



Natal Joint Municipal Pension  
KwaZulu-Natal Joint Municipal  
Provident Funds

"Your Fund, Your Savings, Your Future"



31 March 2011 updated to 31 May 2013

# **INVESTMENT POLICY STATEMENT**

**OF THE**

**NATAL JOINT MUNICIPAL  
PENSION FUND  
(SUPERANNUATION)**

Introduction	1
Duties and Roles of Parties Involved with Fund's Investments	2
Governance Principles	3
Analysis of Liabilities of the Fund	10
Investment Objectives	11
Investment Risks	12
Investment Strategy	16
Portfolio construction and Asset Manager Selection	17
Portfolio Benchmarks and Performance Reviews	18
Communication to Stakeholders	19
Conclusion	20
Appendices:	
Annexure 1 – Regulation 28 of the Pension Funds Act Of 1956	21
Annexure 2 – Annexure B to PF Circular 130	24
Annexure 3 – Benchmarks	31
Annexure 4 – Proxy voting Guidelines for Asset Managers	32
Annexure 5 - Assumptions used in Asset/liability modelling analysis	37
Annexure 6 – Valuation by the Fund's Actuary	38

## 1. INTRODUCTION

This document has been prepared to record the issues considered by the Committee of Management ("COM") of the Natal Joint Municipal Pension Fund (Superannuation) ("the Fund") in establishing an appropriate investment policy for the Fund, as well as to record the investment strategy that the Fund has decided to implement, in accordance with this policy.

This investment policy adheres to the requirements of Regulation 28 of the Pension Funds Act of 1956, and was established in accordance with PF Circular 130 issued by the Financial Services Board ("FSB") as far as this was practical and appropriate. Copies of Regulation 28 and Annexure B to PF130 are appended hereto as Appendices 1 and 2 respectively. The limits imposed by Regulation 28 are attached in Annexure 1.

Regulation 28 states that "*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"*

Regulation 28 of the Pension Funds Act, 1956, was amended and the latest version is effective 1 July 2011. To the extent that this amended Regulation 28 differs from PF130, Regulation 28 will apply.

This policy was developed by the COM together with their appointed Asset Consultant Asset Consultants and the Fund's Actuary. The investment strategy was designed in consultation with the Asset Consultant, and the appointed asset managers where appropriate.

The Fund has a defined benefit structure, and the benefits are set out in the Fund's rules. The COM realises the tremendous importance that future investment returns will have on the cost of meeting these benefits, particularly those payable on retirement.

The COM objective in drafting this document was to: -

- i. Document the Fund's investment policy statement, and summarise the investment strategy established in accordance with this policy.
- ii. Clearly set out the decision-making responsibilities relating to the Fund's assets.
- iii. Provide a framework for the effective implementation and review of all components of the investment strategy.
- iv. Assist stakeholders, including the COM themselves, in understanding the investment policy and strategies of the Fund, and to be able to communicate a summarised version of this investment policy to all stakeholders.
- v. Demonstrate adherence to PF Circular 130, as far as this is appropriate and practical, and the Pension Funds Act of 1956.
- vi. Provide a mechanism to ensure continuity of decision making across generations of members of the COM.
- vii. Document the principles raised in *Regulation 28 of the Pension Funds Act, 1956*, that are required to be documented in the Fund's Investment Policy Statement.

This Investment Policy Document will be updated from time to time, as circumstances dictate but at least annually as required by Regulation 28. All material changes and updates will be captured in this Policy Document.

## 2. DUTIES AND ROLES OF PARTIES INVOLVED WITH FUND'S INVESTMENTS

The COM is ultimately responsible for the Fund's assets, the investment of those assets and the assets' investment performance. The COM can not relinquish or cede these responsibilities but is however, permitted to delegate certain of the actions and activities related to the management of the Fund's assets.

The COM is aware that they are in a position of trust, looking after money that belongs to other people and that members and the employer, given the defined benefit nature of the Fund, can reasonably expect the COM to act prudently.

Whenever the COM is required to make a decision, the decision should always be in the interest of the members rather than any third party or the COM themselves.

The COM has not appointed an investment sub-committee and deals with all investment matters itself.

In some cases the COM will not be fully conversant with the complexity of investment matters. In this situation the Pension Funds Act requires that the COM obtain expert advice from *inter alia* an investment consultant and the Fund's Actuary. The COM will critically evaluate this advice before making any decision.

The roles and responsibilities of the different parties involved in establishing an investment policy and implementing the investment strategy can be summarised as follows:

<b>COM</b>	<ul style="list-style-type: none"> <li>▪ Establish an appropriate Investment Policy Document with assistance of specialists where necessary.</li> <li>▪ Design a Fund-specific Investment Strategy with the assistance of specialists where necessary.</li> <li>▪ Review the Investment Policy annually, and amend as appropriate</li> <li>▪ Make adjustments to the Investment Strategy when necessary to ensure adherence to the policy and achievement of investment objectives.</li> <li>▪ Monitor performance of the Investment Strategy on a regular basis.</li> </ul>
<b>Asset Consultant</b>	<ul style="list-style-type: none"> <li>▪ Provide investment advice to the COM.</li> <li>▪ Assist the COM with the implementation of investment decisions.</li> <li>▪ Assist with the monitoring of investment performance, asset managers and other aspects of the investment strategy.</li> <li>▪ Provide recommendations on strategic asset allocation decision, using stochastic asset modelling tools.</li> </ul>
<b>Actuary</b>	<ul style="list-style-type: none"> <li>▪ Approve that the investment policy is appropriate considering the liabilities of the Fund, using appropriate stochastic asset modelling tools.</li> <li>▪ Be satisfied that the chosen investment strategy is expected to result in an appropriate relationship between the assets and the liabilities of the Fund</li> </ul>
<b>Asset/Manager</b>	<ul style="list-style-type: none"> <li>▪ Manage assets within legislative requirements and in the best interests of the Fund.</li> <li>▪ Achieve the investment return objectives set by the COM, relative to appropriate investment benchmarks.</li> <li>▪ Adhere to the investment mandate agreed with the Fund.</li> </ul>

### 3. GOVERNANCE PRINCIPLES

Good standards of governance should ensure that the Fund's investments are managed appropriately and will collectively reduce the risk of material failure of an investment strategy. Governance principles hence define the framework of an investment policy.

The Fund is firstly governed by the Pension Funds Act of 1956. Regulation 28 of the Act is concerned with pension fund investments. By law the Fund must adhere to Regulation 28.

The COM has taken note of PF Circular 130 issued by the FSB ("PF130"). Whilst FSB circulars are not legally binding on retirement funds, the COM recognises these as "recommended practice" and aim to adhere to PF130 as far as it is deemed appropriate to do so.

A number of principles of good governance that specifically relate to investments have been identified by the COM. Many of these are contained in Annexure B of PF130.

The COM's views and actions pertaining to each of these governance principles are summarised below, together extracts from PF130 (where applicable). The principles are split between those over which the COM have a direct influence, and those that are delegated to the managers appointed to manage the Fund's assets.

For the latter, the COM will review the principles applied by the manager. Where these principles are not in line with the principles that the COM would wish to have applied, the COM will consider changing the Fund's investments to those that are more likely to meet the principles that the COM would wish to have applied.

The governance principles set out in this section will be used as a checklist when considering and evaluating any new investment portfolios. Other principles may be added to the list over time, as and when such issues find their way into the COM discussions.

#### 3.1 Matters over which the COM has direct influence:

##### 3.1.1 Conflicts of interest:

PF 130 states: *"The Trustees should distinguish between conflicts of interest which may be structural, and therefore unavoidable, and those conflicts that can be avoided or, if this does not compromise the credibility of the governance arrangements, managed appropriately."*

The COM agrees that conflicts of interest should be avoided where possible. However, the COM realises that not all conflicts can be avoided, and that certain unavoidable conflicts will thus need to be carefully managed. Further, the COM is of opinion that the benefits to be gained from completely avoiding certain conflicts of interest can be overshadowed by the resulting costs or complexities. Each conflict situation should thus be considered independently. The COM will require all service providers to highlight any areas of conflict of interest in their operations, as far as it relates to the Fund.

Similarly, members of the COM will be expected to disclose where a member has a conflict of interest, and refrain from participating in any related decision.

##### 3.1.2 Pooled or Segregated Investment Portfolios:

PF130 States: *"The Investment policy statement should (state) whether the investments of the fund are in the form of an insurance policy or a segregated mandate, and the reasons therefore."*

The COM has considered the benefits and disadvantage of both approaches, being to hold the assets in the name of the Fund (via segregated mandates), or to invest in pooled investment portfolios through which the Fund's interests are represented by the value of an insurance policy.

The COM considers it prudent to retain the assets in the name of the Fund and in all cases, where the size of the portfolio is not a constraint requiring investment in a pooled portfolio, will invest in segregated portfolios. However, if a pooled fund is the only option available for an investment that the COM considers appropriate for the Fund, such fund will be used

### **3.1.3 Pledging and Borrowing of Assets, and Lending against the Fund:**

Both of the above activities are envisaged by PF130, although the Circular states in both instances that *“extreme care and caution should be taken when considering the possibility of such activities.”*

The COM is aware of a few circumstances when such actions might be appropriate, or indeed desirable:

- Lending fund assets to members for housing loan purposes, or pledging fund assets under pension-backed lending arrangements;
- Borrowing assets on overdraft to meet short term cash flow needs, instead of liquidating assets;
- Securities lending transactions; and
- Pledging fund assets under certain derivative transactions (futures contracts).

The COM would prefer that the Fund does not go into overdraft.

The COM cannot envisage other circumstances where money would be borrowed by the Fund, or where assets will be loaned out by the Fund.

### **3.1.4 Expert Skills:**

PF 130 states: *“Board members are not obliged to have all the expert skills necessary ... It is reasonable for the board to engage professional accounting, actuarial, investment, legal and other experts... and pay the professionals involved appropriately for that advice.”*

The COM recognises that they do not have the requisite skill, experience or time to spend on detailed investments, legal and actuarial matters. As a result the COM has appointed professional advisors to advise on the construction of investment portfolios using, where appropriate, asset liability modelling, and have appointed investment managers to manage the Fund's assets in accordance with its overall objectives.

The COM appointed Alexander Forbes as the Investment Consultants (“Asset Consultant”), Arthur Els & Associates as the Actuary and J. Leslie Smith & Co as the legal advisor to the Fund.

### **3.1.5 Certification by Fund's Actuary:**

The Pension Fund's Act requires that the Fund's Actuary must certify that he or she is satisfied that the Fund's Investment Policy is consistent with the objectives of the Fund and the management of the risks to which the Fund is exposed, and that the chosen investment strategy will result in an appropriate relationship between the assets and the liabilities of the Fund.

The Actuary performs an annual actuarial valuation of the Fund and, as part of the valuation, reviews the matching of the assets and the liabilities. The Actuary has certified that he is satisfied that the Fund's assets are appropriate for its liabilities.

## **3.2 Matters over which COM has indirect influence**

### **3.2.1 Shareholder activism and Voting Rights:**

PF130 states: *“... the voting rights attached to shares of the companies in which funds are invested should be considered an asset of the fund. Accordingly, the board of the fund would be expected to apply the same fiduciary care and consideration to this asset as it does to the financial investments it makes. The board should formulate and develop appropriate voting policies and incorporate these into their mandates to the asset managers including monitoring and reporting of the same.”*

The COM delegates the exercise of voting rights on shares owned by the Fund to expert asset managers, just as the actual investment management is delegated. However, the COM does believe it is important that asset managers' proxy voting policies be considered when appointing asset managers, or when selecting to invest in their pooled investment portfolios.

Whenever an asset manager or pooled investment portfolio is considered, the COM will require the manager to supply a copy of the manager's proxy voting policy, for review by the COM. The COM has established voting guidelines for the asset managers which are attached and marked as Annexure 5. All asset managers' proxy voting policies will be compared to these Guidelines, to check that these policies are reasonably consistent with the COM requirements.

### **3.2.2 Liquidity risk / termination conditions:**

PF1 130 States: *“Investments should be made taking into account the cash flow needs of the Fund for the coming year... it might not be necessary for a portfolio to hold unnecessary amounts of cash or low yielding liquid assets.”*

The COM recognises that there are occasions where investors can be richly rewarded for holding illiquid investments (for example private equity). Whilst the COM will mandate the asset managers to only hold listed publicly traded instruments, the COM will consider all well-motivated recommendations from the asset managers to invest in more illiquid or unlisted instruments. Such proposals will be considered on a case-by-case basis.

Consideration of asset classes or asset class strategies which by their nature are less liquid (e.g. private equity, listed property and hedge funds) will be done by the COM on a case-by-case basis, and as part of the strategic asset allocation decision.

The COM similarly does not believe it is appropriate for the Fund to be tied to an asset manager (or in fact any service provider) for an extended period of time after a decision is taken to replace such an asset manager. Hence the Fund will generally request notice periods of no more than 30 days when appointing asset managers, unless market conditions dictate that more onerous termination conditions must be accepted.

### **3.2.3 Strategic investments:**

Again, this is not a governance principle discussed specifically in PF130, or in fact in Regulation 28. Strategic investments can be defined as any investments held for strategic purposes, in other words not held solely with the intention to generate exceptional investment performance.

The COM outsources the management of all the Fund's assets to professional asset managers. The COM will not directly be in a position to approve any investments of this nature. Hence the Fund will not hold any strategic investments unless these are selected by the Fund's asset managers on whatever basis they normally use to select investments that they believe have

a very high likelihood of producing investment returns in excess of their benchmarks.

**3.2.4 Use of Derivative Instruments:**

PF130 States: *“... investment in derivatives by asset managers should be clearly and properly regulated. Should they decide to permit this form of investment, trustees of funds should have a clear understanding of the use and risks of derivatives and how they will be measured.”*

The COM believes that the responsible use of derivative instruments has become a necessity to ensure the optimal implementation and management of investment portfolios. Derivatives are also highly efficient instruments to reduce investment risk in portfolios. The COM therefore allows the responsible use of derivative instruments by their asset managers, within specified risk limits (refer Section 6: Investment Risks that are specified in the mandate to the investment managers).

**3.2.5 Appointment of Custodians:**

PF130 States: *“The appointment of the custodian of the fund investments should be made directly by the fund to enable the board to have direct access to the custodian information about the fund investments.”*

The Fund’s assets with each manager are held in segregated portfolios in the name of the Fund. The COM has appointed Nedbank as the Fund’s custodian and has a separate contract setting out full details of the custody arrangement.

**3.2.6 Management Fees and Compensation for Active Fund Management Services:**

PF 130 states: *“The Board of the fund must decide between active and passive asset management and determine whether the concomitant fees of active asset management are justified by the returns achieved.”*

The COM has considered the arguments for and against active asset management, and the associated costs. The COM believes that skilled active asset management, undertaken with the benefit of professional advice on all aspects of the investment strategy, can over time achieve returns in excess of passive (benchmark tracking) investments.

**3.3 Regulation 28 Principles**

Regulation 28 has introduced a number of principles that pension funds are required to address and document in their Investment Policy Statement. The COM has considered these principles and adopted the policies as listed below. To the extent that many of the issues raised previously in PF 130 (Pension Fund Circular 130, issued by the Financial Services Board) have been replaced by Regulation 28, they have been removed from the relevant sections in the Investment Policy Statement, and have been included in the section below.

**3.3.1. “A fund must comply at all times with the limits set out in Regulation 28”**

The COM has considered the limits in Regulation 28 and do not think that these constrain them in any way from achieving what is in the best interests of its members.

The Fund requires the domestic managers to comply with the limits specified in Regulation 28.

The COM requires the managers to report on compliance of all portfolios available to members of the Fund with the limits set out in Regulation 28. Where Regulation 28 does not apply to specific portfolios (for example policies which fall under the Long-term Insurance Act), the necessary certificates from the issuer will be obtained.



The COM will ensure that that the Fund complies with the offshore exposure limit of 25% by repatriating assets in excess of 23% when necessary. The level of 23% was selected so as to ensure continuous compliance with the Regulation 28 limit for offshore of 25%.

**3.3.2. “A fund must have an investment policy statement, which must be reviewed at least annually”**

This document represents the Fund’s Investment Policy Statement, and the COM will review this document at least annually. The annual review will be captured into the annual meeting calendar, where the underlying principles raised in Regulation 28 will be discussed to establish whether any changes are required to the policies, given the changing profile of the membership and the environment in which the Fund operates. The policies relating to the specific principles raised in Regulation 28 are addressed below.

**3.3.3. “A fund and its board must at all times apply the following principles:-”**

**3.3.3.1 “Promote the education of the board with respect to pension fund investment, governance and other related matters;”**

The COM recognises the importance of promoting the education of the committee in all matters related to the management of the Fund, but specifically investments, governance and other related matters. To this end the appointed committee members are expected to maintain and update their knowledge and experience as part of their duty. Formal training will be provided on an ongoing basis.

**3.3.3.2 “Monitor compliance with this regulation by its advisors and service providers;”**

The COM recognises the importance of this regulation in providing a framework that will assist pension fund boards to govern their pension funds. They also recognise that it is therefore important to ensure that their advisors and service providers should be monitored as these parties are relied on by the COM. Specifically, the COM will require their service providers to initially provide a detailed account of how compliance with the regulation is undertaken. The COM will then require an annual report from their service providers on their compliance throughout the period since the last report. Any breaches of compliance with the regulation will be reported, as well as a summary to be included in the annual report.

**3.3.3.3 “In contracting services to the fund or its board, consider the need to promote broad-based black economic empowerment of those providing services;”**

The COM recognises the importance of promoting broad-based black economic empowerment, and the Fund’s ability to assist in this initiative. The COM will first and foremost consider appointing service providers that meet their requirements to assist in managing the Fund, preferring those service providers that are more likely to provide higher quality advice or service. The COM will however prefer service providers with more broad-based black economic empowerment credentials from the service providers that are otherwise seen as providing an equivalent level of service and advice. The COM requires the managers to provide details of their policy with regard to promoting BBEE within their own organisation.

**3.3.3.4 “Ensure that the fund’s assets are appropriate for its liabilities;”**

The COM recognises the importance of the Fund’s liabilities in designing an investment strategy i.e. the considerations of the interactions between the assets and the liabilities with respect to nature (whether real or nominal), term (from short-term, to long-term),

currency (Rand or foreign exchange), and certainty (with respect to timing and amount of receipts and payments).

**3.3.3.5 “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;”**

The COM decides on manager selection on the basis of advice from the Asset Consultant. The COM has also delegated the ongoing due diligence function to the Asset Consultant.

The COM will require their managers to report back regularly (at least annually) to the COM, and will use this opportunity to query their due diligence and risk management systems, processes and people. If the COM is uncomfortable with any aspect of their managers' due diligence capabilities, they will take appropriate action. This action could be the termination of the manager if the COM has no confidence that the manager can address the deficiency within a reasonable timeframe, or engaging with the manager to resolve the deficiency.

**3.3.3.6 “In addition, 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;”**

The COM recognises the additional importance of assessing country and currency risks, when deciding to invest in foreign assets. Currency risk is especially important in the context of a pension fund's liabilities which are denominated in South African Rand. The COM has decided to follow the same due diligence process as above (i.e. delegating the due diligence to the Asset Consultant).

**3.3.3.7 “In performing due diligence referred to in 5 and 6, 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 2.1;” (in Regulation 28)**

The COM recognises that credit rating agencies may be somewhat useful, but also recognise that there are major weaknesses in relying on these ratings in isolation. The COM will delegate the responsibility to perform due diligence on assets to their managers

**3.3.3.8 “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;”**

The COM recognises that the risk profile of individual securities, groups of securities and whole asset classes change over time, as do the liabilities of pension funds. The COM therefore recognises that the investment process is a continuous process requiring constant and continual reassessment of the risks of assets and their appropriateness in isolation and in combination with all the other assets and the liabilities of the Fund. The COM therefore requires ongoing education, information on markets and ongoing evaluation of the changing risk profile of the assets invested in from their managers and Asset Consultant.

**3.3.3.9 “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;”**

The COM recognises the increasing importance of environmental, social and governance factors in social society, and the important role that pension funds (as large institutional investors with significant power if yielded in unison) can have in ensuring responsible corporate behaviour.

The COM will require the managers to report on their internal guidelines with regard to their ESG policies and will, when possible, ensure that appropriate policies are followed.

**3.3.3.10 “With the appointment of third parties to perform functions which are required to be performed in order to comply with the principles ... above, the fund retains the responsibility for compliance with such principles.”**

The COM recognises that they retain the responsibility for compliance with Regulation 28 principles, even when appointing third parties to perform such functions. The COM will therefore provide third parties with the Fund’s policies in respect of the principles raised in Regulation 28, or examine the third parties’ policies in relation to those principles to ensure that they are consistent with the Fund’s own policies. The Fund will also require third parties to report annually on compliance with such policies, or on breaches that may have occurred with reasons for such breaches. The COM has provided the managers with a copy of this IPS.

## 4. ANALYSIS OF THE LIABILITIES OF THE FUND

When deciding on appropriate investments to match the Fund's liabilities, the liabilities need to be analysed both by nature and term. Before analysing the liabilities, it is appropriate to summarise to main characteristics of the Fund.

### 4.1 Fund's Characteristics

The Fund was established in 1942 and is a defined benefit fund with the primary benefits being based on service and salary. The benefits provided by the Fund include:

- Lump sum and monthly pension benefits to members upon early retirement from age 55 to normal retirement at age 65, or on account of ill-health;
- Lump sum and/or monthly pension benefits to spouses and eligible children upon the death of members and pensioners;
- Benefits to members who exit the Fund for reasons other than the above.

### 4.2 Nature of the liabilities

The liabilities of the Fund are determined by the Actuary as the present value of future benefits and pensions.

The Executive Summary of the Actuary's report on the Actuarial Valuation of the Fund as at 31 March 2011 is attached and marked as Annexure 6.

## 5. INVESTMENT OBJECTIVES

The COM has a statutory and fiduciary duty to invest the Fund's assets in a responsible and prudent manner in those asset types such that the long term overall objective of the Fund can be achieved.

The investment objectives of the Fund are as follows:

- a) To achieve a long-term real return of at least CPI plus 5.0% effective 1/4/2011 (previously CPI plus 4.5%) net of investment fees over rolling five-year periods. This long term real rate of return is, in the COM considered opinion, the minimum required.
- b) In addition, the manager is expected to add returns of 2% a year in excess of that achieved from the passive benchmark portfolio (see Annexure 3), measured over rolling five- year periods.

In re-evaluating the objectives of the Fund, and understanding how different investment strategies will impact on the likelihood of achieving the objectives, the COM commissioned an asset/liability modelling exercise from the Fund's Actuary.

The main assumptions used in the asset/liability modelling exercise conducted in 2013, are summarised in Annexure 5. The asset/liability exercise included an analysis of the level of investment risk attributable to each asset class that the Fund invests.

## 6. INVESTMENT RISKS

In terms of the Fund's strategy, the COM views risk primarily as the possibility that the investment return objective will not be achieved by the chosen strategy over the longer term.

The strategy adopted is designed with the intention of maximising the likelihood of meeting the investment return objective, by controlling as far as possible those risks which may result in the objective not being met.

In arriving at their investment strategy, the COM has considered the following specific risks:

### 6.1 Negative real returns

This arises if the nominal returns fall below the rate of inflation and the real value of assets declines over time. This risk is reduced over the long term by investing in assets that are assumed to provide a hedge against inflation such as equities, offshore assets and properties (so-called "real assets" or "growth assets"). Due to volatility of most of these asset classes, and especially the equity market, it may not be possible to eliminate this risk over the short term.

### 6.2 Capital loss

This risk can be avoided in the short term by investing in cash and shorter-dated fixed interest securities, where the future capital value is largely certain. The long term returns on these assets are however expected to be materially lower than that expected from real assets.

### 6.3 Volatility

Different asset classes experience different volatilities of return. This risk may be reduced by diversifying the portfolio between the asset classes which are expected to have relatively low correlation, and investing a greater proportion in assets typically displaying lower volatility, such as cash and short-term bonds. In establishing the Fund's ranges and benchmarks the volatility of returns for the various asset classes have been considered by the Fund's Actuary, Asset Consultant and the COM.

### 6.4 Liquidity

Liquidity risk involves not having liquid assets to meet liabilities as they fall due, or being unable to realise assets on a reasonable basis when cash is required. This risk is avoided by investment in liquid assets and highly tradable assets, or in pooled investment portfolios where a fund's investment represents a small portion of the total portfolio and liquidation terms are not onerous. The Fund holds a significant percentage of tradable assets

### 6.5 Asset failure

The risk of asset failure is reduced by diversifying the investment portfolio between investments in different companies in the case of equity investments, in different issues in the case of bond investments and deposits with different institutions in the case of cash deposits. The risk is further reduced by investing in well-researched companies and by investing in bonds with high credit ratings. Government bonds are underwritten by the Government and are therefore considered to have no risk of failure. The COM's requirements in respect of minimum investment grades on cash and other fixed interest investments are set out in the mandates to the investment managers.

### 6.6 Market timing

Market timing is an investment technique where the investor seeks to improve long-term returns by correctly anticipating major moves in asset class prices. The Fund has engaged the services of professional asset managers who have the resources, expertise and track record to add value from various investment management techniques.

### **6.7 Tactical Asset Allocation**

Tactical Asset Allocation (or TAA) is a portfolio management technique applied by professional fund managers whereby they move assets between asset classes when their research suggests that the short-term prospects for one asset class are better than for another. The Fund's investment managers use TAA to add excess returns over their benchmarks.

Like most portfolio management techniques, TAA introduces an opportunity to add value to portfolios when decisions are correct, but also introduces a chance of destroying value when decisions are incorrect. In the long term, TAA by competent investment managers can be expected to enhance returns, but in the short term the possibility exists that a degree of additional risk can be introduced.

The COM has provided the investment managers with ranges around the benchmarks and has therefore provided freedom for the managers to implement an active TAA policy.

### **6.8 Benchmark risk**

The performance of a Fund's investment managers must be measured against a suitable benchmark in order to determine whether they are performing their function adequately. Asset managers will often be cognisant of their benchmarks, even if they are not given tracking error restrictions. The choice of benchmark can therefore be very important.

The COM has adopted appropriate benchmarks against which the investment managers will be measured. The benchmarks have been structured to be consistent with the Fund's overall investment objectives and provide a quantitative tool against which the performance of the Fund's managers can be measured. The benchmark does not reflect the preferred structure of the portfolios and managers are expected to add value by deviating from the benchmark within any limits specified in the mandate.

The Actuary, having knowledge of the liabilities of the Fund, has recently reviewed and approved the benchmarks. The Actuary will from time to time review the appropriateness of the benchmarks.

### **6.9 Tracking error or Benchmark Deviation Risk**

It is generally accepted that active portfolio management by top quality investment managers, through techniques such as stock-picking and sector rotation within equities, can add additional value over passive management or index-tracking. Active management however introduces the risk of significant underperformance of benchmark indices if excessively divergent positions away from the benchmarks are taken (high tracking errors).

High tracking errors may however imply that risk in *absolute* terms (i.e. the risk of capital loss) can be reduced.

The COM is of the opinion that individual asset managers should generally not be restricted by tracking error mandates. However, the COM does monitor the tracking error of the overall portfolios from time to time with the assistance of the investment consultants, to ensure that this decision does not in time expose the portfolios to extreme tracking error risk

### **6.10 Asset Manager Risk**

The risk exists that a particular investment manager employed by the Fund could underperform its peers, resulting in poor *peer relative* returns. Manager specific risk is thus reduced by investing across a range of managers. The Fund has three investment managers for the Fund's domestic assets and three international investment managers for the Fund's international assets.

### **6.11. Active Investment Managers**

These managers often display a style bias (growth versus value, or small cap versus large cap). The different investment styles each go through periods when they are rewarded or penalised by investment markets. The risk of being exposed to investment managers whose style is not in favour with investment markets is reduced if a fund invests with managers of opposite styles in such a manner as to result in the overall fund being style neutral.

The COM is aware of the styles adopted by the managers and have adopted a multi-style approach in consultation with the Asset Consultant.

### **6.12 Exchange Rate Volatility**

Investors seek to reduce volatility of returns and dependence on the South African economy by investing a portion of their assets in foreign investments. The great majority of assets in respect of the Funds liabilities are denominated in Rands, hence investing in foreign investments introduces currency-mismatch risk, in that the currency invested in could weaken against the Rand. However, the risk of producing negative real returns for the Fund is reduced over the long term by investing in offshore assets as they do provide a hedge against inflation.

The asset/liability analysis indicated that the maximum exposure permitted by legislation applicable at the time of the analysis, that is 25% of the market value of the assets of the Fund, be earmarked for offshore investments and the associated currency exposure. The COM will review this percentage from time to time when exchange control legislation changes.

### **6.13 Derivative instruments**

Derivatives serve a useful purpose in investment portfolio management, when used for asset allocation or hedging purposes. The COM therefore will invest in portfolios that allow for the responsible use of derivatives, within the following broad guidelines:

- (a) The asset manager is permitted to use derivative instruments provided that the portfolio holds sufficient cash or securities to cover the full net exposure (i.e. no "naked" positions may be taken).
- (b) The derivative instruments that may be used include futures contracts, traded options, "Over-the-Counter" (OTC) options, warrants (detached), swaps and re-purchase (repo) agreements.
- (c) There must be no leverage of any nature of the Portfolio.
- (d) Other than OTC contracts, all other derivative instruments must be traded on a recognized or designated investment exchange.
- (e) OTC contracts may only be entered into with counter-parties that have a minimum short-term credit rating of A1 or equivalent by a recognised rating agency. For instruments of more than one year's duration the counter-party must have a minimum long-term credit rating of AA or equivalent by a recognised rating agency.
- (f) Further detail in the use of derivatives is specified in the manager's investment mandate.

### **6.14 Credit Risk or Counterparty Default Risk:**

The recognition and management of this risk is not specifically mentioned in PF130. However the COM believes this to be an important risk, and will require disclosure of limits in terms of credit exposure applied by all the Fund's asset managers. The credit exposure will primarily affect money market and bond portfolios, but can also be important when considering investment transactions involving contractual arrangements with counter-parties (for example scrip lending). Regulation 28 also provides guidance in this respect, and will be adhered to.

The expected long term return from an investment portfolio may reasonably be



expected to increase as the risk increases. Thus, higher returns are a likely consequence of a less risk-averse strategy.

Risk and return will therefore always be a trade-off, with no obvious immediate winner. The control of one of the aspects of risk is often at the expense of another. For example, investing in cash will reduce the risk of a decrease in fund value (capital loss), but will increase the risk of the assets being eroded by inflation (negative real returns).

One of the main objectives of the Fund should be to manage risks, and allow for acceptable trade-offs. One of the best ways of managing risk is to have a tailored investment strategy depending on the liability profile of the Fund.

#### **6.15 Professional Indemnity Cover**

The Fund's investment managers, Asset Consultant and Actuary are required to have adequate malpractice insurance cover in the form of professional indemnity and fidelity insurance so that the Fund's right of recourse against service providers, where required to be invoked, is safeguarded.

The COM has fidelity insurance cover.

## **7. INVESTMENT STRATEGY**

The principal objective of the Fund is to provide the benefits as set out in the Fund's rules.

The liabilities of the Fund have been analysed in detail. Appropriate benchmarks and target returns have been developed that are expected to produce the minimum rate of return required by the Fund's Actuary in determining the value of the Fund's liabilities.

## 8. PORTFOLIO CONSTRUCTION AND ASSET MANAGER SELECTION

The COM selects portfolios and managers in consultation with the Fund's Asset Consultant and Actuary that are appropriate to meet the Fund's overall investment objectives.

The COM conducts in-depth reviews of the existing investment managers and potential new investment managers. The managers selected by the COM after taking advice from the Fund's Asset Consultant and considering management fees, custodial fees, transaction costs, and potential future investment performance are:

### **Domestic assets**

- Allan Gray
- Coronation Investment Managers
- Prudential Portfolio Managers
- Stanlib Asset Management

### **Foreign assets**

- Orbis Global Equity
- Russell Investments
- Walter Scott
- Contrarius Investment Management

At the latest review carried out in May 2013, the Fund's exposure to Allan Gray was reduced and assets were allocated to Stanlib. In addition the exposure to Orbis was reduced and allocated to Contrarius.

The above managers have been provided with mandates that convey the COM's objectives as set out in this policy document.

## 9. PORTFOLIO BENCHMARKS AND PERFORMANCE REVIEWS

The benchmarks against which each investment portfolio will be monitored are set out in the attached Annexure 3.

The performance of each investment manager is monitored regularly against the appropriate benchmark over a range of periods. The main focus will be on performance over a rolling three-year period. A performance review is conducted quarterly and in addition, monthly data and returns are submitted to the CEO/Principal Officer of the Funds.

Where an investment portfolio underperforms the benchmark for extended periods, the COM will seek to understand what caused this underperformance and determine whether they are satisfied that the portfolio continues to meet the Fund's investment objectives. Where the COM is not satisfied that the portfolio continues to meet the Fund's investment objectives, the COM will seek to replace the investment portfolio with an alternative that can be expected to achieve these objectives.

The COM will review the Fund's overall investment strategy from time to time, but at least triennially. In addition to this, the COM will review the strategy whenever there is a material change to the Fund. A material change would be either:

- A significant change in the membership of the Fund or
- A significant change in the benefit structure of the Fund or
- A significant change in the value of the asset that is considered to inhibit the implementation of the investment strategy or give the Fund access to previously unachievable opportunities or
- A material change in taxation treatment of the Fund or
- A relaxation of foreign exchange controls or
- A significant change in the investment environment.

## 10. COMMUNICATION TO STAKEHOLDERS

The COM will ensure that the investment strategy is communicated to members. This communication will include:

- a) A brief summary of governance principles, including who makes which investment decision;
- b) A description of the investment philosophy of the Fund;
- c) A brief summary of the overall investment objectives of the Fund;

A description of the investment benchmarks and performance measurements of the Fund; once adopted by the COM the Investment Policy Statement will be circulated to all employers of the Fund, the Fund's Actuary and Asset Consultant

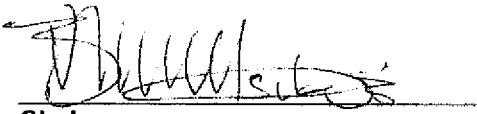
11. CONCLUSION

This document has been prepared to record the issues considered by the COM of the Natal Joint Municipal Pension Fund (Superannuation) in establishing an appropriate investment policy for the Fund, as well as to record the investment strategy that the Fund has decided to implement, in accordance with this policy.

This investment policy adheres to the requirements of Regulation 28 of the Pension Funds Act of 1956, and was established in accordance with PF Circular 130 issued by the Financial Services Board ("FSB") as far as this was practical and appropriate.


This policy was developed by the COM in consultation with the Asset Consultant and the Fund's Actuary. The investment strategy was designed by the Asset Consultant in consultation with the Funds Actuary and has been accepted by the COM.

Signed on 14 August 2013 at Pietermaritzburg

  
Chairman

  
CEO/Principal Officer

I hereby confirm that I am satisfied that the investment policy recorded above is consistent with the objectives of the Natal Joint Municipal Pension Fund (Superannuation) and the management of the risks to which the Fund is exposed, and that this policy will result in an appropriate relationship between the assets and the liabilities of the Fund.

 14.8.2013  
ACTUARY

**ANNEXURE 1**  
**REGULATION 28 OF THE PENSION FUNDS ACT OF 1956**

	<b>Column 1</b>	<b>Column 2</b>	
<b>Item</b>	<b>Categories of assets</b>	<b>Limits being the maximum percentage of aggregate fair value of total assets of the fund</b>	
		<b>Per issuer / entity, as applicable</b>	<b>For all issuers / entities</b>
<b>1.</b>	<b>CASH</b>	<b>100%</b>	
<b>1.1</b>	Notes and coins; any balance or deposit in an account held with a South African bank;  A money market instrument issued by a South African bank including an Islamic liquidity management financial instrument;  Any positive net balance in a margin account with an exchange; and Any positive net balance in a settlement account with an exchange, operated for the buying and selling of assets.	25%	100%
<b>1.2</b>	Any balance or deposit held with a foreign bank; A money market instrument issued by a foreign bank including an Islamic liquidity management financial instrument;	5%	
<b>2.</b>	<b>DEBT INSTRUMENTS INCLUDING ISLAMIC DEBT INSTRUMENTS</b>	<b>100% for debt Instruments issued by or guaranteed by the Republic, otherwise 75%</b>	
<b>2.1</b>	Inside the Republic and foreign assets		
	(a) Debt instruments issued by, and loans to, the government of the Republic, and any debt or loan guaranteed by the Republic		100%
	(b) Debt instruments issued or guaranteed by the government of a foreign country	10%	
	(c) Debt instruments issued or guaranteed by a South African bank against its balance sheet:		75%
	(i) listed on an exchange with an issuer market capitalisation of R20 billion or more, or an amount or conditions as prescribed	25%	
	(ii) listed on an exchange with an issuer market capitalisation of between R2 billion and R20 billion, or an amount or conditions as prescribed	15%	
	(iii) listed on an exchange with an issuer market capitalisation of less than R2 billion, or an amount or conditions as prescribed	10%	
	(iv) not listed on an exchange	5%	25%

	(d) Debt instruments issued or guaranteed by an entity that has equity listed on an exchange, or debt instruments issued or guaranteed by a public entity under the Public Finance Management Act, 1999 (Act No. 1 of 1999) as prescribed: -	10%	50%
	(i) listed on an exchange	10%	50%
	(ii) not listed on an exchange	5%	25%
	(e) Other debt instruments: -	5%	25%
	(i) listed on an exchange	5%	25%
	(ii) not listed on an exchange	5%	15%
<b>3.</b>	<b>EQUITIES</b>	<b>75%</b>	
<b>3.1</b>	Inside the Republic and foreign assets		
	(a) Preference and ordinary shares in companies, excluding shares in property companies, listed on an exchange: -		75%
	(i) issuer market capitalisation of R20 billion or more, or an amount or conditions as prescribed	15%	
	(ii) issuer market capitalisation of between R2 billion and R20 billion, or an amount or conditions as prescribed	10%	
	(iii) issuer market capitalisation of less than R2 billion, or an amount or conditions as prescribed	5%	
	(b) Preference and ordinary shares in companies, excluding shares in property companies, not listed on an exchange	2.5%	10%
<b>4.</b>	<b>IMMOVABLE PROPERTY</b>	<b>25%</b>	
<b>4.1</b>	Inside the Republic and foreign assets		
	(a) Preference shares, ordinary shares and linked units comprising shares linked to debentures in property companies, or units in a Collective Investment Scheme in Property, listed on an exchange:-		25%
	(i) issuer market capitalisation of R10 billion or more, or an amount or conditions as prescribed	15%	
	(ii) issuer market capitalisation of between R3 billion and R10 billion, or an amount or conditions as prescribed	10%	
	(iii) issuer market capitalisation of less than R3 billion, or an amount or conditions as prescribed	5%	
	(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	5%	15%



<b>5.</b>	<b>COMMODITIES</b>		<b>10%</b>
<b>5.1</b>	Inside the Republic and foreign assets		
	(a) Kruger Rands and other commodities listed on an exchange, including exchange traded commodities: -		10%
	(i) gold	10%	
	(ii) each other commodity	5%	
<b>6.</b>	<b>INVESTMENTS IN THE BUSINESS OF A PARTICIPATING EMPLOYER INSIDE THE REPUBLIC IN TERMS OF: -</b>		
	(a) section 19(4) of the Pension Funds Act 5%		5%
	(b) To the extent it has been allowed by an exemption in terms of section 19(4A) of the Pension Funds Act 10%		10%
<b>7.</b>	<b>HOUSING LOANS GRANTED TO MEMBERS IN ACCORDANCE WITH THE PROVISIONS OF SECTION 19(5) 95%</b>		<b>95%</b>
<b>8.</b>	<b>HEDGE FUNDS, PRIVATE EQUITY FUNDS AND ANY OTHER ASSET NOT REFERRED TO IN THIS SCHEDULE</b>		<b>15%</b>
<b>8.1</b>	Inside the Republic and foreign assets		
	(a) Hedge funds		10%
	(i) Funds of hedge funds	5% per fund of hedge funds	
	(ii) Hedge funds	2.5% per hedge fund	
	(b) Private equity funds		10%
	(i) Funds of private equity funds	5% per fund of private equity funds	
	(ii) Private equity funds	2.5% per private equity fund	
	(c) Other assets not referred to in this schedule and excluding a hedge fund or private equity fund		2.5%

**ANNEXURE 2**  
**ANNEXURE B TO PF CIRCULAR 130**

**FINANCIAL SERVICES BOARD**

Rigel Park 446 Rigel Avenue South Erasmusrand Pretoria 0181 South Africa  
**PO Box 35655 Mento Park Pretoria 0102 South Africa**  
 Tel +27 12 428 8000 Fax +27 12 347 0221 E-mail info@fsb.co.za  
 Toll free 0800 110443 Internet http://www.fsb.co.za



ENQUIRIES:	W MOKUPO	D. DIALLING NO.:	+27 12 428 8032
OUR REF:	12/12/1	FAX:	+27 12 347 8787
DATE:	11 JUNE 2007	E-MAIL:	wilmam@fsb.co.za

**ANNEXURE B TO CIRCULAR PF 130**

**GOOD GOVERNANCE GUIDELINES TO AN INVESTMENT POLICY STATEMENT (IPS)**

This guideline sets out the following:

- The purpose and scope of the IPS;
- Preparing the IPS;
- Essential elements of the IPS;
- Risk management;
- Voting rights;
- Asset Manager Mandates, and
- Communication

**PURPOSE AND SCOPE OF THE IPS GUIDELINES**

1. Investments and the allocation of surplus funds should be made in the best interest of members and beneficiaries of the fund. There should be impartiality between different classes of members, and beneficiaries and those of the employer (where it has obligations to the fund). Boards have a fiduciary duty to deal with the investments with due care, diligence and in good faith and ensure that it complies with the rules of the fund, pensions law, the Financial Institutions (Protection of Funds Act) and all other applicable laws.
2. These guidelines contain the minimum standards and the issues that boards should consider when establishing a written IPS. The guidelines should be adapted by each board of fund to suit their particular obligations, objectives and all other factors that may affect the solvency and funding of their fund and its ability to meet its financial obligations. The board of fund should be prepared to explain any deviations from the IPS.
3. The guidelines are intended to serve as a guide only without intending to limit the care that boards of fund are expected to take in the performance of their duties. The IPS should be based on the standards that a reasonable person would apply to the investment portfolio of a fund – the “prudent person portfolio approach”.
4. It is recommended that some of the guidelines set out herein should be included in the investment manager mandates rather than the IPS itself.
5. When required, the board of fund must be prepared to deliver a copy of the IPS to the fund’s actuary and/or the Financial Services Board.

**Board Members** Dr CDR Rustonjee (Chairperson) AM Sithole (Deputy Chairperson) BM Hawksworth  
 Ms JV Mogadime Ms AMM Mokgabudi Ms L M Mojela Prof PJ Sutherland Ms HS Wilton  
**Executive Officer** R.J.G Barrow



## PREPARING THE IPS

- 6 In the case of established pension funds, consideration must be given to existent investments when formulating the IPS. Furthermore, additional considerations will have to be applied when dealing with specific funds.

### 6.1 *Defined Benefit Funds:*

The board should consider the following to properly understand the obligations of the fund, namely:

- 6.1.1 Whether contributions are to be increased to keep pace with the cost of living;
- 6.1.2 Whether the pension formula adjusts to increases in salaries over time or whether such increases need to be granted to keep the formula current;
- 6.1.3 How fund obligations are spread amongst the categories of members and former members, and, within these categories, by age and time to retirement;
- 6.1.4 Whether changes in employment levels or conditions will change patterns of retirement;
- 6.1.5 Important ancillary benefits contingent on full or partial retirement;
- 6.1.6 Any planned changes to the fund.

In addition, factors relating to solvency ratios and the maturity of the fund as set out more fully below, must also be taken into consideration.

### 6.2 *Defined Contribution Funds:*

In this instance, the fund may appear to discharge its investment obligations by paying out contributions accumulated in beneficiaries' accounts along with investment returns, even though they may be low. However, it is recommended that the following factors also be taken into account, namely the:

- 6.2.1 Needs and reasonable benefit expectation of the beneficiaries;
- 6.2.2 Mix of members and the related growth and risk tolerance levels;
- 6.2.3 Variation in risk tolerance levels of members of the same age group;
- 6.2.4 Ability of beneficiaries to choose investment options – in this regard, the board should consider providing ongoing information and training to beneficiaries to enable them to make informed decisions.

In addition, the board should monitor "default" accounts for beneficiaries who have not indicated an investment option, the participation rate and the investments selected by beneficiaries. The purpose of such monitoring being to assess whether changes may be required in communication and/or education programs.

### 6.3 *Investment Policy and Procedures:*

In order to be able to determine the fund's investment policy, it is essential that the board of fund has first identified the profile of its beneficiaries. This will enable the board to identify what portion of funds will be required for short, medium and long term investments and the risk profile attached to each category of beneficiaries e.g. those retiring in the short term will require low risk, high liquidity. As this is an essential element of determining the investment policy, the board should, where appropriate, obtain the advice and guidance of independent consultants and/or actuaries.

In determining the appropriate IPS, boards should consider the:

- 6.3.1 Current investments;
- 6.3.2 Degree of risk tolerance they wish to sustain;
- 6.3.3 Volatility of contributions;
- 6.3.4 Current and future liabilities of the fund;

regularly traded as well as the fund's exposure to fluctuations in interest rates, foreign exchange, inflation and market prices.

- 12 For monitoring and ease of reference purposes, boards should maintain records of the fund's investment portfolio to enable analysis of:
- 12.1 Asset quality and diversification;
  - 12.2 Interest rate and any maturity mismatching;
  - 12.3 Diversification of income sources;
  - 12.4 A comparison of current assets measured against the IPS limits.
- 13 Furthermore, areas of potential conflict of interest should be identified and recommendations made as to how those tasked with the investment of funds are to deal with the same as outlined in the fund's code of conduct and other policies.

#### **ESSENTIAL ELEMENTS OF THE IPS**

- 14 All IPS should be reviewed at least annually to ensure that they take into account any changes in economic conditions or obligations of the fund. Taking the above factors into account, it is recommended that the below mentioned elements be included in the IPS:

##### *14.1 Asset mix and rate of return expectations:*

The IPS should stipulate the:

- Expected rate of return of the portfolio;
- Anticipated volatility of the rate, setting parameters;
- Time frame for the expected returns; and
- Monitoring of performance against the stated expectations (linked to the stated expectations should be an explanation of the action that the board will take if the stipulated targets are not met).

Examples of the rate of return expectations are the following:

- A real rate of return of "x" percent over a given period; or
- A nominal rate of return; or
- A rate of return over an agreed benchmark portfolio.

##### *14.2 Categories of Investments:*

- In order to protect the fund from arbitrary investment decisions and/or investments that may be in conflict with the fund's risk profile, limits should be placed on the range of authorized investments. Such investments should be defined taking into account the building of a portfolio that meets the needs of the fund and avoids the concentration of investments in any particular market sector.
- Depending on the risk profile of the fund, limitations could also be placed on the quality of the assets with stipulations of the action required if such assets become downgraded to a quality below that stated in the IPS.
- In the event that the use of derivatives by asset managers are to be authorized, and provided such investments are allowed in terms of the fund rules and are within regulatory or statutory limitations, the investment in derivatives should be properly and clearly regulated. Should they decide to permit this form of investment, s of fund should have a clear understanding of the use and risks of derivatives and how they will be measured. Such regulations should include stipulations relating to:

- A list of acceptable derivative instruments;
  - The proportion of assets that may be invested;
  - The purpose for which they are to be used (hedging, index replication etc.);
  - The managers authorized to use derivatives and the limits placed on them;
  - Where the derivative products are to be obtained; and
  - How over-the-counter products are to be managed.

#### 14.3 Diversification:

In principle, investment risks can be reduced through investing in diverse asset types, industries and geographic regions. However, diversification usually carries a cost in the form of transaction fees, custody costs etc as well as potentially lower returns. Therefore, a balance between the mitigation of risk and the related costs must be maintained. Accordingly the degree of diversification will be determined by the fund's size, risk profile and the inherent risk of the particular investment.

One way to achieve diversification at low costs is to invest in investment vehicles that have been formed to hold a diverse portfolio. Selection of the appropriate vehicle should not only be on the basis of past performance and track record but also on the synergies between the policies of the particular fund and those set out in the IPS.

#### 14.4 Liquidity requirements:

As mentioned above, investments should be made taking into account the fund's cash flow needs in the coming year to avoid having to liquidate medium or long term investments to cover short term requirements. By the same token, it might not be necessary for a portfolio to hold unnecessary amounts of cash or low yielding liquid assets. Accordingly the fund should have a clear idea of what its cash flow requirements will be.

#### 14.5 Pledging and borrowing of assets:

It might be preferable for funds to borrow against assets in order to meet short term cash flow needs. Similarly it may be necessary for a fund to pledge assets for the purposes in engaging in futures contracts. However, in order to protect the fund from placing the investments at risk, clear limits and procedures should be established for such borrowing or pledging to occur and these should be closely monitored. Furthermore, it should be established whether such activities are authorized in terms of the fund's rules or subject to any regulatory or statutory restrictions.

*CAVEAT: Accordingly extreme care and caution should be taken when considering the possibility of such activities.*

#### 14.6 Lending against the fund:

To the extent that it is permitted by the rules and statutory or regulatory restrictions, the IPS should clearly set out the circumstances under which funds may be lent against the fund. Such policies and procedures should set out:

- The circumstances under which the lending may occur;
- Who is authorized to commit the fund to the loan and under what limits;
- The maximum exposure of the fund in aggregate;
- The interest rate and collateral required; and
- Margin requirements.

*Accordingly extreme care and caution should be taken when considering the possibility of such activities.*

#### 14.7 *Management fees and compensation:*

Management fees, custodial fees and transaction costs must be taken into account when considering asset managers. The board of fund must decide between active or passive asset management and determine whether the concomitant costs of active management are justified by the returns achieved. In order to make this assessment of performance over a given period, it may be useful to secure expert advice, however, care should be taken to avoid a conflict of interests.

Payment of fees should be linked to clearly defined responsibilities and those tasked with particular functions should be accountable. There should be mechanisms in place to ensure proper monitoring including the relevant checks and balances to alert the board to any significant losses and deviations from authorized policy.

The remuneration of asset managers must not encourage deviation from the mandate assigned to them nor encourage unethical behaviour. Costs and fees paid by the fund to asset managers and administrators should be subject to full disclosure and transparency and communicated to the beneficiaries.

#### 14.8 *Socially Responsible Investment:*

The issue of socially responsible investment often raises the question of whether such investments offer the best returns on the 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 s is to provide optimum returns for its beneficiaries. However, once these returns have been met, funds should consider socially responsible investments. Boards of fund should consider how shareholder activism can be applied to promote good governance and citizenship in companies in which their funds are already invested. Such activities may actually enhance the performance of the companies and therefore the returns to the fund.

It is recommended that s of fund apply their minds to formulating a suitable policy regarding such investments as well as incorporating shareholder activism into their investment mandates. Examples of how this can be done are elaborated in more detail below.

### **RISK MANGEMENT**

- 15 There will always be an element of risk in the investments of a fund. Furthermore, the risk tolerance level of a fund will be influenced by factors such as the age profile of its beneficiaries. The board of fund's responsibility is to manage and, where possible, mitigate the risks to which the fund is exposed. For it to perform this function effectively it needs to be aware of the types of risk to which a fund can be exposed. A separate risk assessment conducted by an independent expert may be required by the board, from time to time to assess the effectiveness of governance structures, mandates, terms of reference used, etc.

### **VOTING RIGHTS**

- 16 It has been argued that the voting rights attached to shares of the companies in which s are invested should be considered an asset of the fund. Accordingly, the board of fund would be expected to apply the same fiduciary care and consideration to this asset as it does to the financial investments it makes. Indeed, there is an inclination internationally to require s of fund to be more proactive in ensuring that the voting rights are utilised effectively by the asset managers in accordance with the shareholder activism obligations of the
- 17 In order to fulfil this obligation, and in accordance with the recommendations of King II, the board of fund should formulate and develop appropriate voting policies and incorporate these in their mandates to the asset managers including the monitoring and reporting of the same. Such policy should also be disclosed to the beneficiaries along with the steps taken by the board of fund to monitor the effective implementation of the same by the asset managers. More in this regard is incorporated under the asset manager mandate recommendations detailed below.



## RECOMMENDATIONS FOR INCLUSION IN ASSET MANGEMENT MANDATES

- 18 The relevant portions of the IPS should be included in the mandates to asset managers. This will include the category of investments, risk profile, diversification policies etc. as stipulated above. In addition, it will contain the expected rate of return and the actions to be taken in the event of the said managers not meeting performance targets. Furthermore, in order for the board of fund to effectively monitor the fund's performance, the reporting frequency and performance targets should be clearly spelt out.
- 19 In addition, and in order to ensure that the asset managers practice the same corporate governance standards and best practices that s are expected to maintain, and in order to met their fiduciary obligations relating to voting and shareholder activism issues, the mandates should also require the asset managers to report on the following matters, as recommended by the International Corporate Governance Network, namely:
  - 19.1 The corporate governance policies of the asset managers detailing how they are applied in investment policies;
  - 19.2 The voting guidelines followed by the asset managers and how these are aligned to the policies formulated by the board;
  - 19.3 Information on the companies in which the fund's assets have been invested and the relevant percentages;
  - 19.4 An explanation of actions taken by the asset managers in important matters;
  - 19.5 An explanation how the asset managers monitor, measure and review the companies in which they are invested in accordance with stated policies and guidelines;
  - 19.6 A summary of voting records indicating the percentages voted and whether the votes were cast for or against management as well as full records in important matters;
  - 19.7 The resources allocated by the asset managers to execute corporate governance policies;
  - 19.8 Where no resources have been applied, and explanation how they have "weighed the various arguments coming to this decision and an indication of what developments would make them change their decision."
  - 19.9 Details of any conflicts of interests in companies in which they are invested;
  - 19.10 A description of procedures they have developed to deal with the stated conflicts;
  - 19.11 Details of agents to whom they have outsourced their responsibilities and an explanation of how these agents are monitored to ensure governance polices are properly implemented.

This information should be reported to the board of fund at least annually to enable the board in turn to report meaningfully to the beneficiaries on how it has applied and monitored its governance responsibilities.

### COMMUNICATION:

#### *20 Monitoring and reporting on IPS:-*

The IPS should be reviewed regularly to ensure that it continues to meet the objectives of the fund and any deviations or changes should be explained to the beneficiaries.

Effective and regular communication between the board, the beneficiaries and the asset managers is essential, not only for the purposes of transparency and disclosure, but also to establish proper and regular monitoring of the fund performance, adherence to the terms of the mandate and the IPS.

The IPS should be disclosed to fund beneficiaries, investment managers and, where required, to the relevant regulatory authorities.

There should be regular, reporting to the beneficiaries, preferably quarterly, in a manner and a form which is easily understood, on relevant performance, risk/return and fund matters especially relating to any changes, that the might deem appropriate.

Refer to the relevant guidance issued by the Registrar from time to time which sets out the minimum disclosure to beneficiaries and the frequency thereof.

\*\*\*\*\*

**PRESCRIBED INVESTMENT AND LENDING LIMITS FOR PENSION FUNDS**

To be provided from time to time via Regulation and Directives

**INVESTMENT POLICIES AND PROCEDURE GUIDELINES**

To be updated by FSB from time to time

**COMMUNICATION: MINIMUM DISCLOSURE TO MEMBERS, DEFERRED MEMBERS, DEPENDANTS, PENSIONERS AND BENEFICIARIES OF DECEASED MEMBERS**

To be updated by FSB from time to time in circulars, etc.





## ANNEXURE 3

### BENCHMARKS

#### Domestic Managers

Asset Class	Benchmark	Range
Equity	56%	44% – 67%
Fixed Interest, Cash and Property	44%	33% - 56%

For the purposes of performing attribution analyses on the Fixed Interest component, a split of 45% bonds and 5% cash will be used.

Equity benchmark	FTSE/SWIX
Bond benchmark	BEASSA Index
Cash benchmark	STeFI Composite Index

The above benchmarks were determined by the Fund's Actuary and Asset Consultant in terms of the asset/liability modelling analysis done by the Actuary.

The above benchmarks and ranges are effective from 1 September 2013

#### Offshore managers

Orbis Global Equity	100% MSCI World
Russell World Equity	100% MSCI World
Walter Scott Global Equity	100% MSCI World
Contrarius Global Equity	100% MSCI World

For the Total Fund, a combination of 80% in the Domestic benchmarks and 20% in the Offshore benchmarks is used.



Natal Joint Municipal Pension  
KwaZulu-Natal Joint Municipal  
Provident Funds

"Your Fund, Your Savings, Your Future"



## ANNEXURE 4

### PROXY VOTING GUIDELINES FOR ASSET MANAGERS

#### 1. INTRODUCTION

The discretionary mandates provided to the Fund's asset managers require that the managers actively manage the Fund's investments and related shareholder rights.

The Fund expects every asset manager that it may appoint to pursue corporate activity that enhances shareholder value, and accordingly requests that such managers have corporate activity and voting procedures in place which are focused on protecting shareholder value.

The COM wishes to ensure that the managers are applying policies and guidelines in this respect, that are broadly in line with the Fund's approach to shareholder activism. This document therefore sets out the Fund's broad views to shareholder activism, and specifically proxy voting on company resolutions.

#### 2. GENERAL

This document is divided into three components: *Voting Guidelines*, *Corporate Governance Recommendations* and *The Investment Mandate* and contains principles which the Fund believes are important considerations for all asset managers and the Fund's custodian to be aware of in order to further the interests of corporate governance in South Africa.

However, the Fund does not expect that every principle be adopted or embraced in totality. The Fund recognises that some of the 'Guidelines' and 'Recommendations' may not be appropriate for every situation.

As part of a monitoring process the Fund may request that all asset managers report on their voting actions from time-to-time.

#### 3. VOTING GUIDELINES

The overriding principle which the Fund expects asset managers to apply when voting is that they must act in the best financial interests of the Fund in order to maximise long-term returns. Therefore, in voting the Fund's beneficial holdings, asset managers should consider, on a case-by-case basis, those factors that may affect the value of the Fund's investments which they manage.

##### 3.1 General

Asset managers should vote at shareholder meetings according to the guidelines set out hereunder. Irrespective of the number of votes the Fund may hold, asset managers need not initiate or undertake voting in respect of certain standard matters which are the subject of common resolutions presented at annual general meetings of shareholders.

If an asset manager requires the Fund to consider the question of voting, sufficient information and clear motivation of the asset manager's voting proposal should be provided to the Fund timeously.

## 3.2 Annual General Meetings

### 3.2.1 Board Composition and directorship

#### i) Independent directors (as defined in King III)

Board membership should comprise a balance of executive and non-executive directors who have broad experience and are in a position to act independently. The Fund supports resolutions that lead to this.

#### ii) Separate CEO and Chairman

The Fund supports the election of an independent non-executive Chairman so that the Board represents the interests of shareholders, rather than executive management, and clearly expects listed companies to adhere to the JSE Securities Exchange listing requirements in this regard.

#### iii) Re-election of directors

Generally, asset managers should consider opposing resolutions that re-elect a number of directors en-bloc, in favour of re-elections/appointments on an individual basis.

### 3.2.2 Share Capital

#### i) General authority to place unissued shares under the control of the directors

Generally, asset managers should consider opposing resolutions that place more than 5% of unissued shares under the control of the directors, particularly if there was a risk of further issues diluting existing shareholders' value. Any such actions should rather be specifically motivated to shareholders through calling a general meeting as and when required.

#### ii) General authority for the directors to issue shares for cash

The Fund recognises that managements/directors of companies should be allowed some flexibility to manage capital where they need to move quickly and confidentially (e.g. in instances of price sensitive transactions), and therefore agree to asset managers voting in favour of resolutions that provide directors with the general authority to issue shares for cash in line with the JSE Listing Requirements.

However, asset managers should consider opposing resolutions that provide directors with the authority to issue shares for cash, where such issues could dilute existing shareholders' value.

Nevertheless the Fund prefers a separate resolution at the time of any further issue with the appropriate motivation provided by management, rather than providing management with a general control over the unissued shares.

#### iii) Authority to repurchase shares

Generally, asset managers should consider opposing resolutions that allow share repurchases to impact negatively on the "free float" of the company and where the share repurchase could have a material negative impact on liquidity, net asset value or earnings.

The Fund does however acknowledge that share repurchases may result in earning enhancements for a company and there may be instances in which shares may not be voted in strict adherence to this guideline in the interests of enhancing value.

### **3.3 Corporate Actions**

#### **3.3.1 Share Capital**

##### **i) Dual Capitalisation, Preferential Voting Rights**

Asset managers should consider opposing proposals to divide share capital into two or more classes or to otherwise create classes with unequal voting and/or dividend rights. The Fund is concerned that the effect of these proposals, over time, is to consolidate voting power in the hands of relatively few insiders disproportionate to their percentage ownership of the company's share capital as a whole.

##### **ii) Repricing or issuing of options at a discount**

Asset managers should consider opposing proposals that allow for the repricing or issuing of options at a discount. The Fund does however acknowledge that repricing certain share options may align the interests of management and shareholders and there may be instances in which shares may not be voted in strict adherence to this guideline.

#### **3.3.2 Black Economic Empowerment Transaction**

The Financial Sector Charter on shareholder activism records that pension fund trustees, asset managers and consultants play a critical role in influencing the flow of funds, and further states that initiatives should be developed to enhance trustees' understanding of investments and participation in targeted investments and financing of Black Economic Empowerment transactions so as to make a contribution to shareholder activism: pension fund trustees are encouraged to play an active role in promoting the objects of the Charter on their respective boards and in the entities in which investments are held.

To this end the Fund supports the advancement of Black Economic Empowerment and is conscious of the fact that employment equity is guided by legislation.

#### **3.3.3 Other corporate actions**

For other corporate actions (e.g. mergers, takeovers, acquisitions etc.), which may or may not have an effect on the value of the Fund's holdings, asset managers are requested to notify the Fund if they intend voting or not, the reasons therefore, and the direction in which the votes will be cast.

Such notification is to be provided to the Fund with sufficient time for the Fund to require the asset manager to vote in a particular manner, if necessary.

## 4. CORPORATE GOVERNANCE RECOMMENDATIONS

### A Directors

#### i) Election/re-election of directors

With respect to the election/re-election of directors, asset managers are requested to consider:

- Effectiveness of the board as a whole.
- Relevant experience of new directors proposed.
- Past attendance record of directors.

#### ii) Members of asset managers' investment teams having directorship on the Board of Listed Companies

The Fund believes that asset managers should preserve the independence and flexibility of their investment team and process. Therefore they should preferably not appoint investment team members to the boards of listed companies.

Where asset managers diverge from this guideline, the Fund requests a written explanation of the rationale for such a decision. In these circumstances, for so long as there is divergence from this guideline, the Fund must be notified of every resolution put to shareholders of the company and how the asset manager intends voting and why.

### B Remuneration

Levels of remuneration should attract, retain and incentivise directors. Given that remuneration has implications for corporate performance and shareholder returns, this is an area in which shareholders have a valid role to play in approving remuneration policies that have been set by formal and independent procedures.

Items asset managers should consider:

- Detailed disclosure (in line with the JSE listing requirements as a minimum) of director and employee compensation, particularly where the company does not have a majority independent board.
- The independence of the Remuneration Committee and its recommendations.
- Peer group comparisons and performance benchmarks for management bonus rewards.

Whether compensation is reasonable, especially with respect to:

- Total compensation to CEOs per annum.
- "Golden parachutes" for early termination of service or if triggered by a takeover.
- Executive severance pay.

### C Appointment of auditors

The audit process must be objective, rigorous and independent to maintain the confidence of the market. Asset managers need to consider any issues that may have compromised the audit firm's independence and objectivity with respect to the company over the past year.

## **D Empowerment/equality**

Asset managers should encourage development of an employment equity plan and reporting on empowerment with specific focus on:

- Shareholders;
- Board of Directors;
- Executive and senior management;
- Staff/labour force; and
- Suppliers/Contractors.

## **E King III Report on Corporate Governance for South Africa, 2002**

The Fund supports the principles and recommendations contained in King II. Where issues arise that are not addressed or insufficiently covered in this document, the Fund requests asset managers to be aware of the principles and recommendations of King II.

## **5. ENVIRONMENTAL ISSUES**

### **i) Environmental Hazards**

The public has a right to know whether a company uses substances that pose an environmental health or safety risk to a community in which it operates. Asset managers should support resolutions that ask for the adoption of a policy that makes information available to enable the public to assess a company's potential impact.

### **ii) Environmental Reports**

Asset managers should support resolutions asking companies to prepare general reports describing environmental management plans. Asset managers should also encourage companies to disclose current or potential environmental liabilities.

## **6. GUIDANCE**

Where asset managers are uncertain, or require guidance as to any of the principles in this document, the Fund requests that asset managers bring to the Fund's attention, in writing, any uncertainties, so that these can be resolved.



Natal Joint Municipal Pension  
KwaZulu-Natal Joint Municipal  
Provident Funds

"Your Fund, Your Savings, Your Future"



## ANNEXURE 5

### ASSUMPTIONS USED FOR ASSET LIABILITY MODELLING 10 YEAR ASSET CLASS RETURNS-2012

#### Assumptions

	Nominal p.a.	Expected real return (net of fees) p.a.
Equities	10.5%	5.0%
Property Trust	9.2%	3.7%
Direct Property	8.9%	3.4%
Interest Bearing	6.9%	1.4%
Inflation-Linked Bonds	6.4%	0.9%
Cash and Deposits	6.0%	0.5%
International Equities	10.5%	5.0%
International Bonds	5.1%	-0.4%
International Cash	4.0%	-1.5%
Inflation	5.5%	



## ANNEXURE 6

### NATAL JOINT MUNICIPAL PENSION FUND (SUPERANNUATION) REPORT ON THE INTERIM ACTUARIAL VALUATION OF THE FUND AS AT 31 MARCH 2011 (BASED ON AUDITED FINANCIAL STATEMENTS)

#### EXECUTIVE SUMMARY

- We have performed a statutory actuarial valuation of the Natal Joint Municipal Pension Fund (Superannuation) (the "Fund") as at 31 March 2012 ("the valuation date"). A copy of this report must be submitted to the Financial Services Board. The last statutory actuarial valuation of the Fund was performed as at 31 March 2011 and the report on that valuation was accepted by the Financial Services Board on 19 March 2012. The period from 31 March 2011 to 31 March 2012 is taken as the "valuation period" for purposes of this valuation.
- At the valuation date (and at the previous statutory valuation date) the Fund covered the following membership:

	31 March 2012		31 March 2011	
	Number	Annual salaries/pension R'000	Number	Annual salaries/pension R'000
Active members	5 333	906 062	5 473	877 786
Pensioners	5 325 <sup>2</sup>	204 561	5 150 <sup>1</sup>	189 146

1 Includes 1 019 suspended and 347 pending pensioners

2 Includes 1 053 suspended and 318 pending pensioners

- The market value of the Fund's assets was R 6 240 605 000 at the valuation date.
- The value placed on the assets for purposes of the valuation are:

	DCF Method	
	31.03.2012 R'm	31.03.2011 R'm
Assets at market value	6 240.6	5 614.5
Investment Reserve	<u>298.3</u>	<u>(113.0)</u>
Actuarial value of assets	<u>6 538.9</u>	<u>5 501.5</u>

For purposes of the valuation, the assets were taken at a value of R298,3 million above market value.

- The valuation disclosed that, for the Fund overall, the liabilities for service to the valuation date were 96% funded as follows:



	<b>31 March 2011</b>	<b>31 March 2012</b>
	<b>R'm</b>	<b>R'm</b>
Value of assets (Appendix 5)	5 501.5	6 538.9
Value of liabilities (Appendix 6)	(5 607.8)	(6 270.6)
Balance of assets in Memorandum Account	( 315.5)	( 405.0)
Risk Reserve	<u>( 127.7)</u>	<u>( 133.3)</u>
<b>Surplus (shortfall)</b>	<b><u>( 549.5)</u></b>	<b><u>( 270.0)</u></b>
Funding level	90.9%	96.0%

6. The valuation results can be split between active members and pensioners as reflected below:

	<b>31 March 2011</b>	<b>31 March 2012</b>
	<b>R'm</b>	<b>R'm</b>
<b><u>Memorandum Account</u></b>		
<b><u>(Pensioners)*</u></b>		
Assets	2 458.1	2 936.1
Liabilities	(2 097.0)	(2 481.7)
Risk Reserve	<u>( 45.6)</u>	<u>( 49.4)</u>
<b>Balance of assets in Memorandum Account</b>	<b><u>315.5</u></b>	<b><u>405.0</u></b>
Funding level	114.7%	116.0%
<b><u>Active Members</u></b>		
Balance of assets	3 043.4	3 602.8
Balance of liabilities**	(3 510.8)	(3 788.9)
Risk Reserve	<u>( 82.1)</u>	<u>( 83.9)</u>
<b>Surplus (Shortfall)</b>	<b><u>( 549.5)</u></b>	<b><u>( 270.0)</u></b>
Funding level	84.7%	93.0%

7. The statutory actuarial valuation of the Fund as at 31 March 2011 disclosed that the Fund was in deficit. In terms of Section 18 of the Act, the Fund was required to submit a "Scheme to Eliminate Deficiency" to the FSB. In terms of the scheme, a surcharge of 9,5% of pensionable salaries is payable for a period of 8 years with effect from 1 July 2012 to meet the deficit. This is in addition to the basic employer rate of contribution required to fund future service benefits.

8. The increased contribution rates were therefore not yet in force at the valuation date.

9. Based on the results of the valuation, we expect that the surcharge of 9,5% of pensionable salaries will meet the deficit within the 8 year period provided for in the Scheme.

	%
by members	9.25
by local authorities	<u>18.00</u>
Total	<u>27.25</u>

10. The contribution rate being paid at the previous statutory valuation date was not sufficient to cover the contribution rate required for future service, showing a shortfall of 3,63% of pensionable salaries, as follows:

Method of valuation	Attained Age
Contribution rate currently payable	27.25
Contribution rate required for future service	<u>30.88</u>
Excess/(Shortfall)	<u>(3.63)</u>

- (1) The General Committee accepted our recommendation to increase the employer's basic contribution from 18,00% to 21,63% (18,00% plus 3,63 with effect from 1 July 2012.
- (2) The total rate of contribution required from the employer, including the surcharge, was thus 31,13% (21,63% plus the surcharge of 9,5%) of pensionable salaries payable for a period of 8 years with effect from 1 July 2012.
- (3) The current valuation shows that the contribution rate required for future service has increased slightly from 30,88% to 31,10% of pensionable salaries. We do not recommend that the employer's rate of contribution be increased any further at this stage. We will continue to monitor the situation at the next interim actuarial valuation at 31 March 2013 and make a recommendation to adjust the required contribution if necessary at that stage.

11. The key findings and recommendations in the report are:

- (1) The Fund self-insures its death benefits and disability benefits. We are satisfied that, given the recommended Risk Reserve, the arrangement is appropriate for the Fund;
- (2) We are satisfied that the composition and nature of the Fund's assets and its investment strategy at the valuation date were appropriate for its liabilities;
- (3) The Fund's assets underlying the pensioner liabilities were sufficient to meet the pensioner liabilities as at the valuation date;
- (4) The assets underlying the active member liabilities were insufficient to meet these liabilities at the valuation date. In terms of the "Scheme to Eliminate Deficiency" that was submitted to the FSB following the previous statutory actuarial valuation, this deficit will be funded by the employer by means of an additional surcharge of 9,5% of pensionable salaries payable for 8 years from 1 July 2012; and
- (5) The required contribution rate for future service benefits for active members exceeded the contribution rate payable with effect from 1 July 2012 by 0,22% of pensionable salaries. I recommend that the local authorities continue to pay the current contribution rate of 21,63% of pensionable salaries. This will be reviewed at the next interim actuarial valuation of the Fund as at 31 March 2013.



**A R ELS (FASSA CFP CFA CERA)**  
**VALUATOR**

In my capacity as valuator to the Fund  
and as an employee of Arthur Els & Associates.  
12 October 2012