

# Submission of comments to National Treasury in the discussion on Retirement Fund Reform.

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## TERMS OF REFERENCE

Possibility: all the suggestions made are with reference to technology already available in the market.

### 1 IMPACT OF FEES & COSTS ON RETURNS

**issue** recent evolution of the industry has introduced systemic efficiencies, greater access to product and information, new avenues of control and a focus on collaboration. In theory, players in the new look industry should be largely self-sufficient, empowered by advances in technology and access to one-stop service providers.

The industry workflow has yet to catch up. The investment process is complicated by a convoluted string of disintermediation and fee generation. To the extent that it is not disclosed, the value chain is out of balance and investors are being forced to support unnecessary and inappropriate infrastructures.

**tech role** on a micro level, the technology platform should be configured to highlight all fee/cost elements, particularly where an investor is looking at the performance attribution. Such disclosure should be extended to the cost of technical infrastructure employed by the fund managers.

On a macro scale, investors/members should be made aware of the technologies available, and trustees should be put in a position where they can challenge the involvement of external suppliers and consultants in favour of systemic efficiencies available through technology.

### 2 CARRYING COST OF SYSTEMS / IT

**issue** many of the systems employed by fund managers are out-dated and based on ex-growth technology. In most cases, there is a significant capital investment and the controllers of IT capex are loathe to migrate to new platforms, despite the fact that the maintenance of their existing systems is proving vastly more costly than a new system.

The trend, also, has been to keep systems “current” through bolting on a combination of patches and supplemental development. These strategies are fraught with operational and systemic risk, not least of which is the inclination of many CTO’s to disguise same to protect their reputation and the veracity of their previous capex recommendations.

THERE NEEDS to be a mechanism whereby the institutions account for their existing technology platforms and ongoing spend.

### 3 AUDIT

**issue** most of the processes within the fund management domain, and specifically the reporting and presentation of data, are driven by accounting and auditing standards, increasingly the quality of reporting is as much dependent on decisions taken by the IT department.

THERE NEEDS to be a system of auditing and certificating the IT processes and systems in place and relied on by the fund executives.

## 4 SYSTEMIC CONTROL

**issue** efficiencies in trading systems

**tech role** technology exists that can bring control and governance to the entire eco-system. This is achieved in a number of ways:

- streamlining all parts of the process into an integrated system;
- maintaining statutory, regulatory and mandate rules within the system, such that violations are flagged or prevented as the case may be;
- enabling access to meaningful information at both a macro and micro level [meaningful being, accurate, timely, interpreted, and in the right hands]

## 5 TIME IS MAJOR ISSUE.

**issue** Most material failures could have been avoided or minimised with quicker action. Time failures occur for a number of reasons: but predominantly:

- information is filtered or distorted by the offender; or
- information is received but is not understood and ignored.

**tech role** with appropriate workflow in a system, and with statutory and mandate requirements built in as inviolable rule-sets, reporting can be automated to counter any number of events, including:

- an attempted breach of the prevailing rule sets that has either been denied, or perhaps somehow over-ridden;
- a limit that is being approached, or one which is breached as a result of market movements;
- an exposure that is flagged as vulnerable – either in a single portfolio or as an aggregate position over a number of portfolios;
- specific portfolio monitors or risk variants that move out of range.

System-driven whistle-blowing functionality must be intrinsic, together with workflow relating to the escalation of each type of event.

## 6 MANDATE CONTROL

**issue** Increasing focus on mandate & investment strategy reflected in likely revamp of Reg 28. Particularly given the increased sophistication of the market, there is no reason for a mandate to be vague. The reform of the legislation should concentrate on the mandate as being the centre of the “contract” between the role-players and should deal with the following:

- mandates must be formulated using measurable, concise and unambiguous terminology;
- a standard format of mandate creation should be devised; including industry-standard measures for all material terminology used, such as “aggressive”, “passive”, “high risk” etc;

- the mandate should include specific targets or limits, measured in either absolute or relative terms;
- in the case of a fully-discretionary mandate, the fund manager should be obliged to reflect their investment strategy within the mandate from time to time;
- hedge funds must be obliged to reflect their investment strategy in the form of a mandate, as above;

**tech role** mandates should reside within the system as an inviolable rule set. The mandate should be elevated within the rules hierarchy and should be used to test both pre-trade and post-trade compliance.

## 7 HEDGE FUNDS

**issue** hedge funds are able to avoid regulation and inspection. In many instances, the mandate / strategy is entirely flexible and fluid and the terms of reference are vague at best.

But there is no plausible reason for the lenient attitude towards Hedge funds from a regulatory perspective. Technology exists that can monitor and measure hedge fund activity just as with any other fund or asset class.

Hedge funds, and their management and workflow, should be brought in line with the rest of the industry. Trading results from the funds should be incorporated real-time into portfolio results and the underlying risk profile should be included in the portfolio aggregate.

## 8 REGULATORY DIALOGUE

**issue** “burden” of compliance not inconsiderable. Material costs involved detract from the pleasures of good corporate citizenship.

**tech role** Technology can ease the burden of compliance – removing much of the administrative burden. Examples being the calculation of accrued interest for it3b’s; the formatting of reports in terms of reg 28 and the communication with members and other stakeholders

Must make it easier for businesses to keep compliant

## 9 MULTI-SYSTEM VULNERABILITY

**issue** out-of process activity, – fixed property, alternative investments, exotic instruments. fund managers can exploit these areas to avoid detection or scrutiny. Also, where multiple funds / portfolios are kept in separate reporting structures, the global position or aggregated risk is often not apparent.

**tech role** Monitor all investments and investment classes within a single, integrated system; employing seamless interfaces to external systems (no manual capture); monitoring (risk & performance) at any level: an investor’s view, portfolio view, fund view, or aggregate institutional-level view.

## 10 LICENCE & CERTIFICATE ROLEPLAYERS

- issue** rogue players not easily identified – prevention against repeat offenders
- tech role** maintain a central register of licensed players without the possibility of ghosting or duplicate identities. – ensure that IT systems interface into central reg and that the activity audit logs the certificated identity of the roleplayers alongside the activity. Should a certificate/license be revoked, said individual / entity will not be permitted to interact with the system.
- Equally, the central reg should log the activities of its certificated operators. Should one turn rogue, the system should proactively alert other entities exposed to the risk.

## 11 RATIONALISATION OF FUNDS - COSTS

- issue** critical need to rationalise many / all of the activities of smaller funds to lower costs and bring the smaller operators into the governance net without crippling them with administration or cost.
- but:** lumping funds together without proper control raises risk levels, looses the identity of the fund and often looses the ability for the members/investors to vote their fund's stake. Moreover, manual administration and reporting is cumbersome and ineffective.
- tech role** technology exists that can manage multiple funds and multiple managers, without compromising confidentiality or the provisions of the individual mandates. Such systems are also able to streamline significant elements of the administrative workload to further enhance delivery to members and reduce costs.

## 12 RATIONALISATION OF FUNDS – MANDATES

- issue** fund managers cannot track and monitor the unique mandate requirements of each fund. Funds will be grouped into Near-fit categories and will be traded as an aggregate view. Mandates will creep to a common denominator.
- tech role** mandates can be maintained as individual, inviolable rule-sets, yet a fund manager will still be able to take a system-wide view and trade (in bulk) what will simply be the aggregated result of individual, detailed mandate requirements

## 13 RATIONALISATION OF FUNDS - ABUSE

- issue** trading in bulk and allocating preferential pricing to favoured clients
- tech role** trade bulking, execution and dissection rules should all sit within the system. Funds should have the choice of whether they want to fall within bulk trades. Individual mandate requirements will prevail and reporting mechanisms can alert trustees where their prices are consistently at the wrong end of the market.

## 14 RATIONALISATION OF FUNDS – SHAREHOLDER RIGHTS

- issue** shareholder identities are thrown into a nebulous singular, and fund members are not able to exert their rights. decisions on corporate events are likewise taken en mass, without particular heed of an individual funds' wishes or requirements.
- tech role** the system should preserve the identity of each fund within the umbrella, and make available independent choice in respect of a fund's shareholder rights and action with respect to corporate events. The system should likewise eliminate the administrative workload and allow the fund managers to focus on their core areas.

## 15 ROLE OF TRUSTEES

- issue** The various roles required of trustees not easily reconciled from a legal or operational perspective.
- on the one hand, trustees are (in practice, if not yet in law) accountable to the members for the fiduciary control over the assets – requiring a highly technical skill set and a constant vigilance over all aspects of the operation;
  - this expertise is also essential when it comes to deciding on an investment strategy applicable to the underlying risk profile of the member base, and the translation of that strategy into an appropriate mandate;
  - slightly less technically onerous are the skills required of trustees for the process of setting the criteria, adjudicating and ultimately appointing the various service providers to a funds operation, and putting in place a mechanism of ongoing evaluation and review;
  - and equally, trustees are required to understand and monitor the corporate events within their portfolio that they might represent the will of their constituency as beneficiary shareholders in the underlying investments.
- tech role** the primary role for technology is to absorb the burden of monitoring and controlling the more technical systemic risk. In effect, many of the fiduciary duties need to be imbedded in the system design with the appropriate controls, alerts and whistle-blowing functions visible and auditable.
- Trustees should be allowed to focus on the “softer” issues of governance and should be thus empowered through appropriate training.

## 16 ROLE OF TRUSTEES – APPOINTMENT OF CONSULTANTS

- tech role** consultants and service providers need to be vetted and “certificated”. The IT system needs to load the certificates (if digital) or reflect the registration number of all service providers or consultants.
- The process and debate around the appointment, and the various approvals sought and given should also be maintained within the system.

## 17 CONSULTANTS - INVESTMENT STRATEGY

- issue** reliance on consultants for advice can erode the independence and efficacy of the trustee. Equally, the trustee is seen to execute the decision and the advisor's role therein is not necessarily witnessed.
- tech role** monitor and log each external intervention / consultation, such that the trustees' decisions are motivated and that there is an explanation..  
Make the consultant's advice visible and accessible and challengeable

## 18 ROLE OF TRUSTEES – MONITORING RISK

- issue** In many instances, the trustees are unaware of the implications of the reports being presented before them, and of the risk parameters under discussion within a report.
- tech role** The system needs to monitor and highlight unacceptable risk as and when it occurs. If it is an avoidable risk, the system should be able to prevent same and notify all stakeholders of such prevention. If the situation is not prevented, the risk warning should be issued and should be escalated until satisfied by appropriately authorised signatories. The risk warnings should be termed appropriate to the level of understanding of the recipient and should include explanatory notes if required.

## 19 ROLE OF TRUSTEES – WHISTLE BLOWING

- issue** much of the existing (and planned) legislation places a legal obligation on trustees and other executive personnel to report suspicious /illegal behaviour.
- tech role** the system rules should be configured to the tolerance levels of the legislation (FICA, etc) and should report out-of-bound activity. The alert workflow should include external parties (auditors / FSB / SAP) if the violation report is not adequately handled.

## 20 ROLE OF TRUSTEES - CONTROLS

- issue** much as the provisions of SOX's 404 demand the executives signing off the adequacy of internal controls, so, too, should trustees have to satisfy themselves regarding the appropriateness and efficacy of their funds control measures. While legislation itself cannot get into the specifics of IT systems, there should be guidelines relating to:
- Mapping the business workflow for audit purposes;
  - Proving the appropriateness and efficacy of IT systems used;
  - Proving the appropriateness and efficacy of all remote operations, and auditing the accuracy of take-on of data from remote systems; and
  - Eliminating the usage of spreadsheets and manual risk management.