



Subject: Governance Guideline for Retirement Funds

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1. INTRODUCTION

- 1.1 The assets of a retirement fund are administered for the main purpose of providing the benefits and values promised in terms of the registered rules of that fund. The management board (also referred to as the board; its members are referred to as trustees) holds fund assets in trust for those persons who will ultimately benefit from them. The board stands in a position of trust or fiduciary relationship members and beneficiaries and therefore must act with integrity. As fiduciaries, the board and all other persons duly appointed by the board to act on its behalf have to deal with the assets or affairs of the fund in terms of the Financial Services Regulatory Authority Act no: 2/2010, the Retirement Funds Act no:7/2005, regulations, the registered rules of the fund, codes of conduct and policies that apply to the fund.
- 1.2 Trustees may be required to exercise a degree of discretion in making decisions. Therefore, not all circumstances relating to the management and functions of the board may be clearly defined within a legal framework. This necessitates the introduction of governance measures which include values and ethical principles which require a certain standard of behaviour from the board. Governance refers to oversight mechanisms, including the processes, structures and information used for directing and overseeing the management and administration of a fund. Therefore, governance encompasses the means by which trustees and senior management are held accountable for their actions and for the establishment and implementation of oversight functions and processes.
- 1.3 The stakeholders in the governance of a fund are the fund's members (they include pensioners, former members and deferred pensioners) and beneficiaries. The other parties affected by the governance of a fund are the employer participating in the fund, the sponsor (if not the employer) and the Registrar. Accordingly, the purpose of good governance in a fund is to ensure that:
 - 1.3.1 the benefits provided for in terms of the rules of the fund are delivered;
 - 1.3.2 the benefits are optimized and the associated investment risks are minimized, with these opposing concepts being appropriately balanced against each other; and
 - 1.3.3 the process involved in the provision of the benefits and the administration of the fund is efficient, cost-effective and transparent.

2. **NATURE AND PURPOSE OF THE GUIDELINE**

- 2.1 This guideline applies to all retirement funds and provides information to the management boards of all retirement funds about the expectations of the office of the Financial Services Regulatory Authority (FSRA) on governance.
- 2.2 The guideline also provides a broad outline of key governance principles. Each fund may adopt different governance practices, taking into account the fund's type, size, scope, complexity and risk profile. The supervisory process takes this into consideration in the evaluation of funds.
- 2.3 Although funds need to adapt their governance practices to specific circumstances and resources, the FSRA expects all funds to adopt a governance structure and processes consistent with the principles that follow.

3. **OBJECTIVES OF RETIREMENT FUNDS**

The overriding objective of a retirement fund is to serve as a secure source of retirement income. The board has a primary duty to act for the benefit of the members and beneficiaries.

- 3.1 To act in the best interest of the fund, members and beneficiaries, an effective board will:
 - 3.1.1 Consider the different types of beneficiaries relevant to each retirement fund including deferred beneficiaries and retirees. For example, the board might need to balance the risks involved in generating sufficient long-term returns to fund the benefits of active members against the possibility that such risks might jeopardise the safety of benefits of existing retirees.
 - 3.1.2 Place the interests of the members and beneficiaries above that of the sponsor of the fund even if the trustee is employed by or appointed to the board by the fund's sponsor.
- 3.2 In carrying out their responsibilities, an effective board will:
 - 3.2.1 Ensure that the balance is made between assets and liabilities, maintaining stable funding costs over time, keeping administration costs down and paying benefits upon the death, disability and retirement or other special circumstances as provided for by the rules of the fund.

- 3.2.2 Carry out the fund's activities in a way that does not impose an unnecessary financial burden on the sponsor and serves the interests of members well.
- 3.2.3 Ensure that fund assets are invested in accordance with the Retirement Funds Act 2005 and Rules of the fund.
- 3.2.4 Consider all relevant risk and value factors deemed appropriate when designing the scheme's investment strategy. In addition to typical financial measures, these factors may include environmental, social and governance issues.

4. **RISK MANAGEMENT**

- 4.1 The management of risk in a fund is a vital component of the governance of a fund. Every fund should have in place a risk management policy which should be reviewed annually and should include, among others:
 - 4.1.1 the identification of significant risks facing the fund;
 - 4.1.2 the assessment of the impact of each risk to the fund;
 - 4.1.3 the process and controls necessary to reduce the impact of key risks;
 - 4.1.4 monitoring the risk process or controls to ensure that they are appropriate; and
 - 4.1.5 the communication to the members and the stakeholders of the fund's risk management policy. The risk management policy may be summarised in the annual financial statements of the fund.
- 4.2 The types of risk will vary according to the type of the fund. Thus, in a defined benefit fund, there will be risks associated with the actuarial valuation (such as solvency ratio, longevity assumptions and the post-retirement interest rates) which may not be found in a defined contribution fund. A common type of risk found in different categories of funds may have different consequences because of the nature of those funds; for example, the investment risk in a defined benefit fund will be different from the investment risk in a defined contribution fund, and the administration risk in a self-administered fund may be different from the more complex administration risks found in umbrella funds.
- 4.3 A fund should establish a delinquency control program with procedures for collecting unpaid contributions, data, and solutions for non-compliance.

- 4.4 In terms of the law, a fund is required to take fidelity cover. The purpose of this cover is to indemnify the fund against any loss suffered by the fund as a result of negligence or theft, which cannot otherwise be recovered. The terms of this cover and the quantum should be carefully considered by the board to ensure that it is appropriate for the fund; where necessary, expert advice should be obtained in this regard. Such cover should include loss arising from negligence.
- 4.5 Trustees themselves should have indemnity insurance provided by the fund, or an indemnity from the sponsor of the fund. The board should also ensure that each service provider has adequate malpractice cover in the form of professional indemnity and fidelity guarantee insurance so that the fund's right against the service provider, where required to be invoked, is safeguarded.

5. INTERNAL CONTROLS

- 5.1 Internal controls encompass the policies, processes, culture, tasks and other aspects of an institution that support the achievement of the fund's objectives. They facilitate the efficiency of operations, contribute to effective risk management, assist compliance with applicable laws and regulations, and strengthen capacity to respond appropriately to the fund's business activities.
- 5.2 The primary function of the board in relation to the business of the fund is to ensure that it (the board) exercises a rigorous oversight function. There should be a clear identification and assignment of operational responsibilities, either to persons with appropriate skills employed by the fund (where the fund is self-administered), or by way of a written agreement with a licensed fund administrator or long-term insurer (where the fund is underwritten).
- 5.3 A fund should provide for the establishment of an internal control framework commensurate with the fund's circumstances and it should address the fund's risks. The framework should include policies on documentation, record keeping, costing, funding, fund investment, expense control, benefits administration, outsourcing, compliance and communication.
- 5.4 Development and implementation of an adequate and sound system of internal controls is the responsibility of senior management. The board, however, is ultimately responsible for ensuring that such a system is established and maintained. As part of this responsibility, the board should regularly, at a high level, review the system of internal controls to determine that it works as expected and that it remains appropriate.

- 5.5 The need for useful inputs into the oversight responsibility of the board requires that there should be a regular review of:
- 5.5.1 management reports on the operations and financial condition of the fund to ensure that they are appropriate. This includes a review of services, fees and all costs associated with the fund's operations;
 - 5.5.2 the information processes, operational software, accounting and financial reporting systems involved in the operation of the fund and internal and external audit opinions on the adequacy of controls of the fund as a whole and recommendations for improvement. Preferably the review should be done with the assistance of independent external advisers;
 - 5.5.3 compliance with regulatory and statutory requirements of the fund;
 - 5.5.4 monitoring and resolution of actual, potential or perceived conflicts of interest among those involved in the operation of the fund; and
 - 5.5.5 the performance of the persons and entities involved in the operation of the fund in terms of the service level agreements, mandates and performance contracts.

6. **COMMUNICATION, TRANSPARENCY AND ACCOUNTABILITY**

- 6.1 A fund should provide for the communication of the governance process to members, beneficiaries and other stakeholders to facilitate transparency and accountability. A governance focused communication policy should be established for the fund and it should provide for transmission of governance-related information to members and beneficiaries. The fund should give sufficient information to members for them to make informed decisions about their retirement options. Cognisance should be taken of the Registrar's Prescribed Minimum Disclosure Requirements to members and beneficiaries. Communication to members should be informative, transparent, and fair and display accountability.
- 6.2 Communication should be appropriate, timely, accurate, complete, consistent, cost-effective and accessible to promote members' and beneficiaries' confidence of the governance process. If the fund is considering significant changes, such as mandating a later retirement age, lowering the percentage of future benefits or closing the fund to new members, the board should communicate this information well in advance to allow affected parties the opportunity to provide input.

- 6.3 The board should communicate aspects of the operation of the fund, including a fair presentation of the performance of the fund's investments, which are of relevance to members and which will assist the members and beneficiaries of the fund to assess the credibility and trustworthiness of the administration of the fund and the delivery of benefits.
- 6.4 Where a fund offers member investment choice, the details of the investments in respect of which members may make an election should be described setting out the severity of any associated risk and the performance benchmarks, as well as the underlying type of investments.
- 6.5 Members should be able to make an informed decision from such information. Members should also be reminded periodically of the need to review the investment choices made by them. The fund's investment performance, average costs per member and also, in respect of any fund which has independent trustees, the fees and disbursements paid to or in respect of them, should be communicated to members at least once a year. Members should also be aware of who the service providers of the fund are.
- 6.6 Fundamental to the governance of a fund is the extent of the accountability of the board. The accountability requirement of the board means that collectively and individually the trustees may be held liable for any breach of governance which results in any loss to the fund and to the members or beneficiaries in the provision of benefits. This accountability for the governance of a fund is very important because of the fact that the assets of a fund are required by members and beneficiaries to fulfil a vital need on retirement, withdrawal from service, death or disability.
- 6.7 All communication with members, beneficiaries and stakeholders should be responded to promptly by and on behalf of the board with thoroughness and respect. In particular, complaints by members or any other person, which are directed to the fund, should be treated seriously and noted by the board.
- 6.8 Members and beneficiaries have a right to voice their concerns and have them addressed quickly. The fund should arrange for capable parties to address member inquiries and complaints, and create effective conflict resolution procedures to handle disagreements. The names and responsibilities of key contacts should be given to members and beneficiaries.
- 6.9 Members and beneficiaries will require the intervention of the Financial Services Ombudsman and legal recourse should the benefits not be provided to them as stipulated in the rules of the fund.

7. CONFLICTS OF INTEREST AND CONFIDENTIALITY

- 7.1 The fiduciary duty owed by the board requires that trustees and delegates avoid conflicts of interest and maintain appropriate confidentiality. The fund should provide for the establishment of a code of conduct and operational policies for both the fund and its delegates to address conflicts of interest and confidentiality. The code should set out required behaviour, establish control procedures and provide for the due process and dispute resolution mechanism. To ensure that the code is effective and that it applies to all trustees and delegates, the board should set up a review process.
- 7.2 The conflict of interest policy should set out an appropriate procedure to disclose and address conflicts of interest. The policy should address both actual conflicts and potential conflicts. The board should distinguish the type of conflicts of interest which may be structural, and therefore unavoidable, and those conflicts of interest which can be avoided. Every fund should require each trustee to complete an acceptance of duties form and a declaration of interests before the commencement of deliberations on any business of the fund. If the conflicts of interest do not compromise the credibility of the governance arrangements, they must be managed appropriately.
- 7.3 A structural conflict of interest may arise where a trustee finds himself or herself in a position in which his or her duties as a trustee conflict with his or her direct or indirect personal financial interests or the financial interests of a stakeholder in the fund (such as the employer or the sponsor), of which he or she is an employee or in which he or she is a shareholder.
- 7.4 Trustees should be impartial when taking decisions and should not be influenced by inappropriate considerations when exercising the board's discretion. At all times trustees are expected to demonstrate their independence and should always act in the best interests of the members.
- 7.5 In a situation which may give rise to, or actually constitutes a conflict of interest, the trustee concerned should promptly disclose to the board such conflict of interest, including:
- substantial financial investment; or
 - personal business dealings; or
 - family or personal ties with the owners or managers; or
 - an affiliation to a service provider;

in relation to a person with which, according to his knowledge, the fund intends to enter or has entered into a contract, or in relation to a person in respect of which the fund

intends to buy or sell, or has bought or sold, financial instruments or has engaged into any financial service.

- 7.6 To protect the fund from the consequences of conflicts of interest, the following rules and procedures may be adopted by the board:

7.6.1 Gifts and invitations

Trustees are not expected to accept any gift, service, favour, entertainment, invitation, or any other thing of value if that thing could reasonably be expected to affect their objectivity or loyalty to the fund. The acceptance of cash, gifts and other financial advantage is prohibited in all circumstances.

7.6.2 Personal financial situation of persons involved in the decision-making process concerning the buying or selling of financial instruments for the benefit of the Fund

7.6.2.1 Trustees are not expected to base their input in the decision-making process concerning the buying or selling of financial instruments for the benefit of the fund on their personal financial situation, or on that of persons known to them.

7.6.2.2 Trustees are not expected to seek to benefit financially or benefit from information in their possession by virtue of their involvement in the Fund (“insider information”). They are also expected to preserve confidentiality of their functioning as a board and may not disclose information about the operations of the board or the fund without written authorization by the chairperson of the board.

7.7 Recourse in cases of conflict of interest

7.7.1 Where a conflict of interest has arisen, the board should consider the information reported to them and promptly establish if a potential or actual conflict of interest exists. Where this is the case, the board, in consultation with the person concerned, should promptly take measures to ensure that the potential or actual conflict of interest is eliminated.

7.7.2 Priority should be given to the following measures in the elimination of the conflict of interest:

- exclusion of the person concerned from participation in the decision-making process and in follow-up actions, and replacement in these activities by another person; and/or
- exclusion of the person or body concerned from participation in invitations to tender; and/or
- termination of appointments or contracts of the person or body concerned.

7.7.3 Trustees must keep a conflict of interest register to records all cases of conflict of interest reported and how they were resolved.

7.8 Where a trustee breaches the fund's code of conduct or acts in contravention of any of the responsibilities imposed upon him or her, the board should take such action as it considers appropriate. This may include declaring that such a trustee is suspended from office for a specified period on such terms and conditions as deemed appropriate by the board. The objective of action by the board against a trustee is to preserve the integrity of the board and its governance role.

7.9 Trustees and delegates are expected to hold strictly confidential all sensitive information communicated to them in the context of their duty to the fund, and they should take all reasonable measures to preserve this confidentiality. This responsibility applies to information related to individual members and beneficiaries as well as any information, the disclosure of which could compromise the fund's ability to meet its obligations. Trustees should ensure that the fund has in place a privacy policy that sets out a framework on how confidential retirement fund information will be collected, used, stored and protected and ensure that this policy extends to external agents and delegates.

8. **COMPETENCY OF THE BOARD AND DELEGATION OF AUTHORITY**

8.1 On appointment, new trustees should undergo comprehensive training on both the legislative and regulatory framework and governance principles in order to equip them to effectively carry out their functions as trustees and to safeguard them against bad decision-making. Training should also be done periodically to ensure that the board understands technical issues relating to the fund such as: taxation, actuarial, legal, regulatory and compliance requirements; risk management; benefit structures; and investment risks and strategies. Funds are encouraged to adopt governance practices that support the development of competency by the board, such as establishing terms of office for trustees of at least three years and staggering the dates at which terms of office are completed.

- 8.2 The board is expected to oversee and assume responsibility for the fund but is not expected to manage the fund on a day-to-day basis. It may delegate operational management tasks to board committees, employees of the fund and service providers. However, such delegation does not relieve the board of accountability for the functions so delegated and it may not abdicate from any of its functions.
- 8.3 The board is ultimately responsible and accountable for managing the fund and for selecting and monitoring the actions of delegates and committees. The fund's governance structure, roles and responsibilities, accountability and reporting relationships (i.e., the chain of delegation) should be clearly documented and communicated to all participants in the fund governance process.
- 8.4 There must be a clear recognition, understanding and separation of roles and responsibilities of each function. This is particularly important when the same person performs both governance and corporate functions.
- 8.5 Committees of the board may be established to exercise specific oversight responsibility, or to carry out board-delegated responsibility provided that the rules of the fund permit. Any such committee should operate within set parameters and should have appropriate written terms of reference with a clear mandate which sets out the functions, scope, authority and the criteria for membership requirements of the committee.
- 8.6 The committees appropriate for each fund will vary from fund to fund but may include, among others:
- 8.6.1 an audit committee
 - 8.6.2 an administration committee;
 - 8.6.3 an investment committee;
 - 8.6.4 a legal committee;
 - 8.6.5 a communication and education committee;
 - 8.6.6 a benefits committee dealing with death and disability benefits; and
 - 8.6.6 a risk management committee, in the case of a defined benefit fund.
- 8.7 Each committee must have a charter that details the following:
- 8.7.1 purpose and objectives;
 - 8.7.2 responsibilities;

- 8.7.3 frequency of attendance at meetings;
 - 8.7.4 qualification of membership;
 - 8.7.5 appointment and removal procedures;
 - 8.7.6 structure and operations; and
 - 8.7.7 reporting to the board.
- 8.8 The principal officer is responsible for regularly monitoring the performance of those to whom functions have been delegated and they should be required to report back regularly on such delegated functions and with sufficient and relevant information to enable the board to make an informed performance assessment and evaluation against established measures.
- 8.9 When selecting and appointing service providers the board should be careful that no service provider should derive any benefit from the fund assets and resources, other than appropriate fees for their services. There are various factors to consider during a formal selection and on-going assessment process for service providers. They include, but are not limited to the following:
- 8.9.1 skills and competence of the service provider;
 - 8.9.2 track record in terms of fulfilment of mandates, breaches, case law, and so forth;
 - 8.9.3 fee-structure of service provider and how it is linked to performance standard or delivery on its mandates;
 - 8.9.4 the internal policies, practices and procedures of service providers such as a policy on conflict of interest;
 - 8.9.5 independent reference checks with past and present clients of the service providers; and
 - 8.9.6 benchmarking against standards as set in the service agreements.
- 8.10 Periodically, the board should also assess its own performance and the performance of its committees and individual trustees. To achieve an unbiased assessment, the board may wish to involve an independent professional in this process

9. EXPERT ADVICE

- 9.1 Trustees are not obliged to have all the expert skills necessary for the day-to-day operation of a fund. The board may engage professional accounting, actuarial, investment, legal and other experts for advice on issues which are the responsibility of the board and to pay the professionals involved appropriately for that advice. However, the board retains the ultimate fiduciary duty and responsibility to monitor the experts and to ensure that the delegated responsibilities are carried out appropriately. The expert advice obtained by the board should be considered and assessed by the board independently and a second opinion should be sought if need be. In considering and assessing expert advice or opinion, the board should not be subject to undue influence from management or other parties.
- 9.2 The board should only make use of qualified professional advisors and should satisfy itself that expert advice obtained is independently given.
- 9.3 The board is not expected to micro-manage the functions delegated to service providers but those functions should, when delegated, contain sufficient detail to ensure that the service provider understands what is expected by the board. There should be a reasonable right of recourse in the event that there is a breach of the delegated functions by the service provider. It is important that a fund should monitor and assess the reasonableness and competitiveness of any fees charged to the fund by service providers.
- 9.4 The board should have the knowledge and understanding to critically review and verify the performance of those to whom functions are delegated (service providers).¹ To effectively carry out this obligation, the board is expected to
- 9.4.1 develop selection policies for service providers;
 - 9.4.2 ensure if the service provider has employed qualified staff and sufficient human and technological resources to thoroughly carry out the functions delegated to it;
 - 9.4.3 ensure that service providers retained by the fund adopt and comply with adequate compliance and professional standards;
 - 9.4.4 review performance assessments of service providers relative to the fund's policy statement annually.

¹ Service providers may include but not limited to: investment managers, fund administrators, auditors, actuaries and consultants.

- 9.5 For the board to exercise this oversight role properly, those to whom functions are delegated should be required to report back regularly on such delegated functions and with sufficient and relevant information to enable the board to make an informed performance assessment. The board should establish specific criteria against which performance will be measured.

10. INVESTMENT PERFORMANCE OF THE FUND

- 10.1 A fund should have sufficient assets to cover obligations to members and beneficiaries. It is important that fund assets be invested prudently and wisely to ensure that they produce reasonable returns and are available to members when needed. The investment performance of the fund assets is therefore an important factor in determining whether the fund will be able to deliver on the retirement benefits.
- 10.2 The board should ensure that the mandates given to service providers and committees clearly define the board's expectations and reporting requirements relating to the performance of the investments. The board should therefore not endorse mandates or agreements that are vague or ambiguous.
- 10.3 The investment of fund assets shall be in compliance with the investment requirements set out in the Retirement Funds Regulations which prescribes the limits within which a fund can invest its assets in terms of types of assets and maximum percentages. Inappropriate investment in commercial mortgages and real estate, along with illiquidity, inadequate portfolio analysis and insufficient reporting on performance to the board, contribute to many fund insolvencies.
- 10.4 Every fund should therefore have a written investment policy which shall satisfy statutory and regulatory requirements and should be communicated to service providers and committees involved in investment activities. The policy should:
- 10.4.1 state who the fund's investment advisers are and where applicable, who the custodians of the investments are;
 - 10.4.2 describe the objectives of the investment program, which should be in accordance with the overall risk philosophy of the fund as outlined in its strategic plan;
 - 10.4.3 outline the composition of the portfolio type, term, purpose and liquidity;
 - 10.4.4 indicate the targeted performance benchmarks in respect of each investment manager and asset class held by the fund, plus risk limits imposed with respect to each class and investment manager;

10.4.5 establish authorization procedures, limits and accountabilities for investment activities. The framework of accountability for all investment transactions should include details on who is authorized to undertake investment; and

10.4.6 outline circumstances in which derivative instruments can be used.

11. **REGULATORY AUTHORITY AND COMPLIANCE**

11.1 The board should provide for the establishment of appropriate mechanisms to oversee and ensure compliance with the legislative requirements, and document its administrative policies. Every fund needs documented processes and standards to enable compliance with legislative requirements. This also ensures all administrative functions, including calculating, paying and receiving contributions and retirement benefits or values, fall within the fund rules, administrative policies and legislative requirements.

11.2 The board should ensure that the requirements of any regulatory authority, particularly those of the Registrar, are complied with and that any query from such regulatory authority is dealt with expeditiously and thoroughly. The existence of an effective compliance officer who reports to the trustees at regular intervals is important.

11.3 The activities of the fund and the powers of the board are limited by its rules the Retirement Funds Act, 2005 and the Financial Services Regulatory Authority Act, 2010. Therefore, it is the board's responsibility to understand the rules of the fund and the requirements of legislation, and should seek assistance as necessary. It is expected that trustees will:

11.3.1 Consult with professional advisors in the legal profession i.e., attorneys to provide technical assistance on the governing legislation.

11.3.2 Regularly investigate and update compliance policies and procedures designed to maintain compliance with the governing legislation.

11.3.3 Report to the regulatory authority any suspected illegal, unethical, or financial irregularities.