section 2 of the FIA and the General Code of Conduct for Authorised Financial Services Providers undoubtedly have been introduced in the public interest and so it is unlikely that, if asked, a court will find that rights conferred on consumers of financial services in terms of them can be waived.

<sup>162</sup> *Meskin et al Henochsberg on the Companies Act* vol 1 at 465.

<sup>163</sup> Or, unless a contrary intention is apparent from the contract, the obligation to abide by an arbitration clause, if any, in the contract. See *Atteridgeville Town Council v Livanos* 1992 1 SA 296 (A) 303I–306C.

<sup>164</sup> The liability of a fiduciary for a breach of fiduciary duty is not delictual (requiring *dolus* or *culpa*) but *sui generis* and may not found a claim for compensation if loss cannot be demonstrated. *Transvaal Lands Co v New Belgium (Transvaal) Land &*



also found a claim by the fund for the refund of any remuneration paid to the investment manager, on the basis that the breach took place in the course of its appointment as such.<sup>165</sup>

76. A transaction concluded by an investment manager on behalf of a fund in breach of the former's duties to the latter may be either void from the outset<sup>166</sup> or voidable at the instance of the fund<sup>167</sup> for so long as full *restitutio in integrum*<sup>168</sup> is possible, other than in a case of a transaction effected by a purported exercise by the investment manager of a non-existent power. If the transaction involved a third party, then it too will be voidable on the same conditions, but with the additional condition that the third party was unaware of the breach.<sup>169</sup>

77. In our opinion, taking into account–

77.1 the purposes of the Financial Institutions (Protection of Funds) Act, 2001; and

77.2 the risks to investors associated with the conclusion of agreements in breach of its provisions,

a court should have little difficulty in finding that an agreement concluded in breach of either is void from the outset.

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*Development Co* [1914] 2 Ch 488 (CA) at 505. *Robinson v Randfontein Estates Gold Mining Co Ltd* (supra) at 199, 242; *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706; *Du Plessis NO v Phelps* 1995 (4) SA 165 (C) at 170–1. See also Cilliers & Benade *Corporate Law* op cit at 328.

<sup>165</sup> See *Levin v Levy* 1917 TPD 702 and *Gerry Bouwer Motors (Pty) Ltd v Preller* 1940 TPD 130.

<sup>166</sup> In its judgment in *ABSA Insurance Brokers (Pty) Ltd v Luttig NO & another* [1997] 3 All SA 267 (A) the appellate division said the following at 273 – 5 about the validity of an agreement entered into in breach of statute:

- (a) If a statute says nothing about the validity of a contract entered into in breach of the statute then the question of its validity falls to be determined on the basis of a proper interpretation of the legislation in question.
- (b) Where the legislature penalises an act, it impliedly prohibits it and the effect of the prohibition is usually to render the act null and void. This principle is not, however, inflexible or inexorable. What must be considered are the subject matter of the prohibition, its purpose in the context of the legislation, the remedies, if any, provided in the event of breach, the nature of the mischief it was designed to remedy or avoid and any cognisable impropriety or inconvenience which may flow from invalidity.
- (c) The purpose of the statute before the court, namely the Insurance Act, was to regulate the insurance industry mainly for the protection of the public. From this it was apparent that the legislature intended to make inroads into the contractual relationship between an insurer and its agent in order to protect the insurer, the broker and policyholders. Allowing a contract in breach of the prohibition to be enforceable would undermine the purpose of the prohibition.
- (d) If another section of the statute declares that related contracts concluded in breach of that section are not invalid merely because of that breach, this indicates that contracts concluded in breach of a section in relation to which no similar provision appears are to be treated as a nullity.
- (e) In that case the court found in that case that the principal agreement was void from the outset and accordingly unenforceable, whether or not one or both of the parties was aware that the contract was prohibited by statute.'

See also *Municipal Manager: Qaukeni Local Municipality & another v FV General Trading CC* 2010 (1) SA 356 (SCA), a judgment in a matter concerning the validity of an agreement concluded by a municipality in breach of its duty to comply with statutory obligations relating to supply chain management in which Leach AJA of the Supreme Court of Appeal said the following at [14]:

'It was suggested by the respondent both in the court below and in the heads of argument filed in this court that a failure to comply with these statutory precepts did not automatically visit a contract with an external service supplier with nullity, and that the court had a discretion to enforce such a contract if the supplier would otherwise be prejudiced. However ... [i]t is not a question of a court being entitled to exercise a discretion having regard to issues of fairness and prejudice. Rather, the question is one of legality.'

[Emphasis added]

<sup>167</sup> *Du Plessis NO v Phelps* (at footnote 164).

<sup>168</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* (supra) at 179, 200; *Gundelfinger v African Textile Manufacturers Ltd* 1939 AD 314 at 326.

<sup>169</sup> *Transvaal Lands Co v New Belgium (Transvaal) Land & Development Co* [1914] 2 Ch 488 (CA) at 505; *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246 (CA) at 295–6, 303–4, 306–7. *Kruger Investments Group Limited and Another v Nuberry Holdings Limited and Others* (14184/15) [2015] ZAWCHC 159 (30 October 2015) at 40.

78. A breach by an investment manager of its duties may also justify
- 78.1 the withdrawal of the fiduciary's license or licenses in terms of FAIS to act as a financial services provider<sup>170</sup> or the debarment of its representative;<sup>171</sup> and/or
  - 78.2 the imposition on it by the FSCA of an administrative penalty unless a prosecution of the investment manager for a criminal offence based on the same facts on which the FSCA would rely has already commenced;<sup>172</sup> and/or
  - 78.3 the conviction of the investment manager of a criminal offence if the breach amounts to a violation of section 2 of the Financial Institutions (Protection of Funds) Act, 2001, in which case it may be sentenced to a fine of up to R10 million or imprisonment for a period not exceeding ten years or both.<sup>173</sup>

### FUTURE DEVELOPMENTS

79. As already mentioned, the sustainability reporting requirements contemplated in the draft directive published by the then registrar of pension funds have not yet been published in their final and binding form by the FSCA. Nonetheless, in our opinion it is likely that, when these requirements are prescribed, they will not be substantially different to those in the draft directive.
80. There is another likely regulatory development of importance in the context of the issues canvassed in this opinion: At the annual conference of the Pension Lawyers Association in March 2018, Olano Makhubela<sup>174</sup> announced that, during the course of 2018, the FSCA would issue a directive making compliance with *King IV* governance principles compulsory for all pension funds subject to the PFA.<sup>175</sup> This has not happened yet but, if it does, then the CRISA principles will simultaneously become binding on those pension funds as they are incorporated in *King IV* by reference in its retirement funds sector supplement.

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<sup>170</sup> Section 8(10)(b) read with s 9 of FAIS.

<sup>171</sup> See s 14A of FAIS.

<sup>172</sup> See s 167 of the Financial Sector Regulation Act, 2017.

<sup>173</sup> Section 10 of the Financial Institutions (Protection of Funds) Act, 2001.

<sup>174</sup> Then the deputy registrar of pension funds and a deputy executive officer of the Financial Services Board and now executive director: retirement funds employed by the FSCA.

<sup>175</sup> A copy of his address to the conference may be found at <http://www.pensionlawyers.co.za/wp-content/uploads/2018/03/Session-5-PLA-2018-Regulatory-Update-from-the-FSB-Olano-Makhubela.pdf>.

## CONCLUSION

81. In 2011 the South African Department of Environmental Affairs published a policy paper entitled *Climate Change Response White Paper*. In it Government notes that incentives, including regulatory, economic and fiscal measures, could be used to encourage and reward efforts to curb greenhouse gas emissions. It then said, amongst other things-

‘Government recognises the important role for market-based instruments that create fiscal incentives and disincentives to support climate change policy objectives. Thus, South Africa will employ market-based instruments as part of a suite of policy interventions to support the transition to a lower carbon economy. These instruments will be designed to incentivise behaviour change at the individual, institutional and macro-economic levels for a climate-resilient South Africa contributing to a diversification of our energy mix, drive people to implement far-reaching energy efficiency measures, achieve passenger modal shifts, and generate investments in new and cleaner technologies and industries ...’<sup>176</sup>

‘... Stable, well governed institutions are critical to funding South Africa’s transition path to climate-resilient development. In pursuit of a long-term funding framework for climate finance, Government will ...

- d. [i]dentify opportunities in the existing financial regulations governing the domestic finance sector to enhance the financial sector’s capacity to mainstream climate change in risk and investment decisions ...
- f. [d]evelop a climate finance strategy that contextualises and integrates existing and emerging policy and financing instruments, including addressing the role of market-based measures to achieve the desired economic and social changes.’<sup>177</sup>

82. We have argued that retirement funds already have a duty at common law to take environmental factors, including the risks associated with climate change, into account when making investment decisions. A failure to consider material financial risks arising from climate change may amount to a breach of duty by the board of a pension fund, under both common law principles and Regulation 28 of the PFA.

We trust that the advice given in this opinion will be useful to Just Share, ClientEarth and the boards of the pension funds that read it.



**Rosemary Hunter**

**Fasken**

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<sup>176</sup> White paper at pp 41-42.

<sup>177</sup> White paper at para 11.1 at pp 44-45.

## ANNEXURES

### Annexure 1: Different kinds of funds

There are many different kinds of retirement fund, all of which fall within the scope of the definition of the term ‘pension fund’ in section 1 of the PFA.

<b>OCCUPATIONAL (COMPULSORY) FUND</b>		
This is a fund to which a member belongs in terms of his or her conditions of employment. While not every employer is required by law to enroll its employees in a pension or provident fund, it can make membership of such a fund a condition of employment. In this sense, then, membership of the fund is ‘compulsory’		
<b>Pension fund</b>	A retirement fund that pays a retired member an annuity (also called a ‘pension’) for the remainder of his or her life in quarterly or monthly installments. It may also pay an annuity to the member’s surviving spouse or child, if applicable. The fund may allow a member who is about to retire to elect to take up to one third of the capital value of the member’s pension at retirement in the form of a lump sum but it will not allow the whole of the capital value to be used in this way. Instead the balance must be paid in the form of an annuity.	
<b>Provident fund</b>	A retirement fund that pays only a lump sum benefit (instead of a pension and maybe also a lump sum) to a member when he or she reaches retirement age.	
<b>Defined benefit fund</b>	A retirement fund which provides a benefit on retirement that is determined as an amount equal to a percentage of the member’s final average salary multiplied by the years of his or her membership of the fund. The rate at which the member contributes to the fund is usually fixed as a percentage of that portion of his or her remuneration which is treated in the rules of the fund as ‘pensionable’. The employer’s rate of contributions is usually determined on a ‘balance of cost’ basis. This means that the fund’s valuator works out the rate at which the employer will need to contribute to the fund over the next three years if the fund is to remain financially sound and thus able to meet its benefit liabilities as and when they arise.	
<b>Defined contribution fund</b>	A retirement fund which provides a benefit on retirement which is determined on the basis of the accumulated contributions made to the fund by the member (and/or, if applicable, the member’s employer) increased by returns earned on the investment of those contributions less deductions made from those contributions to meet the costs of running the fund and providing for death and disability benefits. The rates at which the member and employer contribute to the fund are fixed or defined as a percentage of the member’s remuneration and the member carries the risks and rewards of the fund’s investment performance.	
<b>Stand-alone fund</b>	A stand-alone fund has as its members only employees who are employed by one employer, or by a group of employers related to each other by shareholding. Members of the fund must be given the right to elect at least half of the members of the board of such a fund and the balance will be appointed by the employers or former employers of those members.	
<b>Umbrella fund</b>	Also known as a multi-employer fund, this is a fund to which employees of a number of employers belong. The members of the board of the fund are usually appointed by the fund’s sponsor or creator (usually a fund administrator, insurer, bargaining council or union) rather than by the members and their employers. The rates at which contributions are made in respect of members employed by specific employers and the benefits to which such members are entitled may be captured in what are known as ‘special rules’ which form annexures to the main body of rules that provide for the governance, operation and management of the fund.	
	<b>Employer group fund</b>	This is a fund established for the benefit of employees of employers related to each other by shareholding eg a holding company and its subsidiaries
	<b>Union fund</b>	This is a fund established by a trade union for the benefit of its members and to which its members (and possibly other employees as well) belong in terms of collective agreements concluded between the union and an employer or an employer organization. The rules of the fund may provide that all members and all employers will make contributions to the fund at

		the same rate or at rates determined by agreement between the union and each employer in respect of its employees who are members of the fund
	<b>Bargaining council fund</b>	This is a fund established in terms of a collective agreement between one or more trade unions and one or more employers associations and to which the employees of the employers who are members of the employers' association are required to belong in terms of that collective agreement. In terms of the Labour Relations Act, if the unions between them represent, and the employers between them employ, more than 50% of the employees employed in a defined sector, the Minister of Labour may make the collective agreement binding even on those employees employed in the sector who are not members of the union(s) and those employers conducting business in the sector who are not members of the employers' organization(s).
	<b>Sectoral determination fund</b>	This is a fund established in terms of a sectoral determination issued by the Minister of Labour in terms of the Basic Conditions of Employment Act and to which all employees employed in the sector are required by law to belong and to which those employees and their employers are required to contribute
	<b>Trade or occupational fund</b>	This is a fund (such as the Dental Technicians fund) established by a body (usually a conduct standard setting and supervising body) for members of a particular trade, profession or occupation and to which such members may be required to belong in terms of their contracts of employment.
	<b>Commercial umbrella fund</b>	This is a fund established by a provider of financial services or products and to which employees of numerous unrelated employers may be required to belong in terms of their contracts of employment
<b>Wholly underwritten fund</b>		The only assets of this type of fund are policies of insurance. Contributions paid to the fund are used as premiums which are paid to one or more insurers which then undertake to pay to fund benefits as and when they become payable by the fund. The amounts paid by the insurer may be paid to the fund for onward payment to the member or beneficiary or paid to the member or beneficiary directly.
<b>Self-administered fund</b>		This is a fund which owns and invests assets such as shares, bonds, cash and property in order to provide for benefits as and when they become payable in terms of the rules.
<b>Contributory fund</b>		This is a fund to which a member and/or the member's employer makes regular contributions until the member becomes entitled to a benefit. (Note that the term 'non-contributory fund' is sometimes used to refer to a fund to which only employers, and not members, contribute).
<b>Paid-up fund</b>		This is a fund to which a member and/or his or her employer has contributed in the past but to which neither is now contributing for the benefit of the member at the moment. The member will be entitled to receive a benefit from the fund either on retirement or on termination of employment before then
<b>VOLUNTARY MEMBERSHIP FUND</b>		
This is a retirement fund which a member joins of his or her own accord and to which the member alone makes contributions. The fund may be a retirement annuity fund (to which the member may make regular or lump sum contributions) or a preservation fund to which the member's previous fund has transferred the member's retirement savings in that fund. Once the member has joined the fund, no benefit will be payable until the member reaches his or her specified retirement age		
<b>Preservation fund</b>		This is a fund to which a 'contribution' is made for a member in the form of his or her transferred savings from another retirement fund on termination of the member's membership of that fund. Those retirement savings are then kept and invested by the preservation fund until the member reaches retirement age (any date after the member reaches 55 years of age) although the rules may allow a member to make one withdrawal from it before then unless a deduction was made by the previous fund from the member's benefit before the residue was paid to the preservation fund.
	<b>Pension preservation</b>	This is a preservation fund to which benefits may be transferred from a member's pension fund and preserved until he or she reaches retirement

	<b>fund</b>	age
	<b>Provident preservation fund</b>	This is a preservation fund to which benefits may be transferred from a member's pension fund and preserved until he or she reaches retirement age
<b>Retirement annuity fund</b>	This is a fund to which a member may make a single or several contributions during his or her working life. It is a pension fund which means that the maximum share of the members' retirement capital that may be paid in the form of a lump sum is one-third. The balance must be paid as an annuity for life.	
<b>UNCLAIMED BENEFIT FUND</b>		
This is a species of preservation fund but a member's membership of it is not voluntary. It is a fund to which a fund which has accumulated unpaid benefits and which cannot effectively trace and pay those entitled to them may pay those benefits for preservation until claimed by their beneficiaries. An unclaimed benefit fund may not accept the transfer from another fund of liabilities other than liabilities for unpaid benefits and cannot accept the transfer from such a fund of assets other than those required to provide for those liabilities for unpaid benefits.		
<b>Unclaimed benefit preservation pension fund</b>	This is a fund established to receive, invest and pay unpaid benefits that accrued in pension funds (not provident funds)	
<b>Unclaimed benefit preservation provident fund</b>	This is a fund established to receive, invest and pay unpaid benefits that accrued in provident funds (not pension funds).	
<b>BENEFICIARY FUND</b>		
This is a fund to which shares of benefits payable on the deaths of fund members may be paid in certain circumstances. For example, if the retirement fund decides that there is no suitable guardian or caregiver to administer the share of a death benefit allocated to an orphan, it may pay the share to a beneficiary fund which will then be obliged to invest that money and pay out amounts of it to the orphan or for the benefit of the orphan as and when required until he or she reaches the age of 18.		

## Annexure 2: PF 130 (June 2007)

In 2007 the registrar of pension funds (since replaced by the Financial Sector Conduct Authority) issued *PF 130*<sup>178</sup> a non-binding guidance circular in which the registrar sought to provide comprehensive guidance to boards on matters relating to the governance of their funds.

In relation to fund investments he advised, in particular, that:

- Investments should be made in the best interests of members and beneficiaries of the fund.<sup>179</sup>
- Every fund should have an investment policy statement (IPS), which should be conveyed to stakeholders and asset managers<sup>180</sup> and reviewed each year when the financial statements of the fund are considered.<sup>181</sup>
- In formulating the IPS the board must take into account the profile of the fund's beneficiaries so as to enable the board, after taking expert advice, to determine appropriate levels of risk, mix of assets and the duration of various investments.<sup>182</sup>
- The IPS should set out the investment objectives of the fund;<sup>183</sup> state who are the fund's investment advisors and custodians (if any); whether the fund has a policy in relation to socially responsible investments and, if so, what it means by this investment 'type';<sup>184</sup> whether the fund's investments are in the form of insurance policies or 'segregated mandates'<sup>185</sup> and the reason for it; what the fund's benchmarks are by which the performance of asset managers and asset classes will be measured; how the fund performed in the previous year as against the fund's benchmarks and the 'tracking error';<sup>186</sup> the level of risk attributed to each asset class and asset manager; and whether the fund exercises the rights (such as voting rights) that attach to investments owned by it and, if so, what its proxy voting policy is and, if not, why not.<sup>187</sup>
- In particular, the following issues should be addressed:
  - categories and mix of investments (by market sector, 'quality' and nature, such as derivatives), the rates of return expected to be earned on them and the time frames for it, expected volatility and what actions will be taken if the performance targets are not met;<sup>188</sup>
  - diversification (by asset type, industry and geographic region) of investments to minimize risk;<sup>189</sup>
  - the fund's liquidity (cash flow) requirements;<sup>190</sup>

<sup>178</sup> See circular issued on 11 June 2007 at <ftp://ftp.fsb.co.za/public/pension/circular/PF1302.pdf>.

<sup>179</sup> See, however, para 27 above.

<sup>180</sup> Para 9 of Annexure B to *PF 130*.

<sup>181</sup> Para 51 of *PF 130*.

<sup>182</sup> Para 6.3 of Annexure B to *PF 130*.

<sup>183</sup> Para 9 of Annexure B to *PF 130*.

<sup>184</sup> Para 51 of *PF130* and para 14.8 of Annexure B to it. A policy in relation to socially desirable investments is a policy that the fund may adopt in relation to the investment of all of its assets, not in relation to a particular 'type' of investment. The circular reflects a limited understanding of the nature and role of 'socially responsible investing', treating it as an asset class which a fund may consider provided that it does not deviate from its objective of maximizing financial returns. It must be conceded, however, that there are many different definitions of 'socially responsible' or socially desirable investments.

<sup>185</sup> This is presumably intended to mean directly held assets.

<sup>186</sup> Presumably this refers to the failure of an investment to meet investment targets set in the IPS.

<sup>187</sup> Para 51 of *PF 130* and paras 16 and 17 of Annexure B to it.

<sup>188</sup> Para 14 of Annexure B to *PF 130*.

<sup>189</sup> Para 14.3 of Annexure B to *PF 130*.

<sup>190</sup> Para 14.4 of Annexure B to *PF 130*.

- the pledging and borrowing of assets;<sup>191</sup>
  - lending against the fund;<sup>192</sup>
  - what voting rights attach to the various investments;
  - how assets that are not publicly traded will be valued; and
  - ‘related party transactions’.<sup>193</sup>
- The board of a fund should ensure that mandates given to asset managers clearly define the funds’ expectations, benchmarks against which the performance of the asset managers would be considered, and reporting requirements.<sup>194</sup> The IPS should make it clear how investment managers will be selected, remunerated and, if necessary, replaced.<sup>195</sup>
  - If the fund allows ‘member investment choice’, the board should ensure that each of the investment portfolios which may be selected by members is ‘appropriate for the fund membership’.<sup>196</sup>
  - Boards of funds other than retirement annuity funds and preservation funds<sup>197</sup> should not enter into any arrangements in terms of which the fund’s investment options are limited to those provided by the fund sponsor or its subsidiary or related entity.<sup>198</sup>
  - If the fund is a ‘balance of cost’ fund, the board must be mindful of the risks to a participating employer that may be associated with its investment decisions and should not make investments that it would not make were the fund not such a fund.<sup>199</sup>

<sup>191</sup> Para 14.5 of Annexure B to *PF 130*.

<sup>192</sup> Para 14.6 of Annexure B to *PF 130*.

<sup>193</sup> The term ‘related party transaction’ is used in Board Notice 43 of May 2006 ‘Categorization and annual financial statements’, but is not defined there. It is defined in clause 10.1 of the listings requirements of the Johannesburg Stock Exchange as ‘a transaction ... or any variation or novation of an existing agreement, between an issuer, or any of its subsidiaries, and a related party’. The term ‘related party’ is then defined to include a material shareholder, a person who is or was within the last 12 months a director or principal executive officer of the company or its subsidiary or holding company, an advisor to the company that has a direct or indirect beneficial interest in the company or any of its associates or controlling shareholder of or a person associated with one of them. For the complete definition, see [http://www.jse.co.za/docs/listings\\_requirements/SECT10.DOC](http://www.jse.co.za/docs/listings_requirements/SECT10.DOC).

The listings requirements include a requirement that a ‘related party transaction’ will require public notice, shareholder approval, and a statement by the directors that the terms of the transaction are fair and reasonable. No doubt a similar principle is sought to be brought into play in the retirement *fund* context, taking into account, however, that members of a *fund* are not shareholders.

<sup>194</sup> Para 50 of *PF 130*. See also paras 18 and 19 of Annexure B to *PF 130* for the *registrar*’s recommendations in regard to items which should be canvassed in asset manager mandates. See also *Twerefoo v Liberty Life Association of SA Ltd & others* [2000] 12 BPLR 1437 (PFA), in which the adjudicator said:

‘However the trustees in my view cannot abdicate all responsibility for performance once they have delegated this duty. They retain residual duties as regard the investment of the fund’s moneys as one of the key operations of a fund, which the trustees must direct, control and oversee. Part of their duty of diligence, care and good faith involves a consideration of whether the person to whom the power of investment is delegated is a suitable person. Furthermore it must involve the duty to monitor the performance of the delatee. As Richard Nobles puts it with regard to English pensions law in his book *Pensions, Employment and the Law* (Clarendon Press, Oxford, 1993):

“However inadequate their efforts might appear in the face of the superior knowledge of financial experts, trustees must not cease their supervisory role; asking for reasons, checking for consistency, seeking to understand.”’

<sup>195</sup> Paras 9 and 14.7 of Annexure B to *PF 130*.

<sup>196</sup> Para 52 of *PF 130*.

<sup>197</sup> The reason why the *registrar* believes that ‘such an investment arrangement is permissible’ for retirement annuity and preservation funds is not clear from the circular.

<sup>198</sup> Para 53 of *PF 130*.

<sup>199</sup> Para 54 of *PF 130*.



- A fund should conclude an agreement with its custodian directly rather than deal with it through the fund's investment advisor.<sup>200</sup>
- An independent expert should be asked to conduct a risk assessment performed in relation to the fund's investments with specific reference to governance structures, mandates, terms of reference and suchlike.<sup>201</sup>
- After formulating appropriate policies and mandates, boards should exercise the voting rights that attach to shares in companies in which the funds have invested or require the funds' asset managers to exercise them on their behalf.<sup>202</sup>

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<sup>200</sup> Or, presumably, through its asset manager. Para 55 of *PF 130*.

<sup>201</sup> Para 15 of Annexure B to *PF 130*.

<sup>202</sup> Para 16 and 17 of Annexure B to *PF 130*.

### **Annexure 3: Code for Responsible Investment South Africa (CRISA) (Feb 2012)**

**Principle 1:** An investor should incorporate sustainability considerations, including environmental, social and governance, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.

1. An institutional investor should develop a policy on how it incorporates sustainability considerations, including ESG, into its investment analysis and activities. The matters to be dealt with in the policy should include, but not necessarily be limited to, an assessment of:
  - a. the sum of tangible and intangible assets of a company;
  - b. the quality of the company's integrated reporting dealing with the long-term sustainability of the company's strategy and operations. If integrated reporting has not been applied, due enquiry should be made on the reasons for this;
  - c. the manner in which the business of the company is being conducted based on, for example, alignment with targeted investment strategies of the institutional investor and the code of conduct and supply chain code of conduct of the company.
2. An institutional investor should ensure implementation of the policy on sustainability considerations, including ESG, and establish processes to monitor compliance with the policy.'

**Principle 2:** An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.

3. An institutional investor should develop a policy dealing with ownership responsibilities. The policy should include, but not necessarily be limited to the following:
  - a. guidelines to be applied (e.g. King III) for the identification of sustainability concerns, including ESG, at a company.
  - b. mechanisms of intervention and engagement with the company when concerns have been identified and the means of escalation of activities as a shareholder if these concerns cannot be resolved.
  - c. voting at shareholder meetings, including the criteria that are used to reach voting decisions and for public disclosure of full voting records
4. Even if passive investment strategies are followed, active voting policies incorporating sustainability considerations, including ESG, should still be followed.
5. An institutional investor should ensure implementation of the policy on ownership responsibilities and establish processes to monitor compliance with the policy.
6. Where the institutional investor outsources to third party service providers, the onus is on the institutional investor as owner to ensure that the mandate deals with sustainability concerns, including ESG, and that there are processes to oversee that the service providers apply the provisions of CRISA when executing their mandate.
7. The institutional investor should introduce controls that prevent it from receiving price sensitive information regarding a company or acting on such information in a manner that makes it an 'insider' in terms of the Securities Services Act No 36 of 2004. These controls should be applied when engaging with the company, and when seeking any information it requires, whether this is to fulfil its duties or to act within the guidelines of CRISA.

**Principle 3:** Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.

8. An institutional investor should consider a collaborative approach to work jointly with other shareholders, service providers, regulators, investee companies and ultimate beneficiaries to, where appropriate, promote acceptance and implementation of CRISA and sound governance. Parties should be aware of the consequences of acting in concert in terms of applicable legislation.

**Principle 4:** An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should pro-actively manage these when they occur.

9. All of the circumstances and relationships that could potentially lead to a conflict of interest should be identified by the institutional investor and a policy for preventing and managing these conflicts should be

developed.

10. An institutional investor should ensure implementation of the policy on prevention and management of conflicts of interests and establish processes to monitor compliance with this policy.

**Principle 5:** Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

11. An institutional investor should regularly engage with its stakeholder groupings, including investee companies and the ultimate beneficiaries, in order to, inter alia, identify and understand information requirements and, at least once a year, fully and publicly disclose to what extent it applies to CRISA.
12. If an institutional investor does not apply some or any of the principles or recommendations in CRISA or applies them differently from how they are set out, it should in a transparent manner explain the reasons for this and the alternative measures employed.
13. The disclosure by institutional investors should be made public in order that it is readily accessible by all stakeholders, including investee companies and the ultimate beneficiaries.
14. The following policies should be disclosed publicly upon CRISA becoming effective and subsequently in the event of changes to the policies:
  - a. policy on incorporation of sustainability considerations, including ESG, into investment analysis and investment activities with reference to the matters as set out under Principle 1.
  - b. policy in regard to ownership responsibilities, including voting as set out under Principle 2.
  - c. policy on identification, prevention and management of conflicts of interests as set out under Principle 4.
15. Non-disclosure of voting records by an institutional investor and its service providers precludes the investee company the opportunity to engage with the institutional investor or its service providers regarding the vote exercised. Therefore an institutional investor and its service providers should, before agreeing to a proxy or other instruction to keep voting records confidential, carefully consider the reasons put forward to justify confidentiality.
16. Disclosure of policies should be reinforced by clear explanation of how the commitments made in the policies were practically implemented and monitored during the reporting period.
17. There should be disclosure by an institutional investor of processes to ensure that its service providers apply CRISA as well as the requirements of the institutional investor's policies.'

## Annexure 4: Pension Funds Act Regulation 28 (July 2011 w.e.f Jan 2012)

### *Asset spreading requirements.—*

#### *Preamble—*

A fund has a fiduciary duty to act in the best interest of its members whose benefits depend on the responsible management of fund assets. This duty supports the adoption of a responsible investment approach to deploying capital into markets that will earn adequate risk adjusted returns suitable for the fund's specific member profile, liquidity needs and liabilities. Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund's assets, including factors of an environmental, social and governance character. This concept applies across all assets and categories of assets and should promote the interests of a fund in a stable and transparent environment.

#### *(1) Definitions.—*

In this regulation—

“Act” means the Pension Funds Act, 1956 (Act No. 24 of 1956), and any word or expression to which a meaning is assigned in the Act is assigned to it in this regulation, unless otherwise defined;

“collective investment scheme” has the meaning assigned to it in section 1 of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002);

“credit ratings” means credit ratings issued by a credit rating agency as may be prescribed;

“derivative instrument” has the meaning assigned to it in section 1 of the Securities Services Act, 2004 (Act No. 36 of 2004);

“exchange” means—

(a) an exchange licensed under section 10 of the Securities Services Act, 2004 (Act No. 36 of 2004);

(b) any other exchange that is a full member of the World Federation of Exchanges; or

(c) where a fund invests in a collective investment scheme, such an exchange as is referred to in Section 45 (b) (ii) of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002);

“fair value” has the meaning assigned to it in financial reporting standards and includes any other conditions as may be prescribed;

“financial reporting standards” has the meaning assigned to it in the Companies Act, 2008 (Act No. 71 of 2008);

“foreign asset” means an asset that is deemed foreign by the South African Reserve Bank for its reporting purposes, and subject to conditions as may be prescribed;

“foreign bank” means a bank that is not a South African bank and is domiciled, registered and supervised as a bank outside of South Africa;

“fund member policy” has the meaning assigned to it in Part 5A of the Regulations issued under the Long-term Insurance Act;

“fund of hedge funds” means a portfolio that invests only in hedge funds, but may also hold notes, coins, and a balance or deposit in a savings, current or money market account with a South African bank or a foreign bank, and subject to conditions as may be prescribed;

“fund of private equity funds” means a portfolio that invests only in private equity funds, but may also hold notes, coins, and a balance or deposit in a savings, current or money market account with a South African bank or a foreign bank, and subject to conditions as may be prescribed;

“hedge fund” means an asset—

(a) which uses any strategy or takes any position that could result in the portfolio incurring losses greater than its fair value at any point in time, and which strategies or positions include but are not limited to leverage and net short positions;

(b) managed by a person licensed as a hedge fund Financial Services Provider as defined in the Code of Conduct for Administrative and Discretionary Financial Service Providers, 2003, or if a foreign hedge fund managed by a person licensed as a Category I Financial Services Provider that is authorized to render financial services on securities and instruments as defined in the Determination Of Fit And Proper Requirements For Financial Services Providers, 2008; and

(c) subject to conditions as may be prescribed;

“investment policy statement” means a document which, at least—

(a) describes a fund’s general investment philosophy and objectives as determined by its liability profile and risk appetite;

(b) addresses the principles referred to in subregulation (2) (c); and

(c) complies with conditions as may be prescribed;

“Islamic debt instrument” means a bond based on the ownership of an underlying immovable property or a tangible asset or portfolio of immovable properties or tangible assets, governed by Shari’ah rules, and that is issued by—

(a) the Government of the Republic;

(b) the South African Reserve Bank;

(c) any public entity listed in the Public Finance Management Act, 1999 (Act No. 1 of 1999);

(d) a South African bank; or

(e) a foreign bank

that is negotiable and in respect of which the title to the underlying property or asset or portfolio of properties and assets is vested in a special purpose vehicle that derives its income from commercial activities related to that property, asset or portfolio;

“Islamic liquidity management financial instrument” means a financial instrument, governed by Shari’ah rules, issued by a South African bank or a foreign bank—

(a) that is negotiable; and

(b) in respect of which ownership of the underlying tangible asset or assets passes from a fund to a third party within seven business days from the date of purchase thereof, and at which purchase date the future sale price of the tangible asset or assets is fixed notwithstanding any increase or decrease in the fair value thereof;

“listed” means to be compliant with the listings and disclosure requirements of an exchange and any other condition as may be prescribed;

“Long-term Insurance Act” means the Long-term Insurance Act, 1998 (Act No. 52 of 1998);

“long-term insurer” means a person registered or deemed to be registered as a long-term insurer in terms of the Long-term Insurance Act;

“pension preservation fund” has the meaning assigned to it in section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962);

“PostBank” means the SA Post Office Limited established pursuant to section 3 the Post Office Act, 1958 (Act No. 44 of 1958), and the South African Postbank Limited Act, 2010 (Act No. 9 of 2010);

“prescribed” means prescribed by the Registrar by notice on the official website, as defined in section 1 of the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002) of the Financial Services Board, unless notice in the *Gazette* is specifically required under a provision of the Act;

“private equity fund” means a managed pool of capital that—

(a) has as its main business the making of equity, equity orientated or equity related investments in unlisted companies to earn income and capital gains;

(b) is not offered to the public as contemplated in the Companies Act, 2008 (Act No. 71 of 2008);

(c) is managed by a person licensed as a discretionary Financial Services Provider as defined in the Code of Conduct for Administrative and Discretionary Financial Service Providers, 2003, or if a foreign private equity fund managed by a person licensed as a Category I Financial Services Provider that is authorized to render financial services on securities and instruments as defined in the Determination Of Fit And Proper Requirements For Financial Services Providers, 2008; and

(d) is subject to conditions as may be prescribed;

“property company” means a company—

(a) of which 75% or more of the fair value of its assets consists of immovable property, irrespective of

whether such property is held directly by that company as registered owner, or indirectly through ownership of the shares or the exercise of control over another company that is the registered owner of the property; or

- (b) of which 75% or more of its income is derived from investments in immovable property, or from an investment in a company of which 75% or more of the income of that company is derived from investments in immovable property;

“provident preservation fund” has the meaning assigned to it in section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962);

“reporting period” means the financial year determined in the rules of a fund;

“South African bank” means a bank or branch as defined in and registered under the Banks Act, 1990 (Act No. 94 of 1990), a mutual bank as defined and registered under in the Mutual Banks Act, 1993 (Act No. 124 of 1993), a cooperative bank as defined in the Cooperative Banks Act, 2007 (Act No. 40 of 2007), or the PostBank.

**(2) Principles—**

- (a) A fund must at all times comply with the limits as set out in this regulation.
- (b) A fund must have an investment policy statement, which must be reviewed at least annually.
- (c) A fund and its board must at all times apply the following principles—
  - (i) promote the education of the board with respect to pension fund investment, governance and other related matters;
  - (ii) monitor compliance with this regulation by its advisors and service providers;
  - (iii) in contracting services to the fund or its board, consider the need to promote broad-based black economic empowerment of those providing services;
  - (iv) ensure that the fund’s assets are appropriate for its liabilities;
  - (v) before making a contractual commitment to invest in a third party managed asset or investing in an asset, perform reasonable due diligence taking into account risks relevant to the investment including, but not limited to, credit, market and liquidity risks, as well as operational risk for assets not listed on an exchange;
  - (vi) in addition to (v), before making a contractual commitment to invest in a third party managed foreign asset or investing in a foreign asset, perform reasonable due diligence taking into account risks relevant to a foreign asset including but not limited to currency and country risks;
  - (vii) in performing the due diligence referred to in (v) and (vi), a fund may take credit ratings into account, but such credit ratings should not be relied on in isolation for risk assessment or analysis of an asset, should not be to the exclusion of a fund’s own due diligence, and the use of such credit ratings shall in no way relieve a fund of its obligation to comply with all the principles set out in paragraph 2 (c);
  - (viii) understand the changing risk profile of assets of the fund over time, taking into account comprehensive risk analysis, including but not limited to credit, market, liquidity and operational risk, and currency, geographic and sovereign risk of foreign assets; and
  - (ix) before making an investment in and while invested in an asset consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an environmental, social and governance character.
- (d) With the appointment of third parties to perform functions which are required to be performed in order to comply with the principles in (c) above, the fund retains the responsibility for compliance with such principles.

**(3) Asset limits—**

- (a) A fund must only hold assets and categories of assets referred to in Table 1 and must comply with the limits set out in this regulation.
- (b) Any portion of a fund’s total assets associated with a specific category of members, or a specific member where the fund provides individual member choice, must comply with the limits in this regulation.
- (c) Notwithstanding (a) and (b), the portion of the total assets of a retirement annuity fund, pension preservation fund or provident preservation fund that is associated with a fund member policy, or with

another contractual arrangement between the member and the fund relating exclusively to the fund's liability to a particular member (or to the surviving spouse, children, dependants or nominees of the member) in terms of the rules of the fund, entered into before 1 April 2011, need not comply with the limits set out in this regulation until—

- (i) the contractual terms relating to the amount or frequency of premiums or contributions payable in terms of the policy or other contractual arrangement are amended, including where an additional amount over and above any regular contractual premium or contribution is contributed to the policy or arrangement; or
  - (ii) any change is made to the category of underlying assets held in respect of the policy or arrangement.
- (d) A fund must not invest or contractually commit to invest in an asset, including a hedge fund or private equity fund, where the fund may suffer a loss in excess of its investment or contractual commitment in the asset. This does not preclude a fund from investing in derivative instruments subject to subregulation (7). Hedge funds and private equity funds that may expose the fund to a liability must be held in a limited liability structure.
- (e) Assets and categories of assets referred to in Table 1 must be calculated at fair value for reporting purposes.
- (f) The aggregate exposure to assets specified in the following items of Table 1 must not exceed 35 percent of the aggregate fair value of the total assets of a fund—
- (i) item 2.1 (e) (ii): Other debt instruments not listed on an exchange;
  - (ii) item 3.1 (b): Preference and ordinary shares in companies, excluding shares in property companies, not listed on an exchange;
  - (iii) item 4.1 (b): Immovable property, preference and ordinary shares in property companies, and linked units comprising shares linked to debentures in property companies, not listed on an exchange; and
  - (iv) item 8: Hedge funds, private equity funds and any other asset not referred to in this schedule.
- (g) The aggregate exposure to assets specified in the following items of Table 1 must not exceed 15 percent of the aggregate fair value of the total assets of a fund—
- (i) item 3.1 (b): Preference and ordinary shares in companies, excluding shares in property companies, not listed on an exchange; and
  - (ii) item 8.1 (b): Private equity funds.
- (h) The aggregate exposure by a fund to an issuer or entity by the fund specified in items 1.1 and 2.1 (c) of Table 1, irrespective of the limits referred to in Column 1 of Table 1, must not exceed 25 percent of the aggregate fair value of the total assets of the fund.
- (i) The aggregate exposure to foreign assets, referred to in Column 1 of Table 1 and expressed as a percentage, must not exceed the maximum allowable amount that a fund may invest in foreign assets as determined by the South African Reserve Bank, or such other amount as may be prescribed.
- (j) Notwithstanding paragraphs (a)-(i), the limits set out in this regulation may be exceeded where the excess is due to a change in the fair value or characteristic of an asset, and not as a result of discretionary transacting either by the fund or on the fund's behalf, provided that where a fund exceeds any limit—
- (i) such fund must inform the Registrar without delay of the limit being exceeded, including the reasons for such excess;
  - (ii) such fund must not, for as long as the excess exists, make any further investments or contractual commitments to invest in those assets or categories of assets; and
  - (iii) the board must ensure compliance with the relevant limits within 12 months from the date of the excess arising or such other period as determined by the Registrar.
- (4) **Look-through—**
- (a) A fund must not utilise any asset to circumvent the limits as set out in this regulation and, where an asset is made up of underlying assets, the fund must include and disclose the underlying assets in the category in Table 1 to which the economic exposure of the underlying assets relate.

- (b) Notwithstanding (a), where the fair value of an asset comprises less than 5 percent of the aggregate fair value of the assets of the fund, then the fund need only disclose the categories of assets specified in Table 1, and not each underlying asset.
  - (c) Notwithstanding (a) and (b), any direct or indirect exposure to a hedge fund or private equity fund must be disclosed as an investment into a hedge fund or private equity fund as the case may be, and the fund need not apply the look-through principle in respect of the underlying assets of a hedge fund or private equity fund.
  - (d) Notwithstanding (b) and (c), and in accordance with conditions set by the South African Reserve Bank, when applying look-through any direct or indirect exposure to a foreign asset must be disclosed as a foreign asset.
- (5) **Borrowing**—
- (a) A fund must not borrow.
  - (b) Notwithstanding (a)—
    - (i) a fund may only borrow money for bridging purposes to maintain sufficient liquidity to meet its operational requirements;
    - (ii) the aggregate of any loans for bridging purposes must not, throughout the financial year as determined in the rules of a fund, exceed 50 percent of the gross income of the fund (income of the fund before payment of management fees and administration fees) during the preceding financial year;
    - (iii) any loan for bridging purposes must be repaid within 12 months of entering into the loan; and
    - (iv) any loan for bridging purposes must not be subject to an early settlement penalty.
  - (c) A fund may as collateral for default on a loan referred to in paragraph (b) cede a proportionate share of its assets to the lender.
- (6) **Securities lending**—
- A fund may engage in securities lending subject to conditions as prescribed.
- (7) **Derivative instruments**—
- Notwithstanding subregulation 3 (d), a fund may invest in derivative instruments subject to conditions as prescribed.
- (8) **Reporting and exclusions**—
- (a) The Registrar may prescribe the format, content and any other particulars in respect of the disclosure of compliance with this regulation.
  - (b) In applying the limits set out in this regulation, subject to such prescribed reporting and disclosure, a fund may exclude the following assets or categories of assets—
    - (i) participatory interests in a collective investment scheme, in respect of which a fund obtained a certificate issued by the scheme at the end of the financial year of the fund, confirming that the assets of the scheme relevant to the fund have complied with the limits as set out in this regulation, provided that—
      - (aa) the auditor of the scheme confirms the accuracy of the certificate at the financial year end of the scheme; and
      - (bb) the confirmation is made available to the fund on request;
    - (ii) a linked policy as defined in the Long-term Insurance Act, in respect of which a fund obtained a certificate issued by the long-term insurer at the end of the financial year of the fund, confirming that the assets held by the insurer in respect of its net liabilities under the said policy have complied with the limits as set out in this regulation, provided that—
      - (aa) the auditor of the insurer confirms the accuracy of the certificate at the financial year end of the insurer; and
      - (bb) the confirmation is made available to the fund on request;
    - (iii) a long-term policy as defined in the Long-term Insurance Act, other than a policy referred to in paragraph (ii) above, that guarantees or partially guarantees policy benefits and in respect of



which a fund obtained a certificate issued by the statutory actuary of the long-term insurer that the guarantee or partial guarantee is consistent with guidance issued by the Registrar of Long-term Insurance, under the Long-term Insurance Act, in respect of what constitutes a guarantee or partial guarantee for purposes of this sub-regulation, provided that—

- (aa) the auditor of the insurer confirms the accuracy of the certificate at the financial year end of the insurer; and
- (bb) the confirmation is made available to the fund on request; and
- (iv) an asset issued by an entity that is regulated by the Financial Services Board, in respect of which a fund obtained a certificate issued by the auditor of the issuer of the asset at the end of the financial year of the fund, confirming that the underlying assets in respect of such asset have complied with the limits as set out in this regulation, and subject to conditions as may be prescribed.

***Exemptions—***

The Registrar may on written application by a fund or in general, exempt a fund, or categories, types or kinds of funds, from all or any of the provisions of this regulation, subject to conditions that the Registrar may impose.

*[Table 1 with asset allocation limits not included]*

## Annexure 5: Pension Funds Act Regulation 37 (Aug 2017 w.e.f Mar 2019)

Published by the Minister of Finance<sup>203</sup> in terms of section 36 of the Pension Funds Act, 1956.

### Default investment portfolio(s).-

- (1) The board of a fund with a defined contribution category, to which members belong as a condition of employment, must include in its investment policy statement<sup>204</sup> the provision of one or more default investment portfolios.
- (2) The board must ensure, and be able to demonstrate to the Registrar on request, that-

***Default investment portfolio(s) are appropriate for the members who will be automatically enrolled into them***

- (a) the design of the default investment portfolio,<sup>205</sup> including its-
  - (i) objective;
  - (ii) underlying asset allocation;
  - (iii) fees and charges; and
  - (iv) the expected risks and returns to which it exposes members whose retirement savings in that fund are or will be invested in the default investment portfolio,

is appropriate to that category of members whose retirement funding contributions and retirement savings<sup>206</sup> are or will be invested in the default investment portfolio(s);

***The composition of assets and performance of the default investment portfolio are adequately communicated***

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<sup>203</sup> In Government Notice 863 published in the *Government Gazette* No 41064 of 25 August 2017.

<sup>204</sup> The term 'investment policy statement' is defined in PFA Regulation 28(1) as follows:

“investment policy statement” means a document which, at least—

- (a) describes a fund's general investment philosophy and objectives as determined by its liability profile and risk appetite;
- (b) addresses the principles referred to in subregulation (2) (c); and
- (c) complies with conditions as may be prescribe.’

<sup>205</sup> The terms 'investment portfolio' and 'default investment portfolio' are defined in the regulations as follows:

"investment portfolio" means an identifiable portfolio of assets whether those assets are-

- (a) owned by the fund; and/or
- (b) owned by an insurer which has issued to the fund a policy in terms of which policy benefits are directly or indirectly based on the returns on the investment of those assets; and/or
- (c) assets held by a collective investment scheme or pooled fund of which the fund or an insurer contemplated in part (b) is a unit-holder,

in which the fund has invested retirement funding contributions and/or has decided to include in the range of investment options in which retirement funding contributions may be invested;

“default investment portfolio” means an investment portfolio(s) in which the retirement funding contributions of a member must be invested unless the fund has been instructed by the member in writing to invest them in another investment portfolio provided in terms of the investment policy statement of the fund or options available to members of the fund, and which portfolio(s)-

- (a) complies with the requirements set out in Regulation 37;
- (b) may differ in composition from member to member depending on:
  - (i) the age or likely date of retirement from service of each member;
  - (ii) the value of the retirement savings of the member in that fund;
  - (iii) the actual or expected retirement funding contributions of the member; or
  - (iv) any other factor reasonably considered by the board to be appropriate in respect of that member; and
- (c) complies with any conditions that may be prescribed.’

<sup>206</sup> The terms 'retirement funding contributions' and 'retirement savings' are defined in the regulations as follows:

“retirement funding contributions” in a defined contribution category of a fund, means that part of the contributions or transfer values paid to the fund by or in respect of a member, which are applied towards retirement savings in terms of the rules of the fund.’

“retirement savings” in a defined contribution category of a fund, means the member's individual account.’

*to members*

- (b) the composition of assets and performance of the default investment portfolio(s), and fund returns are communicated to members on a frequency and format which may be prescribed;

***Default investment portfolios are reasonably priced and competitive***

- (c) the fees and charges in respect of the default investment portfolio(s) or the assets held in respect of the default investment portfolio(s) are reasonable and competitive, taking account of the size, asset allocation and other characteristics of the fund;

***All fees and charges are disclosed***

- (d) all fees and charges, whether borne directly or indirectly by the fund, implicit or explicit, are disclosed on a regular basis to boards and the relevant information is appropriately disclosed to members, in a clear and understandable language, and in formats which may be prescribed;

***Both passive and active investment must be considered as investment options***

- (e) it considers both passive and active investment strategies as part of the default investment portfolio;

***No loyalty bonuses or other complex fee structures***

- (f) no fees or charges deducted from or amounts credited to members' retirement savings or retirement funding contributions or otherwise paid to members by any service provider in respect of the default investment portfolio may depend on the length of time that an individual has been a member of the fund, the number of contributions made by the member or any similar measure;

***Members are not locked into the default investment portfolio***

- (g) where member investment choice is provided in the rules, members may, at least once every twelve (12) months, instruct the fund to transfer their retirement savings from the default investment portfolio into any other investment portfolios offered in terms of the investment policy statement, in respect of which transfer the fund may deduct reasonable administration costs; and

***The default investment portfolio is reviewed***

- (h) it reviews the default investment portfolio(s) on a regular basis to ensure that it continues to comply with this regulation;

***Exemption***

- (3) The Registrar may on written application by a fund or in general, exempt a fund, or categories, types or kinds of funds, from all or any of the provisions of these regulations, subject to conditions that the Registrar may impose.

## Annexure 6: Draft sustainability reporting and disclosure requirements (March 2018)

**DIRECTIVE PF NO. XXX**  
FINANCIAL SERVICES BOARD  
PENSION FUNDS ACT, 1956

### SUSTAINABILITY REPORTING AND DISCLOSURE REQUIREMENTS

I, Dube Phineas Tshidi, Registrar of Pension Funds, hereby, in terms of regulation 28(8)(a) of the Regulations, publish for comment a draft Directive to be issued to prescribe the following requirements to ensure compliance with Regulation 28(2)(c)(ix).

#### *Introduction*

1. Regulation 28(2)(b) of the regulations to the Pension Funds Act, 1956 (“the PFA”) requires all funds to have an investment policy statement and Regulation 28(2)(c)(ix) requires that boards of funds consider environmental, social and governance factors before investing in an asset. This directive provides guidance in respect of the content of some of the essential aspects of an investment policy statement and the manner in which that content is disclosed by pension funds.
2. Regulation 28 promotes responsible investing of pension fund assets, based on a sustainable, long-term, risk aligned and liability-driven investment philosophy. The preamble to regulation 28 expects pension funds when they are investing their assets to:

“... give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social or governance character. This concept applies across all assets and categories of assets and should promote the interests of a fund in a stable and transparent environment.”
3. This requirement to consider the sustainability of a fund’s assets is repeated in the principle contained in regulation 28(2)(c)(ix), which states that a fund and its board must:

“...before making an investment in and while invested in an asset consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an environmental, social and governance character.”
4. In order for the Registrar to monitor compliance with this important principle and to enable stakeholders to ascertain compliance with it, pension funds are required to adhere to the requirements set out in this directive.

#### *Definitions*

5. In this Directive:
  - 5.1 Terms defined in the PFA and the regulations have the same meaning, unless a term is differently defined below, or the context indicates otherwise.
  - 5.2 The following words and terms have the meanings indicated:

“active ownership” means the prudent fulfilment of responsibilities relating to the ownership of, or an interest in, an asset. These responsibilities include, but are not limited to:

    - (a) guidelines to be applied for the identification of sustainability concerns in that asset;
    - (b) mechanisms of intervention and engagement with the responsible persons in respect of the asset when concerns have been identified and the means of escalation of activities as a holder or owner of that asset if these concerns cannot be resolved;
    - (c) voting at shareholder meetings, or meetings of owners or holders of an asset, including the criteria that are used to reach voting decisions and for public disclosure of full voting records.

“asset class” means a category of asset, whether or not it is located in the Republic, and as referred to in Table 1 of Regulation 28;

“assets” means any type of asset that may be held by a pension fund, as referred to in Table 1 of Regulation 28; and “asset” has a corresponding meaning;

“effective date” means the effective date of this Directive, as published by the Registrar;

“ESG” means environmental, social and governance;

“FSP” has the same meaning as the term “authorised financial services provider” in section 1 of the

Financial Advisory and Intermediary Services Act, 2002

“sustainability” means the ability of an entity to conduct its operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs. Sustainability includes managing the impact that the business of an entity has on the life of the community, the broader South African economy and the natural environment in which it operates. It also includes the converse, namely considering the effects that the society, economy and environment have on business strategy. Sustainability includes economic and ESG considerations. “Sustainable” has a meaning consistent with this.

#### ***Investment Policy Statement Requirements***

6. As the sustainability of the assets of a pension fund is a key factor that should inform its investment policy, every pension fund must reflect in its investment policy statement:
  - 6.1 How its investment approach ensures the sustainable long term performance of its assets;
  - 6.2 Its policy in applying ESG factors to the assets it intends to acquire
  - 6.3 How regularly it measures the compliance of its assets with these ESG factors and its sustainability criteria, in particular, the manner in which broad based black economic empowerment is advanced by the business;
  - 6.4 Its active ownership policy;
  - 6.5 The requirement that the provisions of 6.1 – 6.4, to the extent applicable, be reflected in the mandate given by the pension fund to each FSP engaged by it.
7. Where a pension fund holds assets that limit the application of ESG factors, the sustainability criteria, or the full application of an active ownership policy, the investment policy statement must state the reasons as to why this limitation is to the advantage of both the pension fund and its membership. Alternatively, the investment policy statement must set out the remedial action the fund has taken or intends taking to rectify the position.
8. Every pension fund must make available on request and at no cost, to each member and, if applicable, to each participating employer, its investment policy statement; provided that the investment policy statement may be abridged to reflect those assets relating to a category of members as long as the requirements of paragraphs 6 and 7 in relation to those assets are contained in the abridged investment policy statement.
9. If a pension fund has a website, the provisions of paragraphs 6 and 7 must be set out on the website and be accessible to any person, whether or not a member.
10. The provisions of paragraphs 6 to 9 must be implemented no later than six (6) months after the effective date of this directive.

#### ***Reporting and provision of information to stakeholders***

11. Every pension fund must, in each set of financial statements referred to in section 15(1) as well as in its annual trustee report to members or in any other appropriate communication to its members, include in such a report by the board of the fund the details of:
  - 11.1 how it has applied the provisions of paragraphs 6.1 to 6.5;
  - 11.2 the extent of any non-compliance with these provisions; and
  - 11.3 any changes in its investment policy statement during the reporting period.
12. Every pension fund must state in its annual trustee report :-
  - 12.1 that every member is entitled to a copy of its investment policy statement and the report referred in 11 above;
  - 12.2 Briefly, any change to the investment policy statement from the previous year, including specifically any changes in respect of paragraphs 6.1 - 6.4.
13. Every pension fund must, at least on an annual basis, provide a copy of its investment statement and any changes thereto as referred to in 12.2. to all participating employers in the fund and where there is a representative union or unions in respect of the members of the fund, to the union or unions as the case may be.
14. The provisions of paragraphs 11 to 13 must be implemented by no later than twelve months after the effective date of this directive.

***General***

15. The Registrar may grant exemption from any of the requirements in this directive on application to the Registrar.

D P TSHIDI

Registrar of Pension Funds

Date:

# PENSION FUNDS AND CLIMATE RISK



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