

# **STELLENBOSCH UNIVERSITY RETIREMENT FUND (USRF) OVERVIEW OF THE INVESTMENT FRAMEWORK OF USRF**

**February 2018**

<b>1. BRIEF SUMMARY .....</b>	<b>2</b>
<b>2. INTRODUCTION.....</b>	<b>4</b>
<b>3. INVESTMENT OBJECTIVES .....</b>	<b>4</b>
<b>4. INVESTMENT STRATEGIES .....</b>	<b>9</b>
<b>5. INVESTMENT PHILOSOPHY AND LIMITATIONS .....</b>	<b>10</b>
<b>6. REVIEW OF THE INVESTMENT PROCESS .....</b>	<b>13</b>
<b>7. APPOINTMENT OF ASSET MANAGERS .....</b>	<b>16</b>
<b>8. RESPONSIBLE INVESTING .....</b>	<b>17</b>
 <b>ANNEXURE A: EXTRACT FROM CODE OF RESPONSIBLE INVESTING IN SOUTH AFRICA.....</b>	 <b>18</b>
<b>ADDENDUM – BRIEF HISTORY OF THE INVESTMENT STRATEGY .....</b>	<b>24</b>

## **1. BRIEF SUMMARY**

### **i) Investment Objectives**

The investment objectives of USRF are:

“To achieve excellent investment performance over longer periods, with satisfactory short-term returns and within acceptable risk levels.”

### **ii) Investment Strategies**

The Trustees agreed that a balanced market-related portfolio, managed by at least three asset managers with different risk and return profiles, would be the best option to achieve the investment objectives (hereinafter this portfolio will be called the Growth Portfolio). The asset managers have full discretion with regard to the assets they manage. However, there are geographic limitations.

From the age of 60, a lifestage model is implemented as a default option in order to reduce risk levels close to retirement, by transferring the relevant members' assets from the Growth Portfolio in equal portions (50/50 split) to the Aggressive Absolute Return Portfolio and the Conservative Absolute Return Portfolio.

This final stage of the lifestage model has been designed to enable a seamless transfer for members who want to make use of the in-fund living annuity. The default option for members in the in-fund living annuity is the same equal distribution between the Aggressive Absolute Return Portfolio and the Conservative Absolute Return Portfolio.

Prior to age 53, members have no other option than investing in the Growth Portfolio. Members who wish to invest in a Shariah Compliant portfolio may however opt out and access the Shariah Compliant portfolio offered by the Fund.

From age 53, members are allowed to exercise an option to invest outside the lifestage model default option.

Members may then choose between the following options:

- Aggressive Absolute Return Portfolio;
- Conservative Absolute Return Portfolio;
- Capital Protection Option (Cash Portfolio);
- Portfolio offering hedging against interest rate fluctuations;
- Shariah Compliant Portfolio; and
- Growth Portfolio.

Members who opt for a portfolio other than the lifestage model should note that no automatic transfer of assets will be arranged for them. Such transfers (if required) are to be conducted by the members concerned.

The Fund also offers an In-Fund Living Annuity option where members are able to easily convert all or part of their retirement benefit to a very cost-effective monthly pension from the Fund. The Fund offers a Trustees' Default option as well as a Customised option. Members are however able to convert from the Trustees' Default option to the Customised option (and vice versa) at any stage.

Members in the Customised option may invest in any combination of the Fund's five investment portfolios (Aggressive Absolute Return Portfolio, Conservative Absolute Return Portfolio, Capital Protection Option (Cash Portfolio), Portfolio offering hedging against interest rate fluctuations, and Growth Portfolio).

### **iii) Evaluation of the Investment Process**

The Trustees agreed that investment performance and the extent to which the investment objectives are achieved should be monitored on a regular basis (at least once every six months) and that the entire investment process should be discussed and reviewed at least once a year.

## **2. INTRODUCTION**

The purpose of this document is to provide a framework for the investments of USRF.

The report provides a summary of the current investment objectives and strategies of the Fund and how these will be evaluated. It describes the factors considered in the development of the investment objectives and provides the criteria applied with the appointment of the asset managers that are best equipped to achieve these objectives. The investment strategies agreed upon take into account the nature of the Fund's liabilities, the dynamic nature of the assets over time, the investment objectives and the risk profiles of the asset managers.

This document is reviewed annually by the Trustees to update it with their latest decisions, so it reflects the current investment position of the Fund.

## **3. INVESTMENT OBJECTIVES**

The investment objectives are the starting point of the investment process indicating the short- and long-term objectives to be achieved through the investment decisions made. The objectives serve as a basis for the development of the most acceptable investment strategies and simplify the future review of the investment process.

### **Background**

The liabilities of USRF are primarily medium to long term. The investment horizon reduces as members approach retirement.

USRF is a defined contribution fund. This means the size of the retirement benefits accumulated for members under USRF are linked directly to the investment returns earned on the underlying assets of the Fund. As members share in full in the investment returns earned they want maximum returns on their investments.

Investment theory is based on the principle that the expected returns increase as the investment risk increases. USRF offers no investment guarantees to its members. This means that members carry all the investment risks underlying the management of the assets and therefore require that an acceptable balance be maintained between expected returns and the level of risk taken to achieve these returns.

Given the above, USRF's investment objectives can be described as achieving excellent investment performance over longer periods (for the Growth Portfolio in particular, as the driver of members' long-term returns), with satisfactory short-term returns and within acceptable levels of risk. The investment objectives of the optional portfolios are to reflect the required protected return profile, as well as a favourable comparison with the respective benchmarks and peer groups of these portfolios.

What follows is an explanation of USRF's investment objectives and a more detailed description of "excellent investment performance" and "acceptable risk levels":

### **3.1 Excellent Investment Returns**

Managing the assets of USRF must be aimed at earning optimised short- and long-term returns, taking due note of the investment risks.

#### **3.1.1 The short-term return objective is defined as follows**

The performance of USRF should exceed the median performance of asset managers in the market. Expressed as a half-yearly gross rate of return (as at 30 June and 31 December), it is compared on a gross basis with the Alexander Forbes Best Investment View survey.

#### **3.1.2 The definition of the long-term return objective is twofold, namely**

##### **i) Top-quartile performance**

- a. The performance of USRF should exceed the average rate of return achieved by 75% of asset managers in the market over a rolling three-year term (as at 30 June and 31 December). The results of the Alexander Forbes Best Investment View survey will be used as a benchmark.
- b. The asset managers are also measured individually against their respective benchmarks as per the Investment Management Agreement between the Fund and the respective asset manager.

##### **ii) Rate of return**

The rate of return of USRF (i.e. the average rate of return over a rolling five-year term as measured on 30 June and 31 December) should exceed the inflation rate plus five percentage points. The investment

index of the Fund and the Consumer Price Index are used as benchmarks.

### **3.2 Acceptable Levels of Risk**

In the process of producing optimised returns, the assets of USRF should not be exposed to unacceptable risks.

The following investment risks are taken into account:

#### **3.2.1 Risk of insufficient retirement income**

The loss of income potential of a member's assets in retirement is considered the biggest risk for members.

In order to combat this, the "right risk" is addressed at the "right time" – young members are given exposure to an aggressive investment strategy to combat the risk of insufficient returns over the long term. In this context permanent loss of capital (when assets are sold at a loss relative to a point of reference), instead of volatility, is considered the biggest enemy.

For members who are nearing retirement, the focus shifts to the protection of the income potential of the assets, depending on the annuity used.

So members aged 53 years and older are given the option to select other portfolios that will suit their needs. The Fund implemented a lifestage model as the default option. The model moves members' underlying assets to lower-risk investments with effect from 1 January in the year of their 60th birthday. Members may choose whether or not to participate in this model.

#### **3.2.2 Liquidity risk**

The risk of not having liquid assets or not being able to realise the assets on a reasonable basis in order to pay benefits or meet other liabilities.

This risk is avoided by investing in liquid (negotiable) assets.

#### **3.2.3 Risk of capital loss**

The risk of losing the capital value of the investments. This risk must be considered in the short term and over longer time horizons.

The effect of this risk reduces over longer time horizons, as short-term fluctuations in market values are not realised. The risk is reduced by diversifying the underlying assets (between various asset classes) and by appointing more than one asset manager (giving due consideration to different investment styles).

#### **3.2.4 Risk of negative real returns**

The risk that the nominal returns will be lower than the inflation rate and that the real value of the assets will decrease over time.

This risk is reduced by investing in growth assets such as equities (shares) or property and by adopting a more aggressive investment profile to increase returns in the long term.

#### **3.2.5 Risk of underperformance**

The risk that the returns will be lower than what is required to achieve the return objectives.

This risk is managed by setting clear short- and long-term investment objectives and monitoring performance. Trustees should consider taking action if the objectives are not achieved,

Volatility relative to the benchmark (peer group) should be managed more carefully than volatility in absolute terms.

#### **3.2.6 Volatility of investment returns**

The investment returns of asset managers do fluctuate.

This risk can be reduced by diversifying the portfolio. Asset managers will be monitored with regard to their distribution of returns (e.g. standard deviation).

#### **3.2.7 Global investments**

Investors seek to reduce the volatility of returns and dependency on the South African economy by investing a portion of their assets offshore.

The Fund liabilities are rand denominated, so offshore investments carry an exchange rate risk (also called currency risk), as the currency invested

in may depreciate against the rand. On the other hand, consumers (including pensioners drawing a pension from the Fund) buy imported products that are subject to the exchange rate. In this case exposure to foreign exchange protects the member against import inflation. Nevertheless, currency risk still applies, as various members buy various combinations of local and offshore products.

This risk is reduced when only a limited portion of the Fund's assets is invested offshore. The current limit imposed by the SA Reserve Bank, namely 25% of total assets (with an additional 5% in Africa), is well within the maximum acceptable level of offshore exposure. Should the Reserve Bank limit exceed 30%, the Fund's offshore exposure will have to be reviewed by the Trustees.

### **3.3 Member Choice**

The Trustees believe that member choice is important, but should be limited to avoid confusion among members. So excessive choice should not be a consideration and, where possible, advice should be made available to assist members in making decisions in this regard.



#### **4. INVESTMENT STRATEGIES**

The investment strategies of USRF arising from the investment objectives can be summarised as follows:

- 4.1** Assets of members younger than 53 years are invested in the Growth Portfolio. Members who wish to invest in a Shariah Compliant Portfolio may however do so by opting out of the Growth Portfolio and accessing the Shariah Compliant Portfolio offered by the Fund.
- 4.2** Members aged 53 years and older may choose between the following options:
- Aggressive Absolute Return Portfolio;
  - Conservative Absolute Return Portfolio;
  - Capital Protection Option (Cash Portfolio);
  - Portfolio offering hedging against interest rate fluctuations;
  - Shariah Compliant portfolio; and
  - Growth Portfolio.

Once a member has made a portfolio move, another move is only allowed after three months. This limitation should discourage members from timing moves at short intervals.

#### **4.3 The lifestage model works as follows**

- 4.3.1** The model will be implemented six years before 31 December following the member's 65th birthday.
- 4.3.2** 4% of a member's total portfolio will be moved on a quarterly basis from the Growth Portfolio to an Aggressive Absolute Return Portfolio and a Conservative Absolute Return Portfolio, split into equal portions between these portfolios.
- 4.3.3** The first move of assets will take place on 1 January in the year the member turns 60.
- 4.3.4** The target portfolio as at 31 December following a member's 65th birthday is 50% Aggressive Absolute Return Portfolio and 50% Conservative Absolute Return Portfolio, aligned with the default option for members making use of the in-fund living annuity.

- 4.3.5** For members who are not retiring at their normal retirement age (i.e. 31 December of the year in which the member turns 65), the investment strategy will be kept unchanged. The member concerned must also comply with any employer and/or legal requirements to qualify for this.
- 4.3.6** Members may opt not to make use of the lifestage model.
- 4.4** The Trustees will appoint at least three asset managers to manage the Growth Portfolios, with due consideration given to the different management styles of different asset managers.
- 4.5** The asset managers are given power of attorney in the management of the Fund assets. However, the asset managers are obliged to comply, at all times, with the requirements of the South African Reserve Bank and the Pension Funds Act of 1956, as amended. Derivative instruments may only be used for hedging purposes or to manage asset distribution within the portfolio.
- 4.6** Offshore assets are invested in a balanced portfolio and the underlying assets are managed by specialist asset managers.

## **5. INVESTMENT PHILOSOPHY AND LIMITATIONS**

This section explains the philosophy and limitations applied in the implementation of the investment strategies as mentioned in the previous section.

### **5.1 Limitations**

The Fund investments are subject to applicable legislation, including the Pension Funds Act and Regulation 28 in particular. Regulation 28 govern the permitted levels of exposure to various asset classes and investments in individual assets/securities.

The high-level limits as delineated in Regulation 28 is shown in the table below:

<b>Asset Class</b>	<b>Maximum exposure as % of fair value of all assets</b>
Cash and Money Market	100%
Bonds	100%
Equities	75%
Real Estate	25%
Commodities	10%
Hedge Funds	10%
Private Equity Funds	10%
Other	5%

## 5.2 Allowable Asset Classes

Alternative asset classes may be used when there is a strong investment rationale. In balanced portfolios the decision is made by the investment manager. In a specialised mandate structure the Trustees will set limitations based on liquidity and risk management considerations.

Alternative asset classes include targeted investments, among others.

## 5.3 Balanced versus Specialist Mandates

The Trustees currently believe that balanced mandates are more effectively making use of asset manager capabilities, than specialist mandates.

However, questions are raised about the sustainability of asset managers' capability to add value through tactical asset allocation. Therefore, this approach will be reviewed continually. The offshore asset manager is currently employing underlying specialist mandates.

Specialist mandate structures will also lead to more Trustee and asset consultant engagement and responsibility in the overall strategy.

## 5.4 Active and Passive Exposure

Passive exposure will be considered where there is a strong case to be made that it is more effective than active exposure. If a specialist mandate structure is used passive exposure will be considered separately per individual asset class.

Generically, active asset management is supported with the conviction that active asset managers are able to sustain their outperformance of passive mandates.

### **5.5 Single vs Multi-managers**

Where asset size is sufficient to justify Fund exposure to a combination of single managers to suit the specific needs of the Fund, it will be implemented. Multi-managers will be used where asset size is not adequate to justify the use of single managers.

The Trustees prefer not to use a pricing platform if practically possible to do without one.

### **5.6 Small (new) vs Big (established) Asset Managers**

Appointing upcoming investment managers will not be a strategic consideration. If existing managers' appointments are reviewed other potential asset managers will be considered, including upcoming managers if a strong investment rationale exists.

The same applies to economic empowerment. When two asset managers are assessed and considered to be very similar, economic empowerment may be a decisive factor.

### **5.7 Fees**

Limiting performance fees is considered an important part of an institutional investment strategy. However, limiting fees is a consideration secondary to the investment rationale.

### **5.8 Pooled versus Segregated Mandates**

There is no strong preference for either pooled or segregated mandates. Similarly, where segregated mandates are used, there is no strong preference for or against the use of a centralised custodian.

## 6. REVIEW OF THE INVESTMENT PROCESS

An important part of the investment process is monitoring the investments to ensure that the investment objectives are achieved, and reviewing the investment strategies to ensure that the requirements of the Fund and its members are met.

The investment strategies will be reviewed from time to time, at least once a year. The review will be conducted taking note of new trends (e.g. individual investment choice and offshore investments), feedback received from members, and developments in the investment environment.

Investment performance of the Fund and of the individual asset managers will be monitored on a regular basis, at least twice a year.

The Trustees may consider alternative strategies if the Fund's investment objectives are not met.

Considering alternative strategies may include the replacement of an asset manager where the manager underperformed a related benchmark.

However, historical investment performance is not a reliable indicator of future investment performance and various other factors should be considered before any decision is made to remove an asset manager.

The Trustees should be future oriented when it comes to investment considerations, as historical returns will not change as a result of changing asset managers. So there should be an expectation that a different manager will deliver better results in the future than an existing asset manager, before changing asset managers.

Poor historical investment performance by one asset manager (especially in the short term) is usually not a sufficient reason to replace that manager. Studies have shown that a strategy where asset managers showing poor historical investment performance are replaced with managers showing good historical performance typically leads to a destruction of investment returns, compared to a strategy where no change is made, even before taking into account the trading costs of such a strategy.

Before replacing an asset manager, the Trustees should consider the following factors, among others, to determine whether any further action is required. Of course, poor historical investment performance may adversely affect these factors, and vice versa.

- Does the asset manager have a competent investment team? Have the interests of the asset manager's staff been aligned with the Fund's interest? A loss of top portfolio managers or an unusually high staff turnover, for example, has a negative effect on expected future returns.
- Does the manager follow the required investment philosophy and does the philosophy still make sense? Do the asset manager and Trustees still believe in the investment philosophy the manager is expected to follow, and does it still fit in with the Fund's investment strategy (for example, does the investment manager/philosophy still offer the expected diversification benefits and is the strategy still expected to be successful in the future)?
- How does the asset manager make and implement investment decisions and what measures are in place to, for example, ensure that mandates are not exceeded and that different investors are treated fairly? Is there a sensible portfolio construction process in place?
- Does the asset manager display financial and structural stability?
- Is the compensation the Fund pays to the asset manager still competitive?

If the Trustees believe that an asset manager still performs well considering these factors, and the manager is still expected to deliver sound investment returns in the future, the manager should be retained despite the poor historical investment performance.

The following performance measures, and associated actions if not met, are used as a guideline for future decisions:

### **6.1 Short-term Performance Measure**

The performance of USRF's local assets should exceed the median performance of asset managers in the market. It should be expressed as a half-yearly gross rate of return (as at 30 June and 31 December). (It is compared on a gross basis with the local Alexander Forbes Best Investment View survey.)

The short-term performance of the offshore assets will be compared against 70% of the MSCI World Index and 30% of the Citi WGBI Index, as well as managers managing assets in a similar way.

**Action:**

Concern should be expressed if performance fails to match the short-term performance measure over four semesters. A detailed explanation of the historical performance and future strategy will be required. The Trustees may consider alternative strategies if there is no improvement in the next six months.

**6.2 Long-term Performance Measure (1)**

The performance of USRF should exceed the average return achieved by 75% of asset managers in the market over a rolling three-year term (as at 30 June and 31 December). The results of the Alexander Forbes Best Investment View survey will be used as a benchmark.

**Action:**

Concern should be expressed if performance fails to match the long-term performance measure over six consecutive three-year terms. A detailed explanation of the historical performance and future strategy will be required.

The Trustees may consider alternative strategies if there is no improvement in the next six months.

**6.3 Long-term Performance Measure (2)**

The rate of return of USRF (i.e. the average rate of return over a rolling five-year term as measured on 30 June and 31 December) should exceed the inflation rate plus five percentage points. The investment index of the Fund and the Consumer Price Index are used as benchmarks.

**Action:**

Concern should be expressed if performance fails to match the long-term performance measure over four consecutive five-year terms. The Trustees should consider the investment strategy in the light of future investment return expectations and the reasons for the historic performance.

**6.4 Distribution of Returns**

The returns earned by the USRF asset managers should match (or exceed) the performance they each achieve on other retirement funds (with a similar investment mandate) under their management. This should be compared on an

annual basis (as at 31 December). The results of the Alexander Forbes Best Investment View survey will be used as a benchmark.

**Action:**

Should a negative pattern develop, the Trustees should request the asset manager to provide an explanation and take any other appropriate action.

**6.5 Return/risk Profile**

The risk profile of the asset managers should correspond with the profile according to which they were appointed. This should be compared on the basis of a rolling three-year return/risk profile (as at 30 June and 31 December). The results of the relevant Alexander Forbes survey will be used as a benchmark.

**Action:**

Should the risk profile of the manager change, and the change is sustained over a period of one year, the Trustees may consider alternative strategies.

**7. APPOINTMENT OF ASSET MANAGERS**

The asset managers are selected on the basis of their ability to achieve the investment objectives of the Fund.

The following criteria were applied to select the USRF assets managers:

- The asset manager's track record, including rates of return, volatility of returns over time and variances in returns achieved for different clients.
- Financial structure and stability of the asset manager.
- Resources and competencies of the asset manager's investment team.
- Investment decision processes followed and controls that are in place.
- The investment philosophy of the asset manager.
- Contractual matters, including a competitive fee structure.



## 8. RESPONSIBLE INVESTING

The Fund adopts the principles of Code for Responsible Investing in South Africa (CRISA), delineated in Annexure A, which include –

- 8.1. Incorporating sustainability-, environmental-, social- and governance considerations in investment decisions.
- 8.2. Acceptance of ownership responsibilities
- 8.3. A collaborative approach to promote acceptance and implementation of the principles of CRISA
- 8.4. Managing any conflicts of interests including the asset managers' access to material non-public information; and
- 8.5. Promoting transparency and disclosure on investment decisions.

In practice the USRF will expect its asset managers to provide guidance on these matters with the overriding principle to consider the best interests of the Fund in the process.

The Fund requires all its asset managers to develop and implement a policy on sustainable investing which includes a proxy voting policy and which covers at least:

- Changes in capital structure of the investee company or organization
- Remuneration policies in the investee company
- Election of the leadership of investee companies

All asset managers will be interrogated on their proxy voting and their engagements with investee companies on economic, social and governance matters on an annual basis. Asset managers are therefore to provide statistics on the number of engagements (letters, investor days, in person visits, roadshows, etc.) and examples of where they addressed ESG issues with investee companies.

## **ANNEXURE A: EXTRACT FROM CODE OF RESPONSIBLE INVESTING IN SOUTH AFRICA**

2011 Institute of Directors in Southern Africa. All rights reserved

### **SUMMARY AND RELEVANCE STATEMENT**

The Code for Responsible Investing in South Africa (CRISA) gives guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance.

There are five key principles:

1. An institutional investor should incorporate sustainability considerations, including environmental, social and governance, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.
2. An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.
3. Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.
4. An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these when they occur.
5. Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

## DEFINITIONS

In this Code for Responsible Investing in South Africa ('CRISA'), unless the context indicates otherwise:

**code of conduct** means the internal code of conduct developed by a company by which it expects its directors, managers and employees to behave.

**company or investee company** means a company in which an institutional investor invests or considers investing as a shareholder.

**ESG** means environmental, social and governance.

**institutional investor** means any legal person or institution referred to in the definition of "financial institution" in section 1 of the Financial Services Board Act No 97 of 1990, to the extent that these legal persons or institutions own and invest in the equity of a company and have obligations in respect of investment analysis, activities and returns to ultimate beneficiaries.

**integrated reporting** means a holistic and integrated representation of the company's performance in terms of the value that it has generated within the triple context of the economy, society and natural environment.

**King Report or King Code** means The King Report or The King Code of Governance for South Africa, 2009 or its successor in title.

**mandate** means the arrangement between an institutional investor and its service provider whereby the service provider makes investment decisions or performs investment activities for and on behalf of the institutional investor.

**service providers** means those who act under mandate of the institutional investor in respect of any of the investment decisions and investment activities dealt with in CRISA, including asset and fund managers and consultants.

**supply chain code of conduct** means the code of conduct by which a company expects its suppliers to behave and by which the company undertakes to conduct itself in its relationship with the supplier. The supply chain code of conduct includes conduct in terms of ethics and sustainability considerations.

**sustainability** means the ability of a company to conduct its operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs. Sustainability includes managing the impact that the business has on the life of the community, the broader economy and the natural environment in which it operates. It also includes the converse, namely considering the effect that the society, the economy and the

environment have on business strategy. Sustainability includes economic and ESG considerations.

**stakeholder** means those who reasonably have a legitimate expectation to be engaged with or to receive information from the institutional investor or its service providers on the grounds that they are affected by the investment activities and investment decisions of the institutional investor or its service providers.

**transparent** means easy to understand or recognise, balanced, complete, obvious, candid, open, frank, relevant and accessible to stakeholders.

**ultimate beneficiaries** means those end-beneficiaries or underlying investors such as the individual savers or pension fund members to whom institutional investors owe their duties, including the individual retirement fund beneficiaries and the individuals in whose names on whose behalf unit trusts and policies are held.

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

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

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

3. An institutional investor should develop a policy dealing with ownership responsibilities. The policy should include, but not necessarily be limited to the following:
  - a. guidelines to be applied (e.g. King III) for the identification of sustainability concerns, including ESG, at a company.
  - b. mechanisms of intervention and engagement with the company when concerns have been identified and the means of escalation of activities as a shareholder if these concerns cannot be resolved.
  - c. voting at shareholder meetings, including the criteria that are used to reach voting decisions and for public disclosure of full voting records
4. Even if passive investment strategies are followed, active voting policies incorporating sustainability considerations, including ESG, should still be followed.
5. An institutional investor should ensure implementation of the policy on ownership responsibilities and establish processes to monitor compliance with the policy.

6. Where the institutional investor outsources to third party service providers, the onus is on the institutional investor as owner to ensure that the mandate deals with sustainability concerns, including ESG, and that there are processes to oversee that the service providers apply the provisions of CRISA when executing their mandate.
7. The institutional investor should introduce controls that prevent it from receiving price sensitive information regarding a company or acting on such information in a manner that makes it an 'insider' in terms of the Securities Services Act No 36 of 2004. These controls should be applied when engaging with the company, and when seeking any information it requires, whether this is to fulfil its duties or to act within the guidelines of CRISA.

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

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

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

9. All of the circumstances and relationships that could potentially lead to a conflict of interest should be identified by the institutional investor and a policy for preventing and managing these conflicts should be developed.
10. An institutional investor should ensure implementation of the policy on prevention and management of conflicts of interests and establish processes to monitor compliance with this policy.

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

11. An institutional investor should regularly engage with its stakeholder groupings, including investee companies and the ultimate beneficiaries, in order to, inter alia, identify and

understand information requirements and, at least once a year, fully and publicly disclose to what extent it applies to CRISA.

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

## **ADDENDUM – BRIEF HISTORY OF THE INVESTMENT STRATEGY**

### **i) Growth Portfolio – local assets**

When the Fund was initially established, the Trustees appointed Coronation Asset Management, the Board of Executors and Sanlam Asset Management to manage the market value portfolios of the Fund. Considered the more conservative asset manager, Sanlam Asset Management was given 40% of the assets to manage. The remaining 60% was split equally between Coronation Asset Management and the Board of Executors, seen as more aggressive asset managers.

Following a period of disappointing returns, steps were taken against the Board of Executors and Sanlam Asset Management in terms of the investment framework of the Fund. Eventually, the Trustees agreed to switch the Board of Executors portfolio to Investec Asset Management, terminating the appointment of the Board of Executors on 28 February 1999. Sanlam Asset Management was replaced with Allan Gray, effective 1 March 2002. At that stage Allan Gray was the top-performing asset manager in the Alexander Forbes survey of the ten largest asset managers.

Early in 2000, the Trustees made a decision to appoint a fourth manager, for the market value portfolios. The Trustees were keen to support an empowerment group, at the same time securing a greater degree of diversification of investment styles. Consequently, African Harvest Value Managers was appointed with effect from 1 April 2000 to manage a small portfolio (initial investment R30 million).

Following a period of disappointing returns from Investec and African Harvest, the Trustees demanded regular feedback from the asset managers involved in 2006 and 2007, also reducing the assets under their management by channelling investment flow. In March 2007, a combined amount of approximately R100 million was disinvested from Investec and Cadiz African Harvest and placed with Coronation. In May 2007, the Trustees made a decision to terminate the services of Investec and Cadiz African Harvest and appointed Foord and Prudential to replace them. The transfer was completed in September 2007 and about 18% (approximately R200 million) of the Fund's local assets were placed with each of the two new managers.



In May 2011, the Trustees agreed to reduce the number of local asset managers to three by terminating the appointment of Foord. The assets involved would first be used to increase the offshore exposure of the Growth Portfolio to the permitted 25%, and then the remaining assets in the Foord portfolio would be divided between Coronation and Prudential.

In March 2016, the Trustees made a decision to replace the existing offshore asset managers in the next 12 months with a pooled global balanced portfolio. The portfolio would be managed by asset managers listed as category 1 asset managers by WillisTowersWatson (WTW).

The asset composition of the portfolio is as follows:

- Global equities : 70%;
- Global bonds : 15%;
- Global real estate : 15%.

In September 2017, the Trustees made a decision to terminate and replace Prudential with Investec. This was mainly due to Prudential's risk constraints on performance relative to its benchmark (the median of the peer group), which implies the expectation of second quartile performance, whereas the Fund targets top quartile performance. The blend between Allan Gray, Coronation and Investec is expected to provide the Fund with diversification benefits and therefore a more stable and consistent return profile. Although it was briefly considered to employ 4 managers, the decision was unanimous to make use of only 3 managers in order not to dilute performance to average and maintain commitment to the top quartile target.

## **ii) Growth Portfolio – offshore assets**

At the beginning of 2004, the Trustees reviewed the offshore portfolios and concluded that the Coronation Global Equity Fund, a fund of hedge funds, no longer met the requirements of the Trustees.

The management style (pure hedge fund) and the returns of this fund (particularly following the write-off of the Lancer Fund) led to the Trustees' decision to transfer the management of all offshore assets to Allan Gray Orbis – Best House View. With the

transfer, the offshore component was increased to restore the Fund's position closer to the target of 15% offshore exposure.

In May 2011, the Trustees agreed to increase the Growth Portfolio's offshore exposure to the permitted 25% of assets. Furthermore, it was decided to make use of an additional offshore asset manager, Contrarius. In terms of this decision, the offshore assets of the Growth Portfolio had to be divided equally between the offshore asset managers. The 25% exposure is in line with the SA Reserve Bank limit. Should this limit exceed 30%, the Fund's offshore exposure will have to be reviewed by the Trustees.

In 2015 the investment committee reviewed the offshore portfolios and concluded that the Orbis and Contrarius returns were too unpredictable. On 15 March 2016, the Trustees made a decision to move the offshore assets managed by Orbis and Contrarius, via four quarterly withdrawals, to the Diversified Global Balanced Portfolio (DGBP). The DGBP is a pooled balanced portfolio under the Sygnia life licence, with underlying specialist investment managers appointed on the advice of WillisTowersWatson.

### **iii) Choice from age 53**

The Trustees initially appointed Old Mutual Asset Management to manage a guaranteed portfolio for the Fund. However, when problems arose relating to the fact that Old Mutual's bonuses did not vest in full immediately, the Trustees decided to make use of the Investment Solutions Full-vesting Portfolio with effect from 1 April 1997. In November 2004, a decision was made to use a cash portfolio as a capital protection option instead of a guaranteed bonus-type portfolio, since bonus declarations were not satisfactory. Investment Solutions' Banker Portfolio is used as the cash portfolio.

The Trustees agreed to make the following options available to members aged 53 and older, with effect from 1 October 2016:

- Cash Portfolio (IS Banker);
- Aggressive Absolute Return Portfolio (managed by SMMI);
- Conservative Absolute Return Portfolio (managed by SMMI);
- Growth Portfolio; and

- Portfolio offering hedging against interest rate fluctuations.

#### **iv) Other investment options**

In November 2001, the Trustees agreed to give members the option to invest their fund credits in the portfolio of their choice, by making use of the Individual Investment Plan from Investment Solutions. This facility is offered at no extra costs to the Fund, as the members who make use of this option carry the associated costs.

#### **v) The lifestage model**

On 27 July 2016, the Board of Trustees made a decision to amend the lifestage model with effect from 1 January 2017. The phase-in period has been extended from three to six years prior to retirement, with 25 quarterly asset transfers in equal portions to the Conservative Absolute Return Portfolio and the Aggressive Absolute Return Portfolio, both managed by Sanlam Multi-Managers International (SMMI).

#### **vi) In-Fund Living Annuity**

In July 2015 the National Treasury issued draft regulations on default strategies to be implemented by all Funds. The final regulations were issued effective 1 September 2017 and all retirement funds will amongst others, be required to have an annuity strategy for retirement members. The Trustees have pre-empted these requirements and decided to introduce cost-effective In-Fund Living Annuities from 1 January 2017. The Fund offers a Trustees' Default Option and a Customised option.

The Trustees' Default option requires very little effort from the retired member. It is designed to be sustainable, i.e. to ensure that capital does not erode during retirement. The investment strategy is defined as moderate and is designed to manage risk and volatility in investment returns. The capital is invested in a 50/50 mix between an aggressive and a conservative absolute return multi-managed portfolio.

The Customised option offers retired members flexibility. Members may invest in any combination of the Fund's five investment portfolios (Aggressive Absolute Return Portfolio, Conservative Absolute Return Portfolio, Capital Protection Option (Cash

Portfolio), Portfolio offering hedging against interest rate fluctuations, and Growth Portfolio).

**vii) Shariah Complaint option**

Given a demand from members for a Shariah Compliant portfolio, the Trustees agreed to allow a single-managed portfolio onto its investment menu for members wishing to invest therein. The Old Mutual Albaraka Balanced portfolio was therefore implemented by the Fund to cater to the needs of this particular group of members. Members are therefore able to opt out of the default lifestage strategy to access this option if they wish to.

Approved and signed at Stellenbosch on 27 February ~~2017~~. 2018



CHAIRPERSON



PRINCIPAL OFFICER



ACTUARY