

**CORPORATE GOVERNANCE FAILURES IN SOUTH AFRICA: ARE PENSION
FUNDS NEXT?**

**RESEARCH PAPER SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENTS OF THE LL.M DEGREE IN MERCANTILE LAW IN THE FACULTY
OF LAW OF THE UNIVERSITY OF WESTERN CAPE**

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DECLARATION

I, Zaakir Enoos, declare that **Corporate Governance Failures in South Africa: Are Pension Funds Next?** is my own work, that it has not been submitted for any degree or examination at any other university, and that all the sources that I have used have been indicated and acknowledge by complete references.

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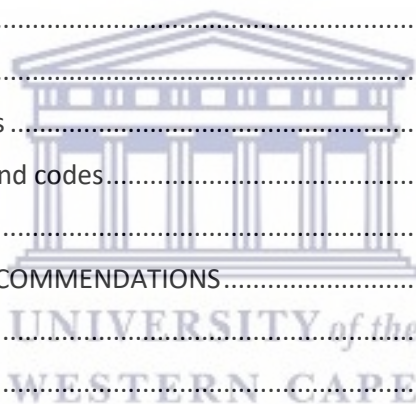
Pension Fund



TABLE OF CONTENTS

DECLARATION	i
ACKNOWLEDGMENTS	ii
KEYWORDS	iii
TABLE OF CONTENTS	iv
CHAPTER 1 – INTRODCUTION	1
1.1 The research background and problem statement	1
1.2 Research objectives	4
1.3 Research question:.....	5
1.4 Research Methodology	5
1.5 Chapter Outline.....	6
CHAPTER 2 – SA PENSION FUND REGULATORY LANDSCAPE	8
2.1 Introduction	8
2.2 Social security structure in South Africa	9
2.3 Pension fund role players	10
2.3.1 Pension Fund and its Board of Trustees	10
2.3.2 Principal Officer.....	12
2.3.3 Auditor	13
2.3.4 Valuator.....	14
2.3.5 Administrator	15
2.3.6 Other role players	16
2.4 Size of the Pension Fund industry.....	16
2.5 Conclusion.....	17
CHAPTER 3 – THE GOVERNANCE PARAMETERS OF PENSION FUNDS	18
3.1 Introduction	18
3.2 Governance framework	19
3.2.1 Relevant Statutes	19
3.2.2 Non- binding guidelines and codes.....	27
3.3. Review of selected pension funds’ annual reports.....	31
3.3.1 Selection process	31
3.3.2 Review of annual reports.....	31
3.4 Conclusion.....	33

CHAPTER 4 – RECENT CORPORATE FAILURES.....	35
4.1 Introduction	35
4.2 Recent corporate failures in South Africa	37
4.2.1 Steinhoff International Holdings.....	37
4.2.2 Tongaat Hulett Ltd	38
4.2.3 VBS Mutual Bank.....	39
4.2.4 Common thread in the recent governance failures in SA.....	41
4.3 Parallel between a Board of directors and a Board of a pension fund.....	41
4.4. Potential for corporate failures to filter into the pension fund domain	43
4.5 To what extent are the existing controls in the regulation of pension funds in SA adequate to mitigate against similar governance failures witnessed in corporate sector	45
4.5.1 Trustee toolkit.....	45
4.5.2 Onsite visits by the FSCA.....	45
4.5.3 Directives by the FSCA	46
4.5.4 Enforceable undertakings	46
4.5.5 Non-binding guidelines and codes.....	47
4.6 Conclusion.....	47
CHAPTER 5 – CONCLUSION AND RECOMMENDATIONS.....	50
5.1 Introduction	50
5.2 Conclusion.....	50
5.2.1 Summary of the salient features across chapters 2 to 4	50
5.3 RECOMMENDATIONS.....	54
5.3.1 Enforcement of minimum skills and training of board members.....	54
5.3.2 Onsite visits.....	54
5.3.3 Non-binding guidelines and codes.....	55
5.4 AREAS OF FURTHER RESEARCH.....	56
BIBLIOGRAPHY	57



CHAPTER 1 – INTRODCUTION

1.1 The research background and problem statement

In recent times, South Africa ('SA') has seen many corporate failures due to poor corporate governance. It spans across Johannesburg Stock Exchange ('JSE') listed companies, State Owned Enterprises ('SOE's')¹ as well as non-listed companies,² ranging from business such as mutual banks and companies that specialise in agricultural products to companies who deal in furniture and household goods. The ramifications of such failures were felt across all corners of SA and beyond.³

Reflecting on the above failures, one will find a common thread of poor corporate governance having played a hand in their catastrophic downfall.⁴ One such corporate failure was that of Steinhoff International, the once darling stock of investors in SA and abroad. It has been reported that Steinhoff overstated its profits over several years in a \$7.4 billion accounting fraud involving a small group of top executives and outsiders.⁵ Pieter Naude notes that *'Steinhoff appeared to comply with all the legal and listing requirements in its various jurisdictions. This created a (false) sense of security for both investments and other stakeholders'*.⁶ It is important to point out that the catastrophic crash resulted in the Steinhoff International shares price plummeting from R46.25 to R 10 in a matter of a two day period, 5 December 2017 to 7

¹ Barlow A 'SOE Failures: a Symptom' The Journal of The Helen Suzman Foundation, issue 78 April 2016 available at <https://hsf.org.za/publications/focus/focus-78-the-economy-1/andrew-barlow.pdf> (accessed on 14 March 2021).

² Corruption watch 'VBS Bank Scandal revealed in explosive report' available at <https://www.corruptionwatch.org.za/vbs-bank-scandal-revealed-in-explosive-report/> (accessed on 14 March 2021).

³ Cronje, J 'A Steinhoff guide for dummies: updated for 2018' Fin24 8 December 2007 available at <https://www.fin24.com/Companies/Retail/a-steihoff-guide-for-dummies-20171208> (accessed on 19 January 2021).

⁴ 'Inside the Steinhoff saga, one of the biggest cases of corporate fraud in South African business history.' CNBC Africa 28 June 2018. available at <https://www.cnbc.com/2018/steinhoff-rise-fall/> (accessed on 28 January 2021); Also see The South African Reserve Bank Financial Stability Review 2nd edition (2018) 31 ;Also see Phillips X 'Lack of SOE governance is a drain on South Africa's economy, warns OECD' theafricareport 10 August 2020 accessed at <https://www.theafricareport.com/36712/lack-of-soe-governance-is-a-drain-on-south-africas-economy-warns-oecd/> (accessed on 31 January 2021).

⁵ Motsoeneng T & Rumney E 'PwC investigation finds \$7.4 billion accounting fraud at Steinhoff, company says' Reuters 15 March 2019 accessed at <https://www.reuters.com/article/us-steinhoff-intln-accounts-idUSKCN1QW2C2> (accessed on 31 January 2021).

⁶ Naude P *Business perspective on the Steinhoff Saga* (2018) 16.

December 2017.⁷ It must be pointed out that investors all around lost copious amounts of money in a matter of days. One such group of investors who were affected by this were SA pension funds. For the purposes of this paper, the term pension fund should be read to mean pension funds in the wider sense which includes pension funds, provident funds and retirement annuity funds. The paper will focus on pension funds that are subject to the Pension Funds Act 24 of 1956 ('PFA') and thus falls within the regulatory ambit of the Financial Sector Conduct Authority to the exclusion of funds that have their own specific dedicated legislation which does not fall within the regulatory ambit of the Financial Sector Conduct Authority.

The Steinhoff scandal affected many pension funds (and their millions of members) as they had some exposure to Steinhoff shares whether it be direct or indirect.⁸ It has been reported by the Financial Services Board (now known as the Financial Sector Conduct Authority) that of the 1 080 pension funds surveyed, 948 pension funds had exposure to Steinhoff shares with a total exposure value of R25bn on 1 December 2017. By 8 December 2017 this exposure had fallen to R7bn thus, the pension funds surveyed who had exposure to Steinhoff suffered losses to the value of R18bn.⁹

Similar to companies, pension funds are separate legal entities which are managed by a board. A pension fund and its board are creatures of statute and thus the primary source of legislation is the PFA as well as the more recent overarching Financial Sector legislation namely, Financial Sector Regulation Act 9 of 2017 ('FSRA'). Section 4 of the PFA makes it mandatory for a pension fund

⁷ Ensor L 'High Court delays bid to liquidate assets of former Steinhoff boss', Times Live 22 December 2017 available at <https://www.timeslive.co.za/sunday-times/business/2017-12-22-high-court-delays-bid-to-liquidate-assets-of-former-steinhoff-boss/> (accessed on 31 January 2021).

⁸ 'The Steinhoff saga: Who are the biggest losers?' Bizcommunity 2 February 2018 available on <https://www.bizcommunity.com/Article/196/516/174106.html> (accessed on 29 January 2021).

⁹ Ensor L 'Pension Funds lost billions over Steinhoff' Times live 31 January 2018 available <https://www.timeslive.co.za/sunday-times/business/2018-01-31-pension-funds-lost-billions-over-steinhoff/#:~:text=Markus%20Jooste%20reported%20to%20Hawks%20over%20Steinhoff%20saga&text=Thus%20the%20pension%20funds%20that,between%200.01%25%20and%206.04%25>. (accessed on 29 January 2021).

to register with the Financial Sector Conduct Authority prior to commencing any pension fund business. Every registered pension fund is required to have rules as prescribed by section 11 of the PFA. Section 13 of the PFA sets out who the funds' rules are binding on, it states the following: *'the rules of a registered fund shall be binding on the fund and the members, shareholders and officers thereof, and on any person, who claims under the rules or whose claim is derived from a person so claiming.'*

Once the fund's rules are registered, in terms of section 7A(1) of the PFA, 'every fund shall have a board consisting of at least four board members, at least 50% of whom the members of the fund shall have the right to elect.' Section 7(1A) continues to state that *'the composition of the board shall at all times comply with the requirements of the rules of the fund any vacancy on such board shall be filled within such period as prescribed'*. In 2016, the Authority prescribed that vacancies on the board must be filled within 90 days from the position becoming vacant.¹⁰ Importantly, section 7B of the PFA grants the Authority the power to exempt funds from consisting of less than four board members or from having at least 50% elected by the members subject to such conditions as may be determined by the Authority.

As mentioned above, pension funds are controlled by board of trustees, akin to that of a board of directors of a company, which has the ultimate responsibility of protecting the shareholders' assets.¹¹ It is evident when exploring what caused the recent corporate failures in SA, that the failures stem from actions or omissions by an individual director or the board of directors as a collective. It is important to point out that there are various mandatory reporting requirements and governance standards applicable for companies to list on the JSE, these include mandatory

¹⁰ FSB Notice 3 of 2016 'Appointment of Board members in terms of section 7A of the// Pension Funds Act, 1956'.

¹¹ Stewart, F. and J. Yermo (2008), "Pension Fund Governance: Challenges and Potential Solutions", OECD Working Papers on Insurance and Private Pensions, No. 18, OECD publishing 5.

applicable of certain sections of the King Code and prescribed reporting requirements¹² yet such failures such as Steinhoff still occurred.

Currently, in the SA pension fund realm, governance practices or requirements are not mandatory in nature, they take the form of guidelines issued by the Authority to boards of trustees. The question to be asked is if such governance failures can occur in an environment (listed companies) where there are mandatory governance requirements, to what extent are pension funds susceptible to such governance failures occurring given that pension funds do not have specific mandatory governance requirements.

1.2 Research objectives

It is against the above backdrop that this paper will explore the state of pension fund¹³ governance in SA. The research paper seeks to sketch an outline of the current pension fund landscape in SA, after which it will place specific focus on the governance requirements for pension funds. Thereafter, it will question whether these measures are enough to mitigate against such failures as seen in the corporate world or is it just a matter of time before we see a similar scenario unfold in the pension funds industry.

This paper will paint a picture of the enormity of pension funds in SA, by membership as well as asset size.¹⁴ It will unpack the regulatory landscape in which pension funds exist and how a typical fund operates.¹⁵ It will then zoom into specific governance related legislation and standards applicable to pension funds, such standards include the fiduciary duties imposed by legislation,

¹² JSE Limited listing requirements Lexis Nexis 55 point 3.8.4 read with point 8.63(a).

¹³ Wide meaning of Pension Fund (private sector funds) which area governed by the Pension Funds Act 24 of 1956.

¹⁴ Financial Sector Conduct Authority *Annual Report (2019/2020)* 90 total membership stood at 17 522 325 as at and R 4 490 617 000 assets as at 31 December 2018.

¹⁵ Hunter R 'Pension & Retirement Plans in South Africa' SA Financial Regulation Journal 13 February 2020 available at <https://financialregulationjournal.co.za/2020/02/13/pensions-retirement-plans-in-south-africa/> (accessed on 28 January 2021)

rules of the fund, non-binding guidance notes by the regulatory authority and the non-binding King IV report of Corporate Governance in South Africa.¹⁶

The paper will then briefly touch on some recent corporate failures seen in South Africa due to poor corporate governance, highlighting some of the governance controls that were applicable to those corporations, yet they still manage to fail. By doing so, it will focus on the Board of Directors and sub-committees.

The paper will then briefly compare the role of Directors to that of Pension Fund Trustees with a firm focus on what makes these roles similar. By doing so, it seeks to conclude that they are indeed similar and that the corporate failures experienced by South Africa could well happen to Pension Funds in SA which will ultimately affect millions of South Africans.

Learning from the recent corporate failures in South Africa, the paper will thus put forward recommendations that could mitigate against such an occurrence happening in the pension funds industry. Strong legislative requirements, accountability and transparency would bode well in avoiding such failures occurring the Pension Funds Industry.

1.3 Research question:

To what extent are the existing controls in the regulation of pension funds in SA adequate to mitigate against similar governance failures seen in corporate SA in recent times?

1.4 Research Methodology

This research paper will be limited to a desktop study. It will use legislation as the bedrock of the research. It will also rely on regulatory instruments used by the Regulatory Authority for pension

¹⁶ Institute of Directors *King IV Report on Corporate Governance from South Africa 2016*.

funds (Financial Sector Conduct Authority) and to a lesser degree, it will make use of annual reports of various companies and the Authority for pension funds. In addition, it will consider textbooks, peer reviewed journal articles, case law, government policy papers and online publications. It may further include recent articles by industry experts.

1.5 Chapter Outline

This research paper will be segmented into 5 chapters including the introductory chapter.

Chapter 1 – Introduction

In this chapter, the foundation for the study was established. It set out the background and purpose of the study, the research objectives and the research method to be employed, followed by a chapter outline.

Chapter 2 – SA Pension Fund regulatory landscape

This chapter will commence with an explanation of the broad purpose pension funds serve in the SA social security context. It will then set out the relevant legislation in which pension funds exist and will explore the sheer size of the pension fund industry in SA. It will further discuss the role players involved in the operation of a typical pension fund. This will be followed by a brief conclusion.

Chapter 3 – The governance parameters for Pension Funds

Chapter 3 will explore the governance tools applicable to pension funds in SA. It will delve into the binding and non-binding nature of each specific tool. Thereafter, it will take a closer look at how selected fund's implement these tools through reviewing their annual reports to members. It

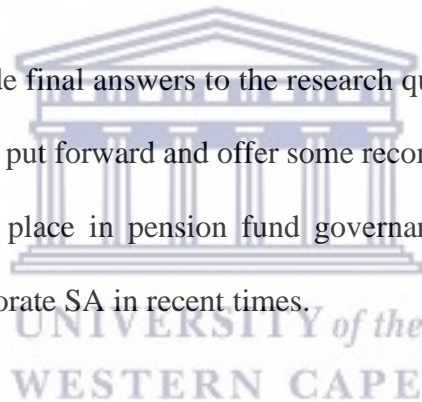
will also explore the evolution of governance in the SA pension fund context. This will be followed by a brief conclusion.

Chapter 4 – Recent Corporate failures

This chapter will examine the recent corporate failures in SA. It will seek to establish a common thread in the downfall of these companies. Furthermore, it will discuss parallels between a board of directors and the Board of a Fund and explore to what extent such failures could filter into the pension fund context.

Chapter 5 – Conclusion & recommendations

The final chapter seeks to provide final answers to the research questions posed. It will include a conclusion based on the research put forward and offer some recommendations to address to what extent adequate controls are in place in pension fund governance to mitigate against similar governance failures seen in corporate SA in recent times.



CHAPTER 2 – SA PENSION FUND REGULATORY LANDSCAPE

2.1 Introduction

In the South African context, social security is rooted in section 27 of the bill of rights which reads as follows: ‘(1) Everyone has the right to have access to (a) health care services, including reproductive health care services (b) sufficient food and water; and (c) social security, including if they are unable to support themselves and their dependants, appropriate social assistance. (2) The state must take reasonable legislative and other measures within its available resources, to achieve the progressive realisation of each of these rights’.¹⁷

The concept of social security has been described as ‘the protection which society provides for its members, through a series of public measures, against the economic and social distress that otherwise will be covered by the stoppage or reduction of earnings resulting from sickness, maternity, employment injury, unemployment, invalidity, old age, death, provision of medical care and provision of subsidies for families and children.’ This protection is provided via social assistance schemes and contributory social insurance programmes.¹⁸

Within the social security realm, one can identify both non-contributory and contributory schemes. Once such contributory scheme would be a pension fund, as defined in the Pension Funds Act (‘PFA’). The Act introduces clear characteristics of such a scheme in that it must exist for the purpose of ‘providing annuities or lump sum payments for members or former members... upon their reaching retirement dates, or for dependant of such member or former members upon the death of such member’.¹⁹ From the definition, it is clear that the term pension fund as defined in the PFA has a wider definition to include pension, provident and retirement annuity funds because as the definition includes characteristics which relate to each of the three retirement savings vehicles.

It is against this backdrop that this chapter will explain the broad purpose of pension funds in the SA context, it will introduce the relevant legislation in which pension funds exist and will detail the sheer size of the pension fund industry in SA. It will further sketch out the key role players

¹⁷ The Constitution of the Republic of South Africa, 1996.

¹⁸ Mpedi LG ‘The evolving relationship between labour law and social security’ available at <https://journals.co.za/doi/pdf/10.10520/EJC125096> (accessed on 9 February 2022).

¹⁹ Section 1 of the PFA definition of pension fund organisation.

involved in the mechanics of a typical pension fund. It intends to set the scene for the later chapters in that it will form a quality base on which the latter chapters will be built.

2.2 Social security structure in South Africa

The current structure of social security in SA can be dissected into three distinct categories, namely, social assistance, social insurance and occupational and voluntary schemes.²⁰

The first category, social assistance, targets a mix of age-related needs and is provided for through, child support grant, care dependency grant, foster child grant, disability grant, older person's grant, war veteran grant, grand-in aid and social relief of distress.²¹ Social assistance is non-contributory in nature and can be linked directly to section 27 of the Constitution.

The second category, social insurance, caters for short term benefits when a worker becomes unemployed or is unable to work due to illness, injury at work and injury on the road. In SA there are three social insurance programmes, namely: the Unemployment Insurance Fund ('UIF'), the Compensation Fund ('CF') as well as the Road Accident Fund ('RAF'). Unlike social assistance, these schemes are contributory in nature.²²

The third category, occupational and voluntary schemes, are schemes where people voluntary belong to, they take the form of pension and provident funds, retirement annuity funds and medical aid schemes.²³

This paper will focus on pension funds, provident funds as well as retirement annuity funds that are subject to the Pension Funds Act ('PFA') and thus regulated by the Financial Sector Conduct Authority.

Occupational retirement funds form a vital cog in government's policy on social security, and forms part of social protection in SA. Government effectively outsourced part of its social responsibility to the private sector.²⁴ In SA, the government seeks to encourage individuals to

²⁰ Inter-departmental Task team on Social Security and Retirement Reform discussion paper *Comprehensive social security in South Africa* (2012) 8.

²¹ Social Assistance Act 13 of 2004 sections 5 – 13.

²² Brockerhoff S 'A review of the development of Social Security Policy in South Africa' 2013 17 -19.

²³ Brockerhoff S 'A review of the development of Social Security Policy in South Africa' 2013 17 -19.

²⁴ Rusconi R 'Regulating South Africa's retirement funds: the case for clearer objectives' 2020 6.

provide adequately for their own retirement and the need of their dependents so that the individual does not have to rely on government (social assistance) when they retire.²⁵ In order to incentivise persons to contribute to pension funds, Parliament via the Income Tax Act²⁶ has made contributions to them tax deductible. The latest amendment to the tax deductibility of retirement contributions was made by National Treasury of SA and signed into law, by the President of SA, in the form of the Taxation Administration Law Amendment Act 23 of 2015 and the Taxation Laws Amendment Act 25 of 2015. It effectively harmonised the tax deductibility to all retirement vehicles and came into effect 1 March 2016. It made provision for all members who contribute to a pension fund to qualify for a tax deduction of up to 27.5% of the greater of taxable income or remuneration up to a maximum of R 350 000 per annum.²⁷

In SA, most pension funds fall within the ambit of the PFA. The exception to this arrangement is pension funds that which the state traditionally contributed towards and were established in terms of separately enacted legislation and thus do not fall within the ambit PFA. These funds include the Government Employees' Pension Fund, Associated Institutions Pension Fund, Post Office Pension Fund, Telkom Pension Fund and the Transnet Pension Fund.²⁸

This paper will focus on the pension funds that fall within the ambit of the PFA which are subject to the supervision of the FSCA to the exclusion of all others that are not regulated by the PFA and thus not supervised by the FSCA.

2.3 Pension fund role players

2.3.1 Pension Fund and its Board of Trustees

Similar to companies, pension funds are separate legal entities which are managed by a board of trustees. The board of trustees are akin to that of a board of directors of a company, which have the ultimate responsibility of protecting the shareholders assets.²⁹

A pension fund and its board are creatures of statute and thus the primary source of legislation is the PFA as well as the more recent overarching Financial Sector legislation namely, Financial

²⁵ National Treasury Republic of South Africa *Retirement Fund Reform discussion paper* (2004) 4.

²⁶ 58 of 1962

²⁷ National Treasury Media Release 'Implementation of Tax Harmonisation of Retirement Fund Contributions and benefits' 3 December 2015 1.

²⁸ Annual report of the registrar of Pension Funds (2017) 15.

²⁹ Stewart F. and Yermo J (2008), "Pension Fund Governance: Challenges and Potential Solutions", OECD Working Papers on Insurance and Private Pensions, No. 18, OECD publishing 5.

Sector Regulation Act 9 of 2017 ('FSRA'). Section 4 of the PFA makes it mandatory for a pension fund to register with the Financial Sector Conduct Authority prior to commencing any pension fund business.

Once the fund's rules are registered in terms of section 7A(1) of the PFA, 'every fund shall have a board consisting of at least four board members, at least 50% of whom the members of the fund shall have the right to elect.' Section 7A(1A) continues to state that 'the composition of the board shall at all times comply with the requirements of the rules of the fund any vacancy on such board shall be filled within such period as prescribed'. Although, it should be borne in mind that, section 7B of the PFA grants the Authority the power to exempt funds from consisting of less than four board members or from having at least 50% elected by the members subject to such conditions as may be determined by the Authority.

The object of board is set out in section 7C(1) of the PFA. These objects include to direct control and oversee the operations of the fund in accordance with the applicable laws and rules of the fund.³⁰ It is important to note the wording used in this section is written in such a way that it lends itself to the interpretation that the board performs an executive function akin to a board of directors of a company as opposed to the day to day running of the fund. The board has more of strategic and oversight function rather than an operational function.³¹ Section 7C(2) of the PFA continuous to detail certain actions expected from a board, these include, but are not limited to act with due care, diligence and good faith, avoid conflicts of interest, act independently and have a fiduciary duty to members and beneficiaries in respect of accrued benefits. One can easily identify similarities between the above and the standard of conduct of directors set out in section 76(3) of the Companies Act 71 of 2008.

Read together with section 7C, section 7D(1) goes further to detail the general duties of the board. Here the wording is clear that that the board 'shall ensure...' - reinforcing that the board has an oversight role and not an operational role. The duties detailed under section 7D include, that the board shall ensure ... that proper records of the fund are kept, proper controls systems are

³⁰ Section 7A(1) of the PFA.

³¹ Hunter R et al *The Pension Funds Act: A Commentary on the Act, regulations, selected notices, directives and circulars* 1st ed (2010) xii 154 -5.

employed on behalf of the fund and that expert advice is obtained on matters where board members may lack sufficient expertise.

As much as the board is responsible to ensure the smooth running of the fund, section 7D(2) provides for the board to ‘in writing and in accordance with a system of delegation set out in the rules, delegate any function under this Act’. Important, the board is not relieved of any functions that is delegated and it may withdraw the delegation at any time.³²

2.3.2 Principal Officer

In terms of section 8 of the PFA, ‘every registered fund shall have a principal executive officer.’ The principal executive officer (‘PO’) must reside in the Republic of SA and must be appointed in terms of the rules of the fund. Every fund must within 30 days after registration of a fund or within 30 days after the appointment of a principal officer give the registrar written notice of the appointment. The FSCA has clarified the information required to be submitted to the FSCA which is encapsulated in Notice 27 of 2011 ‘Directive No. 5’.³³ The directive informs the board that they should ensure that the proposed PO: has the relevant qualifications and experience relating to the management and oversight of pension funds, specifically to the particular office and type of fund in question, is fit and proper to hold such appointment and has been informed of his/her responsibilities in terms of the applicable legislation.³⁴

The PFA makes the PO specifically responsible and accountable for the performance of various duties in terms of the PFA. The PO constitutes a pension funds’ official or contact person with the FSCA for purposes of compliance with the PFA and the regulations.³⁵

The duties of the PO are found in the PFA, board notices and the regulation to the PFA. These duties included: amendments to rules,³⁶ report on financial soundness,³⁷ communicate changes to rules to the membership,³⁸ confirmation of valuation,³⁹ signing of documents,⁴⁰ submission of Annual Financial Statements and confirmation by the PO that all returns required in terms of the

³² Hanekom K et al *Manual on Retirement Funds and other Employee Benefits 25th ed* (2019) 114.

³³ Government Gazette vol 548 No. 34024 *Directive No.5* 14 February 2011.

³⁴ Government Gazette vol 548 No. 34024 *Directive No.5* 14 February 2011.

³⁵ Hanekom K et al *Manual on Retirement Funds and other Employee Benefits 25th ed* (2019) 135.

³⁶ Section 12(2) of the PFA.

³⁷ Section 12(4) of the PFA.

³⁸ Regulation 24(d) of the PFA.

³⁹ Section 16(8) of the PFA.

⁴⁰ Section 20 of the PFA.

PFA has been lodged with the FSCA,⁴¹ signing of transfer in terms of section 14 of the PFA,⁴² monitoring of payment of contributions⁴³ and whistle-blowing duties.⁴⁴

It is evident from the above that the PO holds great gravitas in the operation of a pension fund and thus has a critical role to fulfil with regard to the fund's compliance with the PFA and all other relevant legislation. What is of importance is that a PO forms part of all discussions by the board of trustees but does not have voting rights unless they are, in addition also appointed or elected as a trustee.⁴⁵

2.3.3 Auditor

In terms of section 9 of the PFA, every registered fund shall in a manner set out in the rules appoint an auditor registered under the Auditing Profession Act, 26 of 2005. Per section 9(2)(b), such appointment must be approved by the FSCA. Regulation 30(2)(m) of the PFA makes it mandatory for pension funds to make provision for the appointment of an auditor in the rules for the fund.

In terms of Board Notice 77 of 2014, funds with an asset value of less than R 6 million are exempted from appointing an auditor as well as part of section 15(1) which mandates the submission of audited financial statements. It is important to point out that the auditor is not considered a fund official as he/she is expressly excluded from this definition per the definition section of the act '...but does not include an auditor appointed under Section 9'.

Akin to the PO of a pension fund, the auditor also has whistle blowing duties as set out under section 9(4)(c) of the PFA. More broadly, the auditor to a pension fund is further bound by section 252 of the Financial Sector Regulation Act which puts an onus on the auditor to report anything that the auditor considers 'is causing or is likely to cause the financial institution to be financially unsound; is contravening or may contravene a financial sector law or may result in an audit not being completed or may result in a qualified or adverse opinion on accounts'.

The primary duties of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error and to issue an auditor's report that includes their opinion. The auditor must exercise professional

⁴¹ Government Gazette Vol 589 No. 37844 Board Notice 77 of 2014 18 July 2014.

⁴² Section 14 of the PFA.

⁴³ Section 13A of the PFA.

⁴⁴ Directive No 5 and Section 9B of the PFA.

⁴⁵ Financial Service Board circular PF 130 Good Governance of Retirement Funds 4.

judgment and maintain professional scepticism throughout the audit. They also identify and assess the risk of material misstatements, obtain an understanding of internal controls relevant to the audit, evaluate the appropriateness of accounting policies, conclude on the appropriateness of the board of the pension fund's use of the going concern basis of accounting and evaluate the overall presentation, structure and content of the financial statements.⁴⁶

2.3.4 Valuator

In terms of section 16 of the PFA 'every registered fund, shall, once at least every three years cause its financial condition to be investigated and reported on by a valuator' A valuator is defined⁴⁷ as a 'an actuary who, in the opinion of the registrar (FSCA) has sufficient actuarial knowledge to perform the duties as required of a valuator in terms of this Act'

Section 9A of the PFA makes it mandatory on every registered fund, which in terms of section 16 of the PFA is required to have its financial condition investigated and reported upon by a valuator, to appoint a valuator.

By virtue of regulation 30(2)(j) the rules of a pension fund must make provision for the appointment of a valuator and provision for the triennial investigation if the fund is subject to the provisions of section 16 of the PFA.

Consistent with the position of the auditor, the valuator is also not considered a fund official per the definition of official in the PFA. Similar to that of the PO and the auditor, the valuator also has whistle blowing duties as set out in section 9A(2) of the PFA.

The main duty of a valuator is to evaluate the financial soundness of the fund by valuing the assets and liabilities. The valuator must examine the expected income from, and capital growth on, the investments held by the fund as compared to the expected benefit outflow and must advise the board of the pension fund whether he/she feels the choice of investment is appropriate to the pension fund's obligations.⁴⁸

It is important to point out that the Authority may exempt funds in terms of section 2(5) of the PFA from any provision of the PFA. Board Notice 61 of 2011⁴⁹ sets out the conditions that need

⁴⁶ IRBA Auditor's report template: Audit of financial Statements of a Large Retirement Fund (schedule D) 4.

⁴⁷ Definition of valuator found in the definition Section of the PFA.

⁴⁸ Asisa Today's Trustees 'Retirement Fund Industry Stakeholders & their roles 11 available at https://www.asisa.org.za/media/nuy/bqz/todaystrustee-supplement_vol1_lowres-v3.pdf (accessed on 23 May 2021)

⁴⁹ Government Gazette Vol 549 No. 34152 Board Notice 61 of 2011 25 March 2011.

to be met before the Authority would consider exempting a registered fund from the provisions of section 9A and section 16 of the PFA. These conditions include, if all existing pension payments and any future pension that becomes payable in term of the rules are fully secured through the purchase of an annuity policy from a registered insurer, all members of the fund other than pensioners belong to a defined contribution categories of the fund, where the fund has a contingency reserve account in term of the rules of a fund, other than a processing error reserve account, such account could never have a negative balance and the fund does not have an investment reserve account.⁵⁰

2.3.5 Administrator

In terms of section 13B of the PFA ‘No person shall administer on behalf of a pension fund the investments of such a pension fund, or the disposition of benefits provided for in the rules of the fund, unless the registrar has in a particular case or in general granted approval thereto and the person complies with such conditions as the registrar may from time to time determine in the particular case or in general.’

Importantly from the above definition, it is apparent that it is not mandatory on a pension fund to employ an administrator to administer its benefits. The fund may elect to be self-administered. By being self-administered, the fund will not need to register as an administrator in terms of in section 13B as it will be doing the administration themselves and not enlisting the services of a third party administrator.⁵¹

Alternatively, should the fund decide to outsource full or part of the administration of benefits, section 13B of the PFA will apply and the administrator appointed will need to be registered in accordance with section 13B of the PFA.

Similar to that of the auditor and the valuator, the administrator also has whistle blowing duties as set out in section 13B(10) of the PFA.

The functions delegated to a benefit administrator varies from fund to fund as they are codified in a service level agreement between the fund and the administrator. In the practical experience of the author, these duties generally include one or more of the following: receiving contributions

⁵⁰ Financial Services Board Board Notice 61 of 2011 5

⁵¹ Hanekom K et al *Manual on Retirement Funds and other Employee Benefits 25th ed* (2019) 114

and managing a bank account on behalf of the fund, calculating and paying benefits, arranging for the reinsurance of risk benefits and paying over the premiums, keeping record of the members' salaries and related transactions, performing accounting functions; and legal services.

2.3.6 Other role players

All the role players identified thus far are mandatory appointments as per the PFA. Together with the mandatory role players, it is also possible for board of trustees to appoint additional role players in areas where the board lacks sufficient expertise. These role players may include: an employee benefit consultant, an investment (asset) consultant, and a legal consultant. Importantly, this is by no means a closed list and can differ from fund to fund.

2.4 Size of the Pension Fund industry

The pension fund industry in SA can be dissected into two main categories: those funds subject to the PFA and those funds that are not subject to the PFA as they were established in terms of specific provisions in other statutes and have thus not elected to be subject to the PFA. These funds that fall outside the ambit of the PFA include the Government Employees' Pension Fund, Associated Institution Pension Fund and Transfer Pension Fund.⁵²

According to the FSCA Annual Report 2019/2020 ('FSCA annual report'), the total asset size of pension funds in SA are in excess of R 4 trillion.⁵³ It has been reported that SA has the fifth highest asset to gross domestic product ratio in the world.⁵⁴ The FSCA annual report further provides useful statistics to described the enormity of the industry such as, the total membership of pension funds in SA as at 31 December 2018 stood at 17 522 325 members of which 11 447 361 were active members. It is important to note that some double counting is unavoidable, as some individuals are members of more than one fund.⁵⁵

The FSCA annual report further details that the total contributions received by pension funds in SA increased by 7.29% from R 238.5 billion in 2017 to R255.9 billion in 2018.

⁵² FSCA Annual Report 2019-2020 84.

⁵³ FSCA Annual Report 2019-2020 84.

⁵⁴ South Africa's Market for Retirement Funding, 2019: Covering Comprehensive Profiles of 27 Public and Private companies., accessed at <https://www.globenewswire.com/news-release/2019/06/25/1873443/0/en/South-Africa-s-Market-for-Retirement-Funding-2019-Covering-Comprehensive-Profiles-of-27-Public-Private-Companies.html> (accessed on 11 April 2021).

⁵⁵ FSCA Annual Report 2019-2020 84.

It is evident from the above statistics that the pension funds industry in SA is tremendously significant by any metric and it affects millions of members and their beneficiaries directly or indirectly. Considering the sheer size of the industry, any instability or governance failures in the SA pension fund industry would be catastrophic for all members and their beneficiaries.

At this juncture, it would be worth pointing out that the corporate failure of Steinhoff affected most pension funds (their millions of members) as they all had some exposure to Steinhoff shares whether it be via pooled or segregated investment portfolios.⁵⁶

Later in the paper, the author will explore the idea that if a corporate failure of one listed company (Steinhoff) can have such a devastating effect on pension funds then what effect may a corporate governance failure within a pension fund have on its membership.

2.5 Conclusion

This chapter laid out the law of the land with regard to social security, more specifically pension funds in SA. It introduced the PFA as the primary source of legislation when exploring pension funds. It highlighted the major role players involved in the operation of a fund, one of which was the board of trustees which adopts an oversight role in the running of a fund and another important role player is the PO of a fund. The board of trustees are akin to that of a board of directors of a company and thus the duties and responsibilities are also similar. For purpose of this paper, the focus will solely be on pension funds that fall within the ambit of the PFA. The pension fund industry is in excess of R 4 trillion in assets and in excess of 11 million active members making it the fifth largest asset to gross domestic product ratio in the world. The effect of a single corporate failure wiped out R18bn worth of pension fund assets which makes one wonder what the effect could be if a pension fund in its entirety falls victim to a corporate governance failure. Armed with the above clear distinction of role players in mind, the next chapter will introduce the governance tools applicable to pension funds and how these role players give effect thereto.

⁵⁶ The Steinhoff saga: Who are the biggest losers? Bizcommunity 2 February 2018 available on <https://www.bizcommunity.com/Article/196/516/174106.html> (accessed on 29 January 2021).

CHAPTER 3 – THE GOVERNANCE PARAMETERS OF PENSION FUNDS

3.1 Introduction

The King IV report on corporate governance ('King IV'), defines corporate governance as the exercise of ethical and effective leadership by the governing body towards the achievement of the following governance outcomes: ethical culture, good performance, effective control and legitimacy. It further points out that the word corporate in the term 'corporate governance' refers to organisations that are incorporated to form legal entities separate from their founders and therefore applies to all forms of incorporation whether as a company, voluntary association, pension fund, trust, legislated entity or other.⁵⁷

The definition above makes it clear that corporate governance is relevant and integral not only for companies established for making a profit but more so, to all juristic persons. In South Africa, King IV is intended to apply to any organisation that has a governing body, extending its potential scope further than boards of incorporated companies. Its scope includes the board of trustees of a pension fund. It is important to note that the King IV is voluntary in nature, although, some aspects have been codified as part of the listing requirements of the Johannesburg Stock Exchange.⁵⁸ The King IV report also introduced sectoral supplements one of which specifically relates to pension funds.

In the SA context, pension funds are structured in such a way that a jurist person is created upon the registration of the fund with the Authority.⁵⁹ The pension fund becomes its own legal personality under its own name and is capable of suing and being sued in such name.⁶⁰ As pointed out in the previous chapter, there are various role players in the pension fund eco system who play an important role in the sustainable and proper management of a pension fund. The board of the fund is charged with acting with oversight and is the ultimate accountable body of the fund. In the SA context, with the introduction of the twin peak model of regulation, both the Prudential Authority and Financial Sector Conduct Authority ('FSCA') are responsible for policing pension funds. The FSCA, as the Market Conduct Authority, acts as the watchdog in supervising that board

⁵⁷ Institute of Directors South Africa *King IV Report on Corporate Governance from South Africa* (2016) 11.

⁵⁸ Giles J' The JSE Limited listing requirements' June 2017 available at <https://www.michalsons.com/blog/jse-listing-requirements-king-iii-iv/11545> (accessed 13 June 2021).

⁵⁹ S 4B of the PFA.

⁶⁰ S 5 of the PFA.

of funds follows good corporate governance principles and implement relevant and sustainable governance practices.

This chapter will explore the governance framework relevant to pension funds in SA. It will set out the governance responsibilities placed on the board of the fund who is charged with governance and delve into both the binding and non-binding nature of legislative and regulatory instruments applicable to pension funds. Thereafter, it will take a closer look at how 3 of the top 20 (ranked by asset size) fund's report on governance to their members through reviewing their annual reports followed by a conclusion.

3.2 Governance framework

3.2.1 Relevant Statutes

It is important to note that the governance aspects regulating pension funds are not found in a single statute but fragmented across many Acts, regulations, directives and voluntary codes as detailed below.

3.2.1.1 Pension Funds Act

Within the PFA, one can identify provisions relating to the establishment of governance structures of a fund, these provisions include: the establishment of a pension fund, the creation of a set of rules for a pension fund, prescribed sections dealing with the composition of pension funds, board of fund duties as well as regulations setting out compulsory obligations placed on pension funds.

3.2.1.1.1 Rules of a Fund

Every pension fund registered with the Authority is required to register a set of rules with the Authority.⁶¹ These rules are binding on the fund, its members, shareholders, and officers.⁶² This was highlighted in a case heard by the Supreme Court of Appeal: *Tex Corporation Provident Fund & others v Lorentz*⁶³ where the court held that 'the pension fund, the powers and duties of its trustees, and the rights and obligations of its members and the employer are governed by the Rules of the fund, relevant legislation and the common law.' Further case law establishes that 'the rules of a fund form its constitution and must be interpreted in the same way as all documents.'⁶⁴

⁶¹ S 4 of the PFA.

⁶² S 13 of PFA.

⁶³ 1999 (4) SA 884 (SCA) at 15.

⁶⁴ *Sasol Limited & others v Chemical Industries National Provident Fund* [2015] JOL 33910 (SCA) para 13.

Regulation 30(2) to the PFA sets out what ought to be included in a set of pension fund rules. It states that ‘the rules of a pension fund shall furthermore not be inconsistent with the Act and these Regulations... provide for the following matters...’ it then details the minimum information to be included in the rules. For the purpose of this paper, the author will merely be mentioning the minimum information most relevant to governance of a pension fund. These areas include: the objects of the pension fund⁶⁵ the power of investment of pension fund,⁶⁶ the appointment of a valuator,⁶⁷ the manner in which contracts and other documents binding the pension fund shall be executed⁶⁸ and the appointment of the auditor.⁶⁹

As previously mentioned, the composition of a board of a fund is found in section 7A of the PFA. Section 7A(1A) goes on to make it mandatory for the board composition to at all times comply with the requirements of the rules of the fund. Of great importance is the reference found in section 7A(2) that mandates a board of fund to include the following in their rules specifically relating to trustees: the constitution of a board, the election procedure of trustees, the appointment and terms of office of the trustees, the procedures at meetings, the voting rights of trustees, the quorum of a meeting, the deadlock breaking mechanisms and the powers of the board.⁷⁰

3.2.1.1.2 Duties of the board

As mentioned in the previous chapter, the primary source of legislation in the realm of pension funds in SA is the PFA. Section 7C & 7D of the PFA crystallise the fiduciary duties bestowed on the board of trustees. The board is entrusted with the control of assets of the fund which they are bound to deal with for the benefit of members.⁷¹ As detailed under point 2.3.1, section 7C of the PFA contains the object of the board which is to direct control and oversee the operations of a fund in accordance with the applicable laws and the rules of the fund. Section 7C(2) goes on to detail how in pursuit of the object of the board, the board shall avoid conflicts of interest, act with due care and diligence and good faith, act impartially in respect of all members and beneficiaries and act independently. Of great importance is section 7C(2)(f) which codifies the fiduciary duty the board has to members and beneficiaries as well as to the fund to ensure that the fund is financially

⁶⁵ Reg 30(2)(d) of the PFA.

⁶⁶ Reg 30(2)(i) of the PFA.

⁶⁷ Reg 20(2)(j) of the PFA.

⁶⁸ Reg 30(3)(k) of the PFA.

⁶⁹ Reg 30(2)(m) of the PFA.

⁷⁰ Section 7(2) of the PFA.

⁷¹ Marumoage MC 'The need for effective management of pension funds in South Africa in order to protect members' benefits' (2016) 5 Journal of Contemporary Roman-Dutch Law 614-531.

sound and is responsibly managed and governed in accordance with the rules of the fund and the PFA.

Section 7D of the PFA codifies the general duties of the board which include to keep proper record of the operations of the fund, to ensure proper controls are employed, that adequate and appropriate communication is communicated to members and beneficiaries of the fund informing them of their rights, benefits and duties in terms of the rules of the fund, to take reasonable steps to ensure that all contributions are paid and to obtain expert advice on matters where board members may lack sufficient expertise and to ensure that the rules and the operations and the administration of the fund comply with the PFA, the Financial Institutions Act and all other applicable laws.

3.2.1.1.3 Minimum skills and training of board members

In order for a board to dispense with its duties, it is important that they have a minimum level of skills. In this regard, legislation, per section 7A(3) of the PFA requires that all board members attain such level of skills and training as may be prescribed by the Authority by notice in the Gazette. Although provision was made for minimum level of skill for trustees, there was never a minimum standard enacted prior to July 2020. On 10 July 2020, the Authority prescribed such requirements. The enactment of FSCA conduct standard 4 of 2020(PF)- Minimum skills and training requirements for board members of pension funds appears to be a small step in the right direction. The conduct standard makes it mandatory for trustees to complete the trustee toolkit⁷² within six months from the date of appointment. The communicate⁷³ accompanying the conduct standard expressed that the FSCA's intent was that the toolkit will train and provide board members with basic knowledge relating to legislative requirements and information on fund governance, their responsibilities and obligations towards the fund and its members, as well as guidance on governance matters. It should be noted that except for the completion of the trustee toolkit, there are no formal qualification requirements prescribed to become a trustee. Practically, the rules of a fund will detail the grounds on which a trustee can be removed by the fund. In addition, section 26(4) of the PFA allows the Authority to intervene and remove a trustee on the basis that a trustee is no longer fit and proper to hold office.

⁷² 'Trustee toolkit' means the trustee toolkit facility provided for by the Authority available at www.trusteetoolkit.co.za

⁷³ Statement supporting the conduct standard – minimum skills and training requirements for board members of pension funds available at <https://www.fscsa.co.za/Regulatory%20Frameworks/Pages/Standards.aspx> (accessed 20 June 2021)

It is important to note that since the conduct standard was only released in July 2020 and funds were given 6 months to comply, to date, the FSCA has not clarified what consequences or penalties will apply in respect of non-compliance with this conduct standard or in practice. It is unclear what will happen if a trustee does not complete the prescribed trustee toolkit in the allocated timeframe. After reviewing the latest annual report of the Authority together with the published regulatory action found on the Authority's website, there was no evidence to suggest that any action has been taken by the Authority against trustees for non-compliance with conduct standard 4 of 2020.

Section 167 of the FSRA makes provision for administrative penalties to be sanctioned against the fund or trustee(s) and section 145(d) of the FSRA allows for the removal of a person who no longer complies with the applicable fit and proper requirements. In terms of the PFA, section 26 (1)(c) allows for the Authority to intervene in the management of the fund if the fund is not being managed in accordance with the PFA or the rules of the fund. Furthermore, section 26(2) makes provision for the Authority to intervene where a board fails to comply with any requirements prescribed by the Authority in terms of section 7A of the PFA. The FSRA also makes provision per section 151 for the FSCA to enter into an enforceable undertaking which allows a person to give a written undertaking to the authority concerning that person's future conduct in relation to a matter regulated by a financial sector law.

The author is of the view that the FSCA will most likely use an enforceable undertaking should they encounter a contravention of conduct standard 4 of 2020. This view is supported by the fact that the enforceable undertakings published, to date, mostly deal with the conduct of fund officials⁷⁴ and provide them with an opportunity to rectify the contravention within a certain period of time. Should they not rectify the contravention in the period set out in the enforceable undertaking, the FSCA will most probably look to one of the more severe enforcement mechanisms.

3.2.1.1.4 Regulation 28 of the PFA

In terms of section 36(1)(bB) of the PFA, the Minister of Finance of South Africa may make regulations that may limit the amount which and the extent to which a fund may invest in a particular asset or in a particular kind or categories of assets, prescribing the basis on which the limit shall be determined and defining the kinds or categories of assets to which the limits applies.

⁷⁴ FSCA website accessed at <https://www.fsca.co.za/Regulatory%20Frameworks/Pages/Enforceable-Undertakings.aspx> (accessed on 16 September 2021).

The minister may also introduce regulation in respect to all matters which he considers it necessary or expedient to prescribe in order that the purpose of the PFA may be achieved.⁷⁵ In terms of the above-mentioned provision, regulation 28 was amended by the Minister of Finance on 22 February 2011 and came into effect 1 December 2011.⁷⁶

Regulation 28 is titled ‘asset spreading requirements’ as the regulation intended to provide requirements of how assets are to be spread with the intent to promote prudent investing and sustainable long-term performance.⁷⁷ The preamble of this regulation opens with the following words ‘a fund has a fiduciary duty to act in the best interest of its members whose benefits depend on the responsible management of fund assets’. By examining the preamble, although regulation 28 pertains to asset spreading, it extends that the board, in pursuit of exercising its fiduciary duty owed to the members in terms of section 7C(f) of the PFA, has the responsibility to deploy capital in a responsible manner as part of the fiduciary duty to members. The regulation continues to magnify the importance of governance which can clearly be seen in subsection 2(c)(i) which states ‘A fund and its board must at all time apply the following principles- (i) promote the education of the board with respect to pension fund investment, governance and other related matters...’⁷⁸ If one examines the regulation further,⁷⁹ it becomes evident that the fund (via its board) is mandated to perform reasonable due diligence. This diligence can be directly linked to section 7C(2)(b) which states that ‘in pursuing its object the board shall act with due care, diligence and good faith’. It is important to point out that subsection 2(c)(iii) further encourages the board to consider promoting broad base black economic empowerment when procuring services. Furthermore, subsection 2(c)(ix) promotes that before making an investment in an asset, the board should consider any factor which may materially affect the sustainable long-term performance of the asset. These factors should include, but not be limited to, environmental, social and governance factors.

Given the above explanation of regulation 28 and the binding nature thereof, it is easy to understand why when referring to pension fund governance, regulation 28 is regularly mentioned. Although regulation 28 is primarily focused on responsible investment, which plays a significant

⁷⁵ S 36(1)(c) of the PFA.

⁷⁶ Government Gazette Vol 549 No. 34070 *Government Notice R 1834* March 2011.

⁷⁷ Strydom CPJ The consumer expectation of the role of the institutional investor as shareholder of public companies in South Africa (Master of Business Administration mini dissertation North West University 2020) 24.

⁷⁸ Reg 28(2)(c)(i) of the PFA.

⁷⁹ Reg 28(2)(v) , (vi) and (vii) of the PFA.

part in the eventual retirement outcome of a member,⁸⁰ it is important to point out that good corporate governance would be used as a tool in a fund providing a good retirement outcome for its members.⁸¹

3.2.1.2 Financial Institution Act

As much as the PFA serves as the sector specific legislation, the Financial Institution (Protection of Funds) Act 28 of 20 ('FI') is equally important as it imposes certain duties on pension fund trustees. It provides for the duties of persons dealing with trust property and trust funds under the control of a financial institution.⁸² The FI Act defines a financial institution to include a pension fund and thus the duties provided for in the FI Act is relevant and applicable to pension fund trustees. Section 4 sets out that a person in trust must observe utmost good faith and exercise proper care and diligence, may not make use of the funds or trust property or furnish any guarantee in a manner calculated to gain directly and indirectly any improper advantage for himself or for any other person at the expense of the financial institution. Section 10 (1) of the FI Act sets out that should a person contravene or fail to comply with any provision of the Act, such person is guilty of an offence and on conviction liable to a fine not exceeding R 10 million or to imprisonment for a period not exceeding 10 years, or to both such fine and imprisonment.

3.2.1.3 Financial Sector Regulation Act

The Financial Sector Regulation Act ('FSRA') is the overarching piece of legislation that brought the twin peak regulation into being. For purpose of this paper, the author will limit the discussion to the FSCA portions as the FSCA serves as the market conduct regulator of all financial institutions in SA, which includes pension funds. The author will briefly unpack a selection of regulatory instruments available to the FSCA.

3.2.1.3.1 Regulatory instruments

In terms of section 106 of FSRA, the Authority is empowered to issue conduct standards for or in respect of financial institution or their representatives. The aims of conduct standards are set out in section 106(2) FSRA. For purposes of this paper, the author will only mention the most relevant aims linked to governance which are: ensuring efficiency and integrity of financial markets,⁸³

⁸⁰ FSB Circular PF No. 130 *Good Governance of Retirement Funds* (2007) para 49.

⁸¹ Marumoage MC (2016) 13.

⁸² S 1 of the Financial Institutions acts defines an 'financial institution' to include a pension fund.

⁸³ S 106(2)(a) of the FSRA.

ensuring financial institutions and representatives treat customers fairly⁸⁴ and reducing the risk that the financial institution, representatives,⁸⁵ key persons and contractors engage in conduct that is or contributes to financial crimes. The practical example of a conduct standard can be seen in the publication of FSCA Conduct Standard 4 of 2020 (RF), which prescribed the minimum skills and training requirements for board members of pension funds.

The Authority also has the power to conduct supervisory on-site inspections on financial institutions in terms of section 132 of the FSRA. The purpose of these visits are to check compliance by the entity with financial sector laws for which the financial sector regulator is the responsible authority,⁸⁶ to determine the extent of the risk posed by the entity of contravention of a financial sector law,⁸⁷ and assist the regulator in supervising the relevant financial institution.⁸⁸ These onsite inspections are conducted by employees of the Authority.

Section 134 of the FSRA allows for the Authority to carry out an investigation. In this instance a person (not limited to employees of the Authority) is formally appointed to investigate if there is reasonable suspicion that a person may have contravened, may be contravening or may be about to contravene a financial sector law⁸⁹ or pursuant to a request by a designated authority in terms of a bilateral or multilateral agreement.⁹⁰ Once the investigation has been concluded by the investigator, the Authority will then decide which regulation action, if any, to pursue in terms of the FSRA and/or FI Act.

3.2.1.3.2 Guidance notices and interpretation rulings

The FSRA makes provision for the Authority to publish guidance notices on the application of a financial sector law. Importantly a guidance notice is for information purpose and is not binding.⁹¹ Although, the guidance notice is not binding, in practice a guidance notice is based on a section of the PFA or regulations to the PFA which is binding on the fund. This can be clearly seen when the Authority issued Guidance notice 1 of 2019 titled Guidance Notice: Sustainability of investments and assets in the context of a pension fund's investment policy. This specific guidance notice

⁸⁴ S 106(2)(b) of the FSRA.

⁸⁵ S 106(2)(d) of the FSRA.

⁸⁶ S 132(2)(a) of the FSRA.

⁸⁷ S 132(2)(b) of the FSRA.

⁸⁸ S 132(2)(c) of the FSRA.

⁸⁹ S 135(1)(a) of the FSRA.

⁹⁰ S 135(1)(b) of the FSRA.

⁹¹ S 141 of the FSRA.

provides guidance to boards of funds on how the board must comply with regulation 28(2)(b) read with regulation 28(2)(c)(ix).⁹²

An interpretation ruling in terms of section 142 of the FSRA may be published by the Authority regarding the interpretation or application of a specific provision of that law, in circumstances specified in the statement. The purpose of such instrument is to promote clarity, consistency and certainty in the interpretation and application of the financial sector law.⁹³ In terms of section 142(3) the Authority must interpret and apply the provision of the financial sector law to which the interpretation ruling relates in accordance with the interpretation ruling. It is clear that an interpretative ruling binds the Authority and provides clarity and certainty to industry in respect of how the specific provision will be interpreted and applied by the Authority. In practice, to date, the Authority only issued one such instrument (with regard to pension funds), FSCA interpretation ruling 1 of 2020 (RF), this ruling was to clarify the interpretation and application of the term ‘any benefit’ in terms of section 37C of the PFA. The interpretation ruling clarified that the Authority interpretes the term ‘any benefit’ in section 37C of the PFA to include paid-up member’s benefit, a deferred pensioner’s⁹⁴ benefit and an unclaimed benefit and thus their view is that these categories of members death benefit will need to be distributed in accordance with section 37C of the PFA.

3.2.1.3.3 Directives and enforceable undertakings

Section 144 of the FSRA allows the Authority to issue a written directive requiring the financial institution to take action specified in the directive. Section 24 then details the circumstance in which a directive can be issued. The purpose of a directive may be to stop a financial institution from contravening applicable financial sector laws, or to reduce the risk of such contravention,⁹⁵ ensuring that the financial institution or the directed person complies with the enforceable undertaking that was accepted by the FSCA,⁹⁶ stopping the financial institution or the directed person from being involved in financial crime, and reducing the risk that it may be so involved;⁹⁷

⁹² Guidance notice 1 of 2019(PFA).

⁹³ S 142 of the FSRA.

⁹⁴ A deferred pensioner is defined in the definition section of the Regulations to the Pension Funds Act as a member who has left the service of his employer or has otherwise terminated his contributions and has a paid-up benefit in the fund concerned.

⁹⁵ S 144(3)(a) of the FSRA.

⁹⁶ S 144(3)(b) of the FSRA.

⁹⁷ S 144(3)(c) of the FSRA.

reducing the risk that a systemic event may occur;⁹⁸ or remedying the effects of a contravention of a financial sector law or the person's involvement in financial crime.⁹⁹ According to the latest annual report, the Authority only issued one directive to a fund over the last reporting year.

Another instrument available to the regulator is that of an enforceable undertaking. It is a requirement that the Authority publishes all enforceable undertakings¹⁰⁰ and they are housed on the FSCA's official website.¹⁰¹ A practical example of an enforceable undertaking is Retirement Fund Enforceable undertaking 3 of 2019,¹⁰² where it was found that a trustee (who was also the chairperson of the board) failed or neglected to disclose his involvement and interest in a service provider to the fund that he was a trustee and chairperson of. In doing so, he was found to have breached the duty of care and a failure in his fiduciary duties owed to the fund. The trustee undertook to: never in future become involved in any conduct that may be construed as acting without a duty of care, diligence and good faith, to avoid conflicts between any personal business interest he may have in future, and the interest of pension funds on whose boards of management he may serve and he will at his own cost register for a course on ethics and good governance within 6 months from acceptance of the enforceable undertaking. In practice, the Authority will follow up on any enforceable undertaking when embarking on their routine onsite visits, in terms of section 132 of the FSRA, on a specific fund.

3.2.2 Non-binding guidelines and codes

3.2.2.1 PF 130

On 11 June 2007, the financial services board (now known as the FSCA) issued Circular PF No. 130 on good governance for retirement funds.¹⁰³ The purpose of the circular was to provide guidelines to the effective management of boards of trustees of pension funds. PF 130 requires that trustees put in place a documentary code of conduct, an investment statement, communication strategy to members and have a performance appraisal system for trustees. It also obliges new

⁹⁸ S 144(3)(d) of the FSRA.

⁹⁹ S 144(3)(e) of the FSRA.

¹⁰⁰ S 151(5) of the FSRA.

¹⁰¹ Available at www.fsc.co.za.

¹⁰² Available at <https://www.fsc.co.za/Enforceable%20Undertakings/RFEU%203%20of%202019%20-%20Deon%20Van%20De%20Venter.pdf>.

¹⁰³ FSB Circular PF No. 130 *Good Governance of Retirement Funds* (2007).

board members to receive comprehensive training and all board members to be trained on a continuous basis.¹⁰⁴

The purpose of the circular remains noble and from the wording used in the circular, it is evident that the intention was for it to not only provide guidance to the board itself but also to inform stakeholders what to expect from the board of the fund. This is evident in paragraph 9 of the circular where it states ‘the principals of governance are set out below. These are under the following headings: 9.1 the governance by the board of itself/the governance structure, 9.2 the governance of the board of the operations of the fund/the governance mechanism and 9.3 the management of relationships in the governance of the fund’. Under the head ‘management of stakeholder relationships’, principle 9 of PF 130, provides members with what to expect with regard to communication from the board of the fund.

The circular further details that a fund should have a code of conduct, an investment policy statement, a communication policy and a performance assessment tool.¹⁰⁵ Of importance is that paragraph 11 advises that the fund make reference in its annual financial statements that each of the above-mentioned documents are in existence and they have been reviewed by the board and that they are available to beneficiaries on request. The annexures to the circular provide a proposed template for boards to adopt in respect of a code of conduct, investment policy statement and a performance appraisal.

As much as PF 130 remains sound on paper, the fact that it remains a circular, not a directive or regulation, leaves its status to be merely the regulator’s interpretation¹⁰⁶ and thus not enforceable. In light of this, funds may choose to implement PF 130 partially, in its entirety or may choose not to adhere to it. Since it remains a circular, the FSCA is not empowered to sanction any pension fund for non-compliance of such practices. Although, it may endeavor to link any non-compliance to a wider duty detailed in a financial sector law. As an example, a fund may decide not to implement a risk management policy, which in PF 130 is referred to as a vital component of the

¹⁰⁴ National Treasury technical discussion paper *C Preservation portability and governance for retirement funds* (2012) 25.

¹⁰⁵ PF 130 (2007) para 10.

¹⁰⁶ *The Chairman of the Board of the Sanlam Pensioenfonds (kantoorpersoneel) v The Registrar of Pension Funds* 2007 (3) SA 41 (T) Para 9 ; also see *Hunter R et al The Pension Funds Act: A Commentary on the Act, regulations, selected notices, directives and circulars 1st ed* (2010) xii.

governance of a fund. Since PF 130 is not binding on the fund, the Authority cannot find the fund in breach of PF 130, but the Authority could link not having a risk management policy to a breach of the board's duty to ensure that proper control systems are employed by or on behalf of the board which is codified in section 7D(b) of the PFA.

It is pleasing to note the intention of the Government of South Africa, as detailed in a National Treasury technical discussion paper C Preservation portability and governance for retirement funds, where it stated that 'the non-enforceability might be a concern because the industry and trustees might voluntarily adhere to the circular. It is Government's view that Circular 130 should be legally enforceable by the Registrar of Pension Funds (FSCA), and therefore attain the status of a regulation that would be rigorously applied and complied with by boards of trustees.' The author's view is that prior to it becoming enforceable, due consideration should be given to updating PF 130 to cater for the world we currently live in and by doing so, make it most relevant to the current and future pension fund eco-system. Due consideration should be given to the possible inclusion of topics such as information technology governance, protection of personal information and digital assets.

Interestingly, the technical paper mentioned above was published in 2012 and to date PF 130 remains a circular and not enforceable. As mentioned above under point 3.2.1.1.3, the FSCA has prescribed, via a conduct standard, the minimum skills and training requirements for board members of pension funds. The content of such training is commonly known as the trustee toolkit. The official website of the trustee toolkit informs the reader that the toolkit is based on PF 130 guidelines on good governance for retirement funds.¹⁰⁷ This bodes well in that at the very least, trustees would have interacted with the concepts included in PF 130 in completing the trustee toolkit.

3.2.2.2 King IV Report on corporate governance

The Institute of Directors together with the King committee published the King IV Report for Corporate Governance on 1 November 2016 with an effect date of financial years starting on 1 April 2017.¹⁰⁸ The foreword of the report states that 'the foundation stones of King IV are ethical

¹⁰⁷ Available at <https://www.trusteetoolkit.co.za/login/login.aspx> also see National Treasury technical discussion paper C *Preservation portability and governance for retirement funds* (2012) 25.

¹⁰⁸ Available at <https://www.iodsa.co.za/page/KingIVReport>.

leadership, integrated thinking and integrated reporting. These concepts are relevant to three connected paradigm shifts in the corporate world.¹⁰⁹ One such paradigm shift identified is from short-term capital markets to long term, sustainable capital markets.

It further states the King committee was requested by many entities outside the private sector to draft King IV in such a way as to make it more easily applicable to all organizations, public and private, large and small, for profit and not for profit.¹¹⁰ As a result of this, the King IV report was published with sector supplements. One such sector supplement is part 6.4 of the report which deals with retirement funds. The supplement was introduced to provide high-level guidance and direction on how the King IV should be interpreted and applied by a variety of sectors and organization types.¹¹¹ The supplement details that the scope of application is to all types of retirement funds which include pension funds, provident funds, and retirement annuity funds.

In essence, the King IV report has moved from an ‘apply or explain’ to ‘apply and explain’ model and has reduced the 75 principles in King III to 17 basic principles. The retirement fund supplement translates those 17 principles into the retirement fund context.¹¹² For purpose of this paper, the most relevant governance principles will be mentioned.

Principle 1 states that the governing body should lead ethically and effectively. The section proceeds to use word such as integrity, competence, responsibility, accountability, fairness and transparency.¹¹³ It is easy to notice that should a board adopt this principle it will be in good stead in meeting its fiduciary obligations to the fund and its members. Principle 2 ties closely into principle 1 but its emphasis is not only the board but also the outsourced services procured by the board. The board should be comfortable that the service providers to the fund manage their ethics effectively through codes of conducts, ethics polices and supporting processes.¹¹⁴

Principal 5 focuses on the reporting by the board of trustees to members and the regulator. It emphasizes that communication by the funds should be integrated and should include information

¹⁰⁹ IoDSA *King IV* 4.

¹¹⁰ IoDSA *King IV* 6.

¹¹¹ IoDSA *King IV* 75.

¹¹² Gerald D ‘King IV extends application to retirement funds and introduces sector supplements for easier application’ available at <https://financialmarketsjournal.co.za/king-iv-extends-application-to-retirement-funds-and-introduces-sector-supplements-for-easier-application/> (accessed 26 June 2021).

¹¹³ IoDSA *King IV* 96.

¹¹⁴ IoDSA *King IV* 96.

about the resources and relationships on which the fund relies, its activities, outputs and outcomes. The reports should inform stakeholders about the retirement fund's performance which will also show accountability.¹¹⁵

The supplement emphasises that King IV should be considered in addition to the existing legislation, guidance notes and voluntary codes such as code for responsible investing South Africa, and PF 130.¹¹⁶ When implementing King IV, funds must be mindful that the code should be implemented proportionally meaning taking into account the size and resource of the retirement fund.¹¹⁷

It is important to note the similarities between PFA 130 and the King IV and sector supplement in that both remain voluntary in nature and thus it would be interesting to ascertain which funds actually subscribe to these voluntary guidelines and codes. The author is of the view, at this point in time, the sector supplement did not move the needle in respect of influencing good governance in the pension fund industry as boards of funds merely update the fund's policies to align the sector supplement, but the existing practices were not adapted to align to the policies leading to no practical implementation of the sector supplement.

3.3. Review of selected pension funds' annual reports

3.3.1 Selection process

Since this paper is desktop based, the author has selected to review the annual reports of 3 of the top 20 (measured by asset size) pension funds, as at 21 January 2021, in order to deduce if the funds subscribed to the voluntary guidelines and codes.¹¹⁸ All the reports were readily available on the respective funds' websites.

3.3.2 Review of annual reports

3.3.2.1 Eskom Pension and Provident Fund

This fund is rated as the largest pension fund (by asset size) under the regulation and supervision of the FSCA. The fund's assets are reported to be in excess of R 145 billion, with a membership

¹¹⁵ IoDSA *King IV* 97.

¹¹⁶ IoDSA *King IV* 96.

¹¹⁷ IoDSA *King IV* 77.

¹¹⁸ Accessible at <https://www.fsc.co.za/Regulated%20Entities/Pages/LREP-Retirement-Fund-Registered-Active-Funds.aspx>

size of over 82 000 members.¹¹⁹ In its latest annual report, 2020, it makes reference to both PF 130 and King IV. It has a dedicated chapter to effective governance which includes a detailed breakdown of the role of the board of trustees, the governance structures and focus areas of board committees.¹²⁰ It is exemplary to see that the fund not only subscribes to the voluntary guideline and codes but also produced a detailed integrated report rather than a less detailed annual report. Upon reviewing the report, the author was unable to find concrete proof that the practical aspects of the voluntary codes were actually being implemented. Although, it appeared that the fund had a firm commitment to good governance which was evident in the fact that it has a dedicated legal and governance unit and lists striving for outstanding corporate governance as one of the fund's strategic objectives. The author is of the view that more in depth research will need to be done to establish if the practical aspects of the voluntary code was being implemented.

3.3.2.2 Sentinel Retirement Fund

Sentinel Retirement Fund is rated the 8th largest fund by asset size under the regulation and supervision of the FSCA. Its assets exceed R 78 billion and has a membership in excess of 76 000 members.¹²¹ The latest available annual report was produced in 2020.¹²² The report appears detailed in nature and includes two dedicated chapters to governance and management structures as well as a governance of the board and its committees. Upon review, it is evident that this fund intended to embed PF 130 and King IV into its DNA. It makes clear reference to leading ethically and places adherence to PF 130 and King IV on equal footing to that of the PFA. Much like the Eskom Pension and Provident Fund, this report also resembles an integrated report. Upon reviewing the dedicate chapters to fund governance and the detailed nature of same, the author believes that there was enough evidence to suggest that this fund had implemented the voluntary codes and embedded same in the daily operations of the fund.

¹¹⁹ Accessible at <https://www.fsc.co.za/Regulated%20Entities/Pages/LREP-Retirement-Fund-Registered-Active-Funds.aspx>

¹²⁰ Eskom Pension and Provident Fund 2020 Integrated Report available at <http://www.eppfir.co.za/> (accessed 26 June 2021)

¹²¹ Available at <https://www.fsc.co.za/Regulated%20Entities/Pages/LREP-Retirement-Fund-Registered-Active-Funds.aspx>

¹²² Sentinel Integrated Report 2020 available at <http://sentinel-reports.co.za/sentinel-iar-2020/index.html#downloads> (accessed 26 June 2021)

3.3.2.3 Metal Industries Provident Fund

This fund is rated the 15th largest by asset size with a total asset value of over R 44 billion and membership of over 800 000 members.¹²³ The fund's latest annual report was dated 2020.¹²⁴ The report appears very simplistic in nature. The only reference to governance in the report can be found under the heading fund management. It merely mentions the composition of the board of trustees. The report does not include how the fund is governed nor does it have any reference to PF 130 or King IV. What is of great concern and must be pointed out is that the report does not at the very least reference the PFA. Although there are no legislative requirements for a fund to provide an annual report to members, in terms of section 7D(c) 'the duties of a board shall be to ensure that adequate and appropriate information is communicated to member and beneficiaries...'. Furthermore, it is common practice for funds to provide members with an update of the fund via an annual report. The purpose is to disclose to stakeholders the state of affairs of the fund over the past year.

Upon reviewing the above fund's annual report, together with the fund's website, it could be argued that they have not provided adequate information to the members of the fund and thus are susceptible to regulatory action by the Authority. At this juncture it is important to point out that one of the objects of the FSRA,¹²⁵ and in turn the Authority,¹²⁶ is the fair treatment and protection of financial customers. If the fund is found not to have communicated adequately on governance matters, it could be argued that they are not treating their members (customers) fairly.

3.4 Conclusion

This chapter explored the governance framework applicable to pension funds. It built on from the previous chapter in that the PFA is the primary legislation in respect of pension funds and brought to the fore the significance of the rules of a fund, regulations to the PFA and directives and other instruments issued by the Authority. It further made mention of the applicability of both the FI Act

¹²³ Available at <https://www.fsca.co.za/Regulated%20Entities/Pages/LREP-Retirement-Fund-Registered-Active-Funds.aspx>.

¹²⁴ Metal Industries Provident Fund Annual Report to Members 2020 available at <https://www.mibfa.co.za/downloads/MIPFAnnualReporttomembers2020.pdf> (accessed 26 June 2021).

¹²⁵ S 7(1)(c) of FSRA.

¹²⁶ S 57(b)(2) of FSRA.

as well as the FSRA in relation to the governance of pension funds. It pointed out that the governance aspect of pension funds are fragmented over the relevant statutes and thus hard to follow and implement. All the aforementioned statutes and instrument are binding on the fund and its board. In contrast, the chapter also identified the voluntary guidance notes and codes that are applicable to pension funds. Of importance is government's intention to elevate PF 130 into law. This will definitely bode well for governance in pension funds and will allow the Authority to police adherence to such standard. The author's opinion is that at this point in time, only PF 130 should be made compulsory, and that King IV should remain voluntary to give funds sufficient time to implement PF 130. The Authority, via its engagement with funds, should encourage funds to apply King IV and monitor same. Should there be a low uptake in the application of King IV, then only should the Authority consider making it compulsory. The chapter closed off with a closer look at the annual reports of three top 20 pension funds and their commitment to good governance. It was pleasing to see that two funds had detailed their commitment to governance in their reports. Of concern was that the fund with a membership size of over 800 000 members had not mentioned of any commitment to good governance in its report nor reference to the PFA. Although there is no legislative requirement to adhere to the voluntary codes, the Authority may view this omission in the annual report as a risk identification factor which may lead to a targeted onsite visit by the Authority which could result in regulatory action against the fund.

Now that the governance parameters of pension funds have been set out, the next chapter will take a closer look at the recent corporate failures in SA in search of a common thread. It will then explore the extent to which a similar failure could unfold in the governance of pension funds.

CHAPTER 4 – RECENT CORPORATE FAILURES

4.1 Introduction

In recent times, corporate failures have become common place in SA. They can be identified across the length and breadth of the country affecting both private and public sectors. Companies such as Steinhoff International Holdings (‘Steinhoff’), Tongaat Hulett Ltd (‘Tongaat’), Eskom, VBS Mutual Bank (‘VBS’) and EOH Holdings Limited¹²⁷ have become household names for the wrong reasons.

Although corporate failures are not new and unique to SA, what is of concern is the unexpected failures of many apparently financially robust companies.¹²⁸ These failures not only affect the shareholders of these companies but more so all stakeholders, which include pension fund members, their beneficiaries, and ultimately the communities they live in. In the Steinhoff case, a PricewaterhouseCoopers (‘PwC’) investigation found that there was accounting fraud to the amount of \$7.4 billion.¹²⁹ It has been reported that a group of former Steinhoff executives and individuals outside the company implemented deals which substantially inflated the Steinhoff Group’s profit and asset values.¹³⁰

¹²⁷ Business insider SA ‘The biggest South African business scandals over the past decade’ available at <https://www.businessinsider.co.za/the-top-south-african-business-scandals-the-past-decade-2020-1> (accessed on 6 July 2021).

¹²⁸ Smith RJ & Marx B ‘An analysis of corporate governance in the big four auditing firms in South Africa’ available at <https://ujcontent.uj.ac.za/vital/access/services/Download/uj:41122/SOURCE1> (accessed on 4 September 2021).

¹²⁹ Reuters ‘PwC investigation finds \$7.4 billion accounting fraud at Steinhoff, company says’ available at <https://www.reuters.com/article/us-steinhoff-intln-accounts-idUSKCN1QW2C2> (accessed on 26 July 2021).

¹³⁰ Reuters ‘PwC investigation finds \$7.4 billion accounting fraud at Steinhoff, company says’ available at <https://www.reuters.com/article/us-steinhoff-intln-accounts-idUSKCN1QW2C2> (accessed on 26 July 2021).

At the beginning of June 2019, Tongaat Hulett announced it had concerns over the accuracy of its published financial statements for the year 2018.¹³¹ The company admitted that the 2018 financial results were overstated by up to R 4.5 billion. Interestingly, again the governance failure related to fraudulent financial reporting.¹³²

The VBS failure followed a similar pattern of corporate governance failures by the parties charged with governance duties which will be detailed later in this chapter. In the VBS case, R 2 billion was lost due to corruption and poor corporate governance.¹³³

Upon closer inspection of companies in SA, governance failures in SA are not limited to a specific sector or field. It comes to surface in various shapes and forms, in listed or unlisted companies and can affect institutions in both public and private sectors. It is for this reason that the question has to be asked to what extent governance failures may filter down and translate into failures in the governance of pension funds.

It is against the above backdrop that this chapter will take a closer look at a select group of recent corporate failures in SA. It seeks to establish a common thread in the downfall of these companies. Furthermore, it will discuss parallels between a board of directors and the board of a fund and explore to what extent such failures could filter into the pension fund context. The chapter will conclude by answering the research question of to what extent the existing controls in the regulation of pension funds in SA are adequate to mitigate against similar governance failures.

¹³¹ JGL Forensic Services 'The sweet smell of success has gone sour for Tongaat Hulett' available at <http://jglforensics.co.za/the-sweet-smell-of-success-has-gone-sour-for-tongaat-hulett-2/> (accessed on 26 July 2021).

¹³² Business insider SA 'Another SA company has admitted its financials are wrong- what you need to know about the crisis at Tongaat Hulett' available at <https://www.businessinsider.co.za/tongaat-hullet-south-africa-financial-results-2018-pwc-investigation-2019-6> (accessed on 26 July 2021).

¹³³ Investigator's report to the Prudential Authority 'VBS mutual bank The great bank heist' (2018) volume 1 5.

4.2 Recent corporate failures in South Africa

4.2.1 Steinhoff International Holdings

It has been well publicised that Steinhoff, the once darling of SA stocks, came crashing down in December 2017.¹³⁴ After the dust had settled, it became apparent that Steinhoff looked good on paper in term of tick-box compliance but when one took a deeper dive into the actual workings of the company, one would quickly realise that the workings were not underpinned by a firm commitment to ethics and merely paid lip services to compliance.¹³⁵

Upon closer inspecting of the integrated annual reports of Steinhoff, one will notice the repetition of all the good governance terms, yet the company never really lived these values. The company's practices did not align with what was being reported. After an investigation by the FSCA, Steinhoff was found guilty of publishing false and misleading statements in breach of the provisions of the Financial Markets Act.¹³⁶ Further investigations conducted by PwC found that Steinhoff recorded fictitious or irregular transactions totalling 6.5 billion euros (\$7.4 billion) over a period covering the 2009 to 2017 financial years.¹³⁷

From a governance perspective, it is inescapable that the Steinhoff's compliance was not coupled with an ethical commitment by its board and executives.¹³⁸ This can be evidenced by the fact that the following statement was reflected in the corporate governance reports for years 2011 to 2016: 'Steinhoff has not established a formal process for obtaining assurance on ethical awareness and

¹³⁴ Brent Styan J ' Steinhoff was a JSE Darling, but now a complete outcast' available at <https://www.iol.co.za/business-report/opinion/opinion-steinhoff-was-a-jse-darling-but-now-a-complete-outcast-16522258> (accessed on 13 November 2021).

¹³⁵Institute of Directors South Africa King IV Guidance paper *Corporate failures and lesson learnt* (2021) 4

¹³⁶ Financial Sector Conduct Authority *Annual Report 2019/2020* 92.

¹³⁷ Motsoeneng T & Rumney E ' PwC investigation finds \$7.4 billion accounting fraud at Steinhoff, company says' available at <https://www.reuters.com/article/us-steinhoff-intln-accounts-idUSKCN1QW2C2> (accessed on 23 August 2021).

¹³⁸ Adams M The evolving role of the company secretary and its impact on corporate governance (LLM research paper, University of Western Cape, 2020) 12.

ethical compliance throughout the group'.¹³⁹ The board's repeated acknowledgment of a lack of ethical commitment indicates a failure to implement remedial action year on year. This ultimately displays that ethics did not rank high on the company's list of values. Furthermore, it has been reported that the chairman of the board was also a primary shareholder of the company, making his independence questionable.¹⁴⁰ This coupled with the fact that the company was being led by a charismatic chief executive officer, who was able to influence the board, combined to be a powerful tonic for the eventual governance failure of the company.

4.2.2 Tongaat Hulett Ltd

In June 2019, Tongaat, a JSE listed company admitted that its 2018 financial results were wrong and overstated its assets by up to R 4.5 billion. The company blamed 'certain past practices' for the crisis.¹⁴¹ The board employed PwC to conduct a forensic investigation of the matter. Although the final PwC report was not made public, the board of Tongaat released the document titled 'Key findings of the PwC investigation'. The document identified that senior executives participated in undesirable accounting practices, that there was a culture of deference and lack of challenge, there were a number of governance failures pursuant to which internal policies and guidelines and frameworks were not followed.¹⁴²

¹³⁹ Naude P *Business perspective on the Steinhoff Saga* (2018) 17.

¹⁴⁰ Crous, C 'What Happened to Steinhoff's Governance? Accounting Weekly: 1– 2. available at <https://accountingweekly.com/happened-steinhoffs-governance/> (accessed on 4 September 2021); Niven G 'Pre-transaction forensic vetting' available at <https://www.withoutprejudice.co.za/free/article/6847/view> (accessed on 13 November 2021).

¹⁴¹ De Villers J 'Another SA company has admitted its financials are wrong – what you need to know about the crisis at Tongaat Hullett' available at <https://www.businessinsider.co.za/tonga-at-hullett-south-africa-financial-results-2018-pwc-investigation-2019-6> (accessed on 5 September 2021).

¹⁴² Key findings of PwC investigation available at <https://www.tonga-at.com/key-findings-of-pwc-investigation/> (accessed on 5 September 2021).

The findings report further went on to identify that there were major historical shortfalls in areas such as governance practice, delegation of authority, decision making and oversight.¹⁴³ It is important to point out that all the aforementioned areas are also relevant when looking at the operations of a pension fund.

4.2.3 VBS Mutual Bank

Everything was going well for VBS until 2016. In 2016 the bank agreed to loan R 7.8 million to former president Jacob Zuma for his repayment of his house in Nkandla.¹⁴⁴ Although this in itself was not a problem, it did bring VBS into the spotlight. In 2017, it appeared that that VBS developed a liquidity crisis, where the bank's executive officials failed to effectively manage the rapid expansion of VBS from a period of growth.¹⁴⁵ One of the main reasons VBS ended up with major issues was that it took deposits from municipalities which, in law, as a mutual bank, it was not authorised to do so. In terms of the section 7(3)(b) of the Municipal Finance Management Act 56 of 2003, a municipality may not open a bank account, and thus investment in, an institution not registered as a bank in terms of the Bank Act 94 of 1990. As such, the accepting of municipal deposits is reserved for commercial banks which are governed by the Bank Act of 1990.

In March 2018, the South African Reserve Bank ('SARB') placed VBS Mutual Bank (VBS) under curatorship with the aim of protecting the interest of depositors. Subsequently, the SARB instituted a forensic investigation into possible fraud or material misstatements.¹⁴⁶ The SARB appointed

¹⁴³ Key findings of PwC investigation available at <https://www.tongaat.com/key-findings-of-pwc-investigation/> (accessed on 5 September 2021).

¹⁴⁴ Nicolaides G and Ngatane N 'From bank heist to arrests:a timeline of the VBS scandal' available at <https://ewn.co.za/2020/06/17/from-bank-heist-to-arrests-a-timeline-of-the-vbs-scandal> (accessed on 9 February 2022).

¹⁴⁵ Head T 'VBS Bank explained: Everything you need to know in a nutshell' available <https://www.thesouthafrican.com/news/vbs-bank-how-much-money-who-is-involved/> (accessed on 6 September 2021).

¹⁴⁶ South African Reserve Bank *Annual Report 2017/2018* 12.

Advocate Terry Motau SC in terms of section 134 of the FSRA for purposes of conducting an investigation into the affairs of VBS.¹⁴⁷

The investigation commissioned by the SARB resulted in a report being published which highlighted that substantial bribes were paid to certain VBS directors. Bribes were also paid to various public officials who were in a position to influence the illegal deposits of municipal monies to VBS and the creation enormous fictitious deposits in favour of certain parties.¹⁴⁸In addition to the above, it was found that there was fraudulent misrepresentation contained in the VBS' annual financial statements for the year ending March 2017 as well as fraudulent misrepresentations made in the mandatory monthly regulatory returns by VBS to the Registrar of Banks (SARB).¹⁴⁹ Coupled with the above, from a governance perspective, it was pointed out in paragraph 27 of Advocate Motau's report that the CEO of VBS was central and an active participant in the unlawful conduct of VBS' affairs who was very well rewarded for his complicity. It is important to point out that this action by the CEO substantively violates principle 1 of King IV code of corporate governance in that he failed to practice the principles of ethics which are integrity, competence, responsibility, fairness, transparency and most importantly accountability. Furthermore, three of the non-executive directors received improper payment which contradicted principle 2 of the King IV code which states that the board should govern the ethics of the business in a way that supports the establishment of ethical culture.¹⁵⁰

¹⁴⁷ VBS Mutual Bank: the great bank heist investigator's report to the Prudential Authority available at <http://www.governmentpublications.lib.uct.ac.za/news/vbs-mutual-bank-great-bank-heist-investigators-report-prudential-authority> (accessed on 14 November 2021).

¹⁴⁸ Investigator's report to the Prudential Authority 'VBS mutual bank The great bank heist' (2018) volume 1 9.

¹⁴⁹ Investigator's report to the Prudential Authority 'VBS mutual bank The great bank heist' (2018) volume 1 10.

¹⁵⁰ Sibanyoni B Investigating non-compliance with corporate governance principles on material losses in selected business organisations (MBA mini-dissertation, North West University, 2021) 47.

4.2.4 Common thread in the recent governance failures in SA

If one examines the above recent corporate failures in SA, a common thread emerges. It relates to the interconnected relations between executive directors (specifically the Chief Executive Officers), the non-executive directors and the service providers to the board. The auditors, asset managers and non-executive directors ('independent parties') of these companies should have made sure that the companies' accounts were as close to the truth as possible yet in all the above failures, the independent parties were blinded by the gravitas of the parties who made up the controlling body of the companies.¹⁵¹

In all three of the above corporate failures there were misrepresentations of the actual financial position of the company. What remains true, for all three of the above failures, is that it has had an everlasting effect on investors and pensioners who suffered huge losses, yet the board charged with governance has not been brought to book.¹⁵² Interestingly in all the above cases, a fiduciary duty existed between the controlling body and their stakeholders yet, to date, only the stakeholders bear the impact of the catastrophic down falls of these companies.

4.3 Parallel between a Board of directors and a Board of a pension fund

In the SA context, both a board of directors and a board of a pension fund ('board of fund') operate with an oversight role as oppose to an operational role.¹⁵³ An oversight role entails that the board guides by setting policy and seeking accountability by monitoring results and taking corrective action whereas an operational role is characterised by actioning decisions taken by the board and

¹⁵¹ Cameron J 'Warning: Steinhoff scandal is 'tip of iceberg'. KPMG and friends hide many more sins' available at <https://www.biznews.com/sa-investing/2017/12/18/steinhoff-scandal-kpmg-friends> (accessed on 10 September 2021).

¹⁵² Mechant M & Mosiana M 'Corporations and Economic Crimes Report' Volume 2: The Auditor (2020) 24

¹⁵³ OEDC 'Guidelines for pension fund governance' (2009) 1.

providing hands on day-to-day management of the operations of the company.¹⁵⁴ In the case of *PPWAWU National Provident Fund v Chemical Energy Paper Printing Wood and Allied Workers Union*,¹⁵⁵ the court held that ‘Each of the fund’s trustees is required to exercise an independent judgement as to what constitutes the best interest of the fund. The applicable legal principles are the same as those which apply to directors of companies.’ It was further held in the forementioned case that the role of directors of companies and the legal principles applicable thereto apply mutatis mutandis to the trustees of a pension fund.¹⁵⁶

Hayton in his article titled “The extent of pension trustees’ obligations in South Africa”¹⁵⁷ put forward that a pension fund itself is the owner of its assets, and its board members, like the directors of a company, must direct and control those assets in the interest of the members of the pension fund organisation. In support of the above, Marumoagae argues that the role of a board of a pension fund is more akin to that of a board of directors of a company in that the directors of a company manages the company for the benefit of the company whereas a trustee of a trust manages the trust for the benefit of the beneficiaries.¹⁵⁸

When examining the nature and duties of a board of a fund, it becomes apparent that there are many similarities with such duties bestowed on directors of companies. Upon comparing the two

¹⁵⁴ Business Regulations ‘Board Governance: A Thin line between oversight and operations’ available at <https://www.proshareng.com/news/Business%20Regulations,%20Law%20&%20Practice/Board-Governance--A-Thin-Line-Between-Oversight-and-Operations/53491> (accessed on 14 November 2021)

¹⁵⁵ 2007 ZAGPHC 146 para 25.

¹⁵⁶ *PPWAWU National Provident Fund v Chemical Energy Paper Printing Wood and Allied Workers Union* 2007 ZAGPHC 146 para 27.

¹⁵⁷ Hayton D ‘The extent of pension trustees’ obligations in South Africa’ available at <http://www.pensionlawyers.co.za/wp-content/uploads/2018/10/PensionTrusteesObligationsSouthAfrica.pdf> (accessed on 4 September 2021).

¹⁵⁸ Marumoagae MC ‘Do boards of trustees of South African retirement funds owe fiduciary duties to both the funds and the fund members? - The debate continues’ (2012) 15 *Potchesfstrom Electronic Law Journal* 565.

boards, it is evident that both owe a fiduciary duty to person(s), are in a position of trust and require a degree of independence.

4.4. Potential for corporate failures to filter into the pension fund domain

It has been pointed out above that the selected recent corporate failures in SA related to governance failures by the board of directors of those companies. It has further been established that there exists a close resemblance of the role of a board of a fund and that of the board of directors of a company. It is on this note that it should be explored whether there is a potential for such failures to filter into the pension fund domain.

Upon examining the FSCA's annual report for the reporting periods 2018, 2018-2019 and 2019-2020, it has been reported that the conduct supervision department completed over 100 on-site inspections per year in terms of section 132 of the FSRA. The reports further point out that the FSCA identified significant supervisory issues which included the following:

1. Boards of funds were not properly constituted in terms of section 7A of the PFA;
2. Failure of the board of the fund to monitor compliance with the provisions of the PFA, specifically section 13A of the PFA read with regulation 33 of the PFA,
3. Expenses and remuneration of board members were very high,
4. Funds were being managed in terms of unregistered rules; and
5. Failure by the board to timeously submit annual financial statements and valuation reports.¹⁵⁹

The annual report for the period 2019-2020¹⁶⁰ detailed that in the reporting period, the FSCA appointed a statutory manager to the Amplats Group Provident Fund in terms of section 5A of the

¹⁵⁹ FSCA Annual Report 2019-2020 85.

¹⁶⁰ FSCA Annual Report 2019-2020 86.

Financial Institutions Act. The statutory manager was tasked with assisting the board to comply with its fiduciary duties in terms of section 7C of the PFA. The annual report further referred to funds under curatorship although, no finite number was presented in the report. In addition, eight reportable irregularities were sent to the FSCA from the Independent Regulatory Board of Auditors for the reporting period.¹⁶¹

Given all the above findings in the annual reports of the FSCA over the last three years, it is evident that the potential for a governance failure in the pension fund realm is very possible and has increased over the years so much so that the retirement fund conduct supervision team has dedicated a team to deal with the appointment interim boards in terms of section 26(2) of the PFA and monitor funds under statutory management and curatorship which are collectively known as , distressed entities.¹⁶²

It must be pointed out that as seen with corporate failures of Steinhoff, Tongaat and VBS their downfall started with the misstatement of their financial position. Interestingly the FSCA in their annual report point to ‘failure by the boards to timeously submit annual financial statements and valuation reports’ as well as ‘expenses and remuneration of board members are high’ as two of the significant supervisory issues identified.¹⁶³ It appears from the above that pension funds could easily fall prey to a governance failure. The author’s view is that it is not a question of if a governance failure will occur but merely when a governance failure will occur and to what extent such failure will affect the pension fund industry. Since the FSCA, in their annual report, have not

¹⁶¹ FSCA *Annual Report 2019-2020* 51.

¹⁶² FSCA *Annual Report 2019-2020* 86.

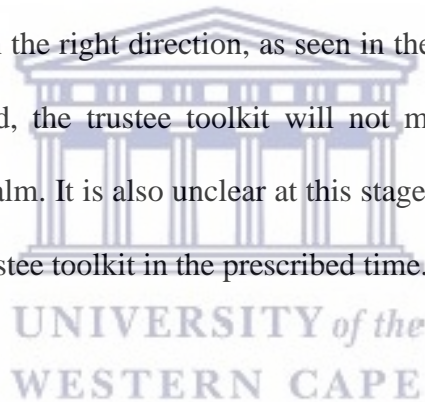
¹⁶³ FSCA *Annual Report 2019-2020* 85.

quantified the significant areas of concern, it would be hard to predict how widespread these areas of concern are in the pension fund industry.

4.5 To what extent are the existing controls in the regulation of pension funds in SA adequate to mitigate against similar governance failures witnessed in corporate sector

4.5.1 Trustee toolkit

As discussed in the previous chapter, the FSCA has made it mandatory on all trustees to complete the trustee toolkit which was designed to train and provide board members with basic knowledge relating to legislative requirements and information on fund governance, their responsibilities and obligations towards the fund and its members, as well as guidance on governance matters. Although this control is a step in the right direction, as seen in the Steinhoff failure, if a tick box compliance approach is adopted, the trustee toolkit will not mitigate much against a failure occurring in the pension fund realm. It is also unclear at this stage what the consequences are if a trustee does not complete the trustee toolkit in the prescribed time. The FSCA has not reported on same in its annual report.



4.5.2 Onsite visits by the FSCA

It has been pointed out in the previous chapter that the FSCA has the power to do onsite visits of pension funds in terms of section 132 of the FSRA. The purpose of an onsite visit is to review compliance by the fund with financial sector laws, determine the extent of risk posed by the fund of the contravention of a financial sector law and assist the regulator in supervising pension funds.¹⁶⁴ Upon reviewing the FSCA annual report for the period 2019 – 2020, the FSCA conducted 103 onsite visits on pension funds for the reporting period.¹⁶⁵ If one compares this to the 1 452 active funds,¹⁶⁶ it appears that just over 7% of funds were visited. This percentage remains

¹⁶⁴ S 132 2(a), (b) & (c) of the FSRA

¹⁶⁵ FSCA *Annual Report 2019-2020* 86

¹⁶⁶ FSCA *Annual Report 2019-2020* 89

consistently low for the reviewed period of 2018 - 2020 although the annual reports do not detail how the specific funds were identified for an onsite visit and thus it might be possible that the funds that poses the greatest risk to the pension fund eco system were visited.

4.5.3 Directives by the FSCA

It has been set out in the previous chapter that in terms of section 144 of the FSRA, the FSCA is empowered to issue a written directive requiring a financial institution to take action specified in the directive. It was stated in the latest FSCA annual report that the FSCA used this section to direct a fund to reinstate a board member who was removed from the board for whistle blowing to the FSCA. It is the author's view that this empowering provision will bode well for the mitigation of governance failures in the pension fund context, although, it is to be seen how often the FSCA will resort to using such regulatory instrument.

4.5.4 Enforceable undertakings

The annual report stated that 6 enforceable undertakings ('EU') were given and accepted by the retirement funds supervision division, of the FSCA, and it related to compliance with the fund rules insofar as it relates to eligibility of membership, avoiding conflicts of interest in terms of section 7C(2)(c) of the PFA and compliance with section 2 of the Financial Institutions (Protection of Funds) Act 2001. The author's view is that this instrument, if used more regularly by the FSCA, could definitely mitigate against the occurrence of governance failures. The reason for such view is that firstly once an EU is entered into, the person consenting to it is bound by same and if such person does not comply with the EU or breaches the conditions of the EU the FSCA can approach the Financial Sector Tribunal ('FST') for enforcement of same. The order made by the FST has the effect of a civil judgement.¹⁶⁷ Secondly, in terms of section 151(5) of the FSRA, the FSCA

¹⁶⁷ Financial Sector Regulation Act section 151 (6),(7) and (8)

must publish all EU's and thus this could act as a deterrent to other boards of pension funds as it may cause reputational damage.

4.5.5 Non-binding guidelines and codes

Since PF circular 130 remains merely a circular and has not been elevated to the status of a directive, it cannot be recognised as a control in preventing a governance failure in the pension fund domain. The reason for this is that funds are not compelled to adhere to the circular and cannot be held liable for any breach of PF 130 as it is not mandatory on them to implement the governance model set out in PF 130. PF 130 remains merely voluntary and unenforceable.

As mentioned in the previous chapter, the King IV report and the retirement sector supplement ('King IV report') was introduced in 2016 (with effect from 2017) as a voluntary code for retirement funds to implement. As with PF 130, in its current state, it cannot be used as a control in preventing governance failures but merely as a nudge to get funds to implement what is deemed a desirable practice. In the author's experience, pension funds are merely updating the fund's policies to incorporate wording that aligns with the King IV report and it is not clear to what extent the funds are practically implementing the King IV report into the operations of the fund.

4.6 Conclusion

The chapter explored a select group of recent corporate failures in SA, namely, Steinhoff, Tongaat and VBS. The chapter then shifted its focus to establish a common thread in respect of these failures, it highlighted the interconnected relations between the executive board members of the board of directors as well as the relationship between them and other parties such as the auditor, asset managers and non-executive directors as an important factor in the corporate failures. It further identified that there was misrepresentation of the actual financial positions of the

companies and that the failures directly affected investors and pensioners, yet the directors of these companies have not yet been brought to book.

It was then pointed out that there are striking similarities between the role of the board of directors of a company and the board of a fund. It concluded that indeed the roles are, in the main, similar in nature and that both owe a fiduciary duty to stakeholders and are in a position of trust.

The focus was moved to explore the potential of such failures seen in the corporate realm to filter into the pension fund domain. By examining the FSCA annual reports for the period 2018 – 2020, it was highlighted that indeed there were serious governance related issues identified which included some boards of pension funds were not properly constituted in terms of section 7A of the PFA, some funds being managed in terms of unregistered rules and the failure of pension funds to submit annual financial statements and statutory valuations timeously. The 2019-2020 report further detailed that a dedicated team had been established to deal with the appointment of interim boards in terms of section 26(2) of the PFA and to monitor funds under statutory management and curatorships. The chapter moved to conclude that it is very possible that such failures could happen in the pension fund realm and that is merely a matter of time before the same is witnessed.

The chapter ended with a closer look at the adequacy of the existing regulatory controls in mitigating against governance failures in the retirement fund domain. In doing so, it identified the controls being used and attempted to provide insight into the effectiveness of same.

The next chapter will offer a conclusion by providing an answer to the research question of to what extent the existing controls in the regulation of pension funds in SA are adequate to mitigate against similar governance failures seen in corporate SA in recent times. It will further provide

recommendations in respect of the enhancement of controls to mitigate against governance risk failures in the pension funds domain.



CHAPTER 5 – CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This final chapter will summarise the conclusions reached in the previous chapters and will seek to provide answers to the research question based on the research put forward. It then seeks to offer recommendations to strengthen certain existing controls to mitigate against the risk of governance failures in the pension fund domain and ends off with areas identified for further research.

5.2 Conclusion

5.2.1 Summary of the salient features across chapters 2 to 4

5.2.1.1 Chapter 2

Chapter 2 explored the main purpose of a pension fund and went on to delve into applicable legislation to pension funds. It then examined the key role players involved in the operations of a typical fund. Once such role player was identified, under point 2.3.1, as the board of a fund. It was put forward that the board of a fund is very much akin to the that of a board of directors. The object of the board of a fund can be found under section 7C of the PFA which includes to direct, control and oversee the operations of the fund. Section 7D goes on to set out the duties of the board of the fund. The chapter then tilted its attention to the enormity of the pension fund industry as detailed under point 2.4. The assets size of the industry is excess of R 4 trillion and is the fifth highest asset to gross domestic product ratio in the world. The industry further has a total membership of over 17 million of which in excess of 11 million were active members. It was pointed out that the pension fund industry in SA has considerable significance by any metric and affects millions of members and their beneficiaries. The chapter highlighted that any instability or governance failure in such industry would be catastrophic for all members and beneficiaries which will ultimately be

to the detriment of the whole SA. The chapter ended with an example of how a single corporate failure, Steinhoff, accounted for a loss of R 18 billion within the pension fund industry.

5.2.1.2 Chapter 3

Chapter 3 laid down the governance architecture of pension funds in SA. It explored the various legislative acts applicable, which included the Pension Funds Act, Financial Institution Act, the Financial Sector Regulation Act. It then pointed out under 3.2.1.1.1, that the rules of a fund form the constitution of the pension fund. It went on to explore the regulatory instruments available to the FSCA which included onsite visits, the issuing of directives as well as the enforceable undertakings. The chapter then turned its focus to the non-binding guidelines and codes applicable to governance of pension funds which takes the form of PF circular 130 and the King IV report together with the retirement fund supplement. It was pointed out under 3.2.2.1 that it is the South African Government's intention to make PF 130 legally binding and enforceable, yet to date, this has not materialised. The chapter then went on to review the annual reports of three pension funds selected from the top 20 funds (measured by asset size) in order to deduce if the funds subscribe to the voluntary guidelines and codes. It was interesting to note that two of the three funds appear, at least on paper, to put governance front and centre of its operations with extensive reference to PF circular 130 and the King IV report. The remaining fund reviewed appears to not to have a focus on governance related matters and no reference is made to the voluntary codes or any other governance matters. It is concerning that a board of a fund with the responsibility of managing assets in excess of R 44 billion would not consider governance front and centre to its operations and reference same in their in their annual report.

5.2.1.3 Chapter 4

Chapter 4 delved into three recent corporate governance failures in SA. It briefly unpacked the reasons for each downfall and identified a common thread relating to the interconnected relations of the controlling body, the lack of independence of company directors and the misrepresentation of the annual financial statements of the companies. The companies on paper, appeared to subscribe to good governance but in practice this was not the case. It was further highlighted that in all instances the controlling body of these companies owed a fiduciary duty to its stakeholders which suffered significant losses yet to date, the persons who made up the controlling bodies of such companies, at the time, were not brought to book.

The chapter went on to unpack the similarities between the board of directors and the board of a fund. In essence, both boards owe a fiduciary duty to their stakeholders, are in a position of trust and both require a degree of independence from the constituencies who appoint or elected them. In addition, both boards require the individual board members to possess the same characteristics of honesty and integrity and must observe utmost good faith and exercise proper care and diligence in dispensing with its duties.

The chapter moved on to explore the potential of a corporate governance failure in the pension fund domain. As pointed out under 4.4, the annual reports of the FSCA were reviewed and it became apparent that indeed pension funds are susceptible to a governance failure. The latest FSCA annual report identified the following areas of concern: that boards of pension funds were not properly constituted in terms of section 7A of the PFA, failure of the board of pension funds to monitor compliance with the provisions of the PFA and specifically section 13A of the PFA read with regulation 33 of the PFA, expenses and remuneration of board members were very high, funds being managed in terms of unregistered rules and the failure by the board to timeously submit

annual financial statements and valuation reports. Coupled with this, the report also included that a statutory manager was appointed to one fund, this reflects that the fund was not properly operated and thus an external party had to be appointed to assist in the regularisation of the fund. Of great significance is to draw the reader's attention to the fact that failure to timeously submit annual financial statements was a serious concern by the FSCA in respect of the funds they supervise and with the corporate failures unpacked in this paper, the problems also began with the misrepresentation of annual financial statements.

The chapter concludes by detailing some of the controls in place to mitigate against governance failures in the pension fund domain. It took a close look at the trustee toolkit and concluded that this control would not be very effective if, like in the Steinhoff case, a tick box approach to compliance is adopted. It then looked at onsite visits done by the FSCA and concluded this control would be effective in pre-empting or mitigating against governance failures as it will act as early warning in respect of problematic funds. Of concern was that the FSCA only conducted onsite visits on approximately 7% of the active funds for the year.

The chapter then moved on to explore use of directives as a control in respect of potential governance failures. It became evident that the FSCA rarely used a directive to compel a fund to take action with only one directive being issued over the reporting year of the annual report. If used more regularly, this control could be very effective in the mitigation of governance failures.

Another instrument used by the FSCA is an enforceable undertaking. This instrument serves a dual purpose in that it binds the person who enters into the enforceable undertaking and should the person breach the conditions of the undertaking, the FSCA can approach the Financial Sector Tribunal for enforcement of same which will have the effect of a civil judgement. Secondly, it is mandatory for all enforceable undertakings to be published by the FSCA and in doing so, it will

deter other boards of pension funds from practising the undesirable actions documented in enforceable undertakings.

5.3 RECOMMENDATIONS

5.3.1 Enforcement of minimum skills and training of board members

As highlighted under heading 3.2.1.1.3, to date, there is no evidence available in the public domain to suggest how the requirement to complete the trustee toolkit is being enforced. Although the introduction of the requirement for all trustees to complete the trustee toolkit is a step in the right direction it will add minimal value if such requirement is not strictly enforced by the FSCA. The author puts forward that the FSCA best utilise section 151 of the FSRA and enter into an enforceable undertaking with the trustee(s) who fail to complete the minimum requirement of completing the trustee toolkit. An enforceable undertaking would mainly serve to compel or prohibit certain conduct. Additionally, it could have a deterrent effect because one of the consequences of this instrument is that it must be published which may lead to reputational damage. The effectiveness of the instrument can be maximised by including a host of further conditions to address any shortfall in trustees' training.

5.3.2 Onsite visits

The author's view is that an onsite visit is the most effective regulatory tool to identify potential governance issues and could be used for early identification and intervention which may mitigate against a governance failure by pension funds. The recommendation is that the FSCA considers placing additional resources and adopt a focused approach to the implementation of these onsite visits. What would assist and would act as deterrent to funds is if the FSCA publishes quarterly reports on its findings of the governance issues identified from the previous quarter's onsite visits. The purpose of the proposed quarterly reporting is to encourage a behaviour change by boards of

funds to pay attention to governance related matters. In doing so, it will encourage better governance practices by funds and thus ultimately leading to a better governed pension fund industry in SA.

5.3.3 Non-binding guidelines and codes

The author's view is that PF circular 130 should be reviewed and elevated to the status of a directive. Should this materialise, it could be used as a control to mitigate against a governance failure in the pension fund realm. Once PF 130 is elevated to a directive, and thus becomes binding and enforceable on all pension funds, the King IV report could be used in tandem but as a nudge to complement the mandatory nature envisaged for PF 130 which could ultimately lead to a behaviour change by boards.

The author believes that should the FSCA implement monitoring and reporting of the implementation of the King IV principles across the pension fund industry, this statistical information together with persuasive framed wording could be used as a nudge to encourage more funds to implement same. The FSCA should consider using herding bias to get more funds to implement the principles of King IV. Importantly, cognisance should be taken in respect of not only funds updating all their policies with the King IV principles but also the practical aspects that will need to filter down into the operations of the fund. This can be achieved by increasing the fund's monitoring controls. One of the mechanisms for implementation of same could take the form of the appointment of responsible or accountable persons at various levels within the fund. This extends beyond the board of the fund itself and includes various services providers and relevant parties acting at the behest of the board of the fund. Importantly, the fund will be delegating duties but will still be ultimately responsible for the monitoring of the controls.

5.4 AREAS OF FURTHER RESEARCH

During the drafting of this paper, there were areas of further researched that were identified by the author. The areas of further research link closely to the topic covered in this paper but did not fall within the scope of this paper and have been identified as follow:

- A critical analysis of the practical implementation of the King IV principles in the governance of pension funds in South Africa.
- Assessing the potential impact of the significant governance issues identified in the conduct supervision of pension funds in South Africa; and
- A review of the use of regulatory instruments bestowed upon Financial Sector Conduct Authority in respect of pension funds in South Africa.

If the recommendations identified above are implemented, it should usher in a new frontier of pension fund governance which, by design, would assist with the early identification and intervention of governance related issues by the FSCA. It would mitigate against governance failures occurring in the pension fund industry which ultimately bodes well for the boards of the funds and all the members they serve.

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