LA RETIREMENT FUND
Securing your retirement

THE LA RETIREMENT FUND
(The Fund)

INVESTMENT POLICY STATEMENT AND PROCEDURES SUMMARY FOR THE PENSIONERS

Last updated July 2021

A. INVESTMENT POLICY STATEMENT

1. INTRODUCTION

This Investment Policy Statement (IPS) is a formal statement of the main principles underlying the long term investment strategy of the LA Retirement Fund (the Fund) as it relates to its pensioners including defined benefit (DB) deferred pensioners. It is intended to provide a dynamic framework for long-term investment decisions taken by the Fund's Board of Trustees and the selected investment managers. While the investment managers may in most cases have complete discretion in the acquisition or disposal of any type of long-term investment, subject to the terms of their mandates, the Board of Trustees expects such decisions to be taken within the framework of the IPS. The performance of the investment managers is evaluated relative to the considerations herein.

2. BACKGROUND OF THE FUND

The Fund was established through an amalgamation of a number of local authority funds, primarily to provide retirement benefits in the form of lifetime pensions.

The LA Retirement Fund incorporates a Defined Contribution (DC) section and a DB section. Originally the DB section included both active members (members who have not yet retired) as well as pensioners. All DB active members transferred to the DC section in various tranches from 2013 and with effect from 1 April 2016 all remaining active members had been transferred to the DC section with the DB section only including pensioners. This DB section is therefore closed to new entrants. All new entrants join the DC section.

The Fund became a Principles for Responsible Investing (PRI) signatory on 1 January 2016. At the time, it was one of the first South African retirement funds to do so. The PRI provides a high-level framework for integrating Environmental, Social and Governance (ESG) issues into investment decision-making and ownership practices within the boundary of the Board of Trustees' fiduciary duties.

3. THE VISION OF THE FUND

"To provide the best possible retirement outcome for all its members, retirees and pensioners."

4. THE MISSION OF THE FUND

The Fund is a trusted financial and investment partner to its members, retirees and pensioners and helps them to achieve positive retirement outcomes through:

1. Innovative, cost-effective and risk-managed retirement investments that grow our members savings, thereby maximising the chances that they will receive the lifelong pension income they need;
2. Ethical retirement fund management, good governance and responsible investment that protects the Fund from external factors that could negatively impact members' retirement savings;

3. Clear communication and ongoing education that helps members to keep their retirement journey on track; and
4. Affordable risk cover, preservation and at-retirement solutions that enable financial security for members, retirees, pensioners and their loved ones.

5. PRIMARY INVESTMENT GOALS OF THE FUND

The Trustees have a fiduciary duty to invest the Fund’s assets for the benefit of the pensioners in a responsible and prudent manner. For this purpose, the Board of Trustees relies on the expertise of the Fund’s Investment Consultant.

Overall, the Board of Trustees has the following as its primary investment objectives:

- to target a pension increase equal to 70% of inflation (CPI) effective 1 January every year but based on CPI to the preceding 30 June (subject to affordability and the minimum increases specified in the Rules);
- every three years perform a catch-up exercise to increase pensions to at least 100% of CPI since the date of retirement, subject to the value of the notional pensioner account and affordability (i.e. to apply the minimum pension increase required in terms of the Pension Funds Act.);
- give appropriate consideration to any factor which may materially affect the sustainable long-term performance, including Environmental, Social and Governance (ESG) considerations;
- to remain financially sound at all times.

The long term objective is to provide a pension increase equal to 100% of CPI.

6. LIABILITY DRIVEN INVESTMENT STRATEGY (LDI)

The Pensioner assets are invested according to a Liability Driven Investment (LDI) Strategy albeit that only a portion has been invested in a de-risking portfolio. The de-risking portfolio is invested in assets such as nominal bonds and inflation linked bonds. The growth assets are invested in assets such as local and offshore equities and direct property. The aim is for the growth assets to achieve higher returns than the de-risking assets over time to improve the targeted level of pension increases and the payment of discretionary annual bonuses. The allocation to the de-risking portfolio can be increased as and when an opportunity arises to de-risk the pensioner portfolio further and to lock in profits as generated by the growth portfolio.

Liabilities are directly linked to interest rates, expected inflation and expected mortality of the members. Liabilities are the present value of the Fund’s future cash flow obligations to the pensioner members.

The performance attributes of bonds are most similar to the liabilities. LDI relates to an investment strategy where all investment decisions are driven by the liabilities. The benchmark is therefore not a market index or a peer group benchmark but is rather the actual liabilities of the pensioners.

The LDI investment strategy:

- takes action relative to the liabilities rather than a market index or a peer group benchmark;
- provides liquidity for short-term cash flows;
- manages the Fund's solvency position;
- provides ongoing transparent attribution of the liabilities;
- provides ongoing transparency of the financial position of the Fund;
- provides ongoing testing of the actuarial assumptions (i.e. mortality assumption);
- provides a more controlled investment strategy to meet the long term objectives of the pensioners;
- incorporates a de-risking portfolio which has a specific purpose i.e. to track the movement of the Fund's future pensioner obligations in response to interest rate and inflation movements;
- incorporates a growth portfolio which has a specific purpose i.e. to outperform the liabilities over time;
- incorporates tactical asset allocation that aims to add value i.e. lock in gains within the growth portfolio at opportune times and to allocate such profits to the de-risking portfolio.

6.1 DE-RISKING PORTFOLIO

The de-risking portfolio endeavours to manage the liabilities in such a way so as to track the movement of the Fund's future pensioner obligations in response to interest rate and inflation movements. The strategy endeavours to manage the allocated pensioner liabilities to provide pension increases in line with the Fund's Pension Increase Policy and ensure that there is sufficient liquidity to meet the Fund's short-term pension payments as and when they fall due.

The de-risking portfolio aims to mitigate as much of the risk as possible using the smallest amount of assets with the residual amount of assets allocated to the growth portfolio.

6.2 GROWTH PORTFOLIO

The objective of the growth assets is to achieve higher investment returns to enable the Fund to target higher pension increases in future. The growth portfolio targets a real return of 6% over five-year rolling periods with no cognisance of capital protection. The Fund aims to maintain adequate diversification across asset classes, investment strategies and investment portfolios. The growth portfolio is invested in local and offshore equities as well as local and offshore listed property and one direct property.

6.3 REBALANCING OF DE-RISKING AND GROWTH PORTFOLIOS

As the financial position or funding level increases to a certain level, the appointed LDI investment manager has predefined triggers in place to ensure that any excess gains achieved on the growth portfolio are banked and then transferred across to the de-risking portfolio. These triggers are a function of the Fund's funding level as adjudged on a risk free basis rather than relying on statistical and model dependent probabilities. When the situation is reached and the financial position of the Fund improves to the trigger point there is a need to consider rebalancing assets from the growth portfolio to the de-risking portfolio. The transfer of assets between the portfolios happens as and when opportunities arise and after the Board of Trustees have considered all the relevant information.

Tactical asset allocation considerations are included in the decision making process such as the hedging of growth assets such as local and offshore equities or the hedging of currency exposures.

At inception of the LDI investment strategy, the strategic allocations of the proportion managed via this strategy as allocated to the de-risking and the growth portfolio were 60% and 40% respectively. Such an allocation is managed dynamically over time. The portion allocated to the LDI investment strategy will be increased as and when an opportunity arises to do so after having considered all the relevant information.

Unitisation services and Regulation 28 compliance reporting have been implemented to facilitate the investment strategy as outlined in the IPS.

7. RESPONSIBLE INVESTMENT

The core objective of Responsible Investment (RI) is to act in the best interests of the Fund's members by recognising that Environmental, Social and Governance (ESG) factors can influence both investment risk and return, and must therefore be considered by the Trustees in all investment decisions. Protecting and enhancing financial returns by incorporating such factors is consistent with their fiduciary duty.

The Board of Trustees aspires to the PRI's six Principles for Responsible Investing that provide a number of ways for the Fund to incorporate ESG issues into its investment decision making framework. The six PRI principles to which the Fund is committed are as follows:

- The Fund will incorporate ESG issues into investment analysis and decision-making processes;
- The Fund will be active owners and incorporate ESG issues into our ownership policies and practices;
- The Fund will seek appropriate disclosure on ESG issues by the entities in which we invest;
- The Fund promote acceptance and implementation of the Principles within the investment industry;
- Then Fund will work together to enhance our effectiveness in implementing the Principles;
- The Fund will report on our activities and progress towards implementing the Principles.

In addition to being a signatory to the UNPRI, the Board of Trustees supports the voluntary Code for Responsible Investing in South Africa (CRISA). CRISA came into effect in February 2012 and provides guidance on how institutional investors should execute investment analysis and investment activities and exercise rights to promote sound governance. Its principles are aligned with those of the UNPRI.

In addition to the requirements of UNPRI and CRISA, the Trustees take into account and implement the governance principles in King IV. King IV states that "sustainable development can be understood as development that meets the needs of the present without compromising the ability of future generations to meet their needs." and is a primary ethical and economic imperative.

The FSCA published Guidance Notice 1 of 2019 to provide guidance to Boards of retirement funds on how a Board's investment philosophy, as encompassed in its IPS, aims to ensure the sustainability of its investments and assets. It also sets out the FSCA's expectations regarding disclosure and reporting on issues of sustainability.

The Fund meets such requirements -

- The Fund has a standalone IPS which is reviewed at least annually;
- The Fund communicates the IPS (in summary form) on the Fund's website. The detailed IPS is accessible by any member of the Fund upon request from the Principal Officer;
- Before making any investment, the Trustees of the Fund consider any factor which may materially affect the sustainable long term performance of the Fund's assets including, but not limited to, those of an Environmental, Social and Governance (ESG) character;
- ESG is a standard agenda item on every Board of Trustees meeting agenda;
- As part of the Fund's Responsible Investment (RI) project plan, the Fund will consider best practice in terms of the adoption of sustainable reporting practices;
- In the context of considering social factors, the Fund also considers the broad based black economic empowerment of the investment managers who manage the Fund's assets.

8. PROXY VOTING

The Trustees delegate their voting power and responsibilities to their selected investment managers. Such proxy voting then formally expresses an approval or disapproval on relevant matters with regards to the Fund's investment in any company, particularly regarding corporate governance and responsible investment issues.

The Fund has implemented this Proxy Voting Policy in order to document the Fund's position with regard to voting practices to ensure that the selected investment managers understand the position of the Fund and thus can be held accountable for the decisions that are made in proxy.

9. CONFLICTS OF INTERESTS

In accordance with Circular PF No. 130 it is the fiduciary duty of the Board of Trustees and the Principal Officer to avoid (rather than manage) conflicts of interest. The Board not only deals with conflicts of interest amongst the members of the Board but also with respect to any service provider of the Fund. Conflicts of interest will be avoided, removed or if not possible, resolved transparently. The Fund discloses how it manages conflicts of interest through its Conflicts of Interest Policy.

10. ACHIEVEMENT OF INVESTMENT OBJECTIVES

The principal long-term investment objective is to optimise investment returns whilst taking into account the level of acceptable risk and liquidity in relation to pensioners' liabilities. This is achieved primarily as follows:

10.1 DIVERSIFICATION

Diversification is fundamental to risk minimization and it is therefore the fiduciary duty of the Board of Trustees to diversify the investments of the Fund.

Diversification is managed in a number of ways such as:

- Asset class composition (i.e. equities, bonds, cash, property etc.);
- Geographical allocation (i.e. local versus offshore assets);

- Portfolio construction (i.e. the optimal combination of asset classes and investment managers, investment styles, specialist mandates and multi asset class mandates);
- Security selection (i.e. the investments which the selected investment managers purchase within their mandates).

Such diversification is further achieved by:
- Investing in uncorrelated assets;
- Controlling the absolute exposure to individual assets classes by setting ranges;
- Robust portfolio construction;
- Selecting investment managers with different but complimentary investment styles and approaches.

10.2 <u>RISK TOLERANCE</u>

The risk of fluctuating returns of market related investment portfolios is borne by the Fund.

The actuarial value of the assets is compared to the value of the liabilities based on long-term assumptions about future asset class performance expectations and assumptions. The market value of the

assets tends to be more volatile over time, whereas the actuarial value of the assets is more smoothed. Hence the difference between the market value and the actuarial value of the assets could be viewed as a "solvency reserve".

The Board of Trustees, on the advice of their investment consultant and the Tactical Asset Allocation (TAA) investment manager, implements tactical asset allocation. Such includes hedging strategies on the local and offshore equity assets as well as the currency exposures as and when they see fit to do so.

10.3 <u>REBALANCING</u>

The Investment Consultant may at its discretion and as outlined in its mandate implement physical investment manager / mandate rebalancing investment decisions where a selected investment manager / mandate may be reduced or increased as a result of cash flow requirements or for purposes of any derivative overlay management or to realise profits from good performing managers and structural changes to the asset allocation of the Fund.

10.4 <u>MATCHING</u>

It is important that the liabilities are adequately matched by assets of appropriate term, nature and currency. The matching liabilities of the Fund are reviewed on an on-going basis as the LDI strategy is dynamic in nature.

10.5 <u>TIME HORIZON</u>

The time horizon of the pensioner portfolio, in common with similar portfolios, is medium-term to long-term (e.g. a longer term applies in respect of spouse's pensions). The effective time horizon for the investment managers is likely to be somewhat shorter, given the need to demonstrate performance on a regular basis. Short-term performance considerations should not outweigh the need to provide for the medium-term to long-term, in the selection of investment managers and assets. However, it should be recognised that sound longer-term performance is dependent upon an accumulation of sound short-term performances.

10.6 LIQUIDITY

The Fund requires cash to fund its operating expenses, most importantly the paying of pensions and other benefits. The Fund's investment holdings should provide sufficient liquidity for this purpose.

The Fund provides for the cash flow requirements through either monthly withdrawals from identified investment manager/s, or the sale of assets as and when required.

10.7 TAX AND COST CONSIDERATIONS

Investment income as well as capital growth is currently tax-exempt.

When deciding on an investment or an investment manager, the cost of the investment or the investment manager is taken into account. The returns of investments are also measured after taking account of costs.

10.8 LEGAL CONSTRAINTS

Notwithstanding the stated investment objectives, such remain subject to the provisions of relevant legislation, more particularly Regulation 28 of the Pension Funds Act no. 24 of 1956, as amended from time to time, as well as the Financial Advisory and Intermediary Services Act (FAIS).

10.9 DERIVATIVES

Derivative investments relate to an instrument whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include equities, bonds, commodities, currencies, interest rates and market indices. Futures contracts, forward contracts, options and swaps are the most common types of derivatives.

Investment managers may use derivatives for the following purposes:

- Asset Allocation: derivatives may be used to allocate funds effectively across different classes;
- Hedging: derivatives may be used to hedge the portfolio without having to dispose of the underlying assets;
- Insurance: derivatives may be bought to insure against specific events;
- Yield Enhancement: the investment manager may take advantage of anomalies in derivative market pricing in order to enhance the portfolio's investment returns.

Derivatives may not be used to:

- Speculate: under no circumstances may the investment manager speculate in the derivative market. This includes uncovered derivative positions;
- Gear: under no circumstances may the investment manager borrow money to fund derivative positions.

10.10 SECURITIES LENDING

Securities lending is the practice of lending securities, such as equity and debt securities, from an investor's portfolio (the lender) to meet the temporary needs of another party (the borrower).

For this transaction the borrower agrees to (1) deliver collateral, (2) pay the lender a fee, and (3) return the securities to the lender at a point in the future.

The Fund has appointed the Fund's custodian as the Securities Lending service provider to act as principal and to act on behalf of and for the benefit of the Fund. The Board of Trustees will as the next step formulate an appropriate Securities Lending Policy (SLP). The SLP will provide a dynamic framework within which prudent securities lending transactions can be conducted to provide additional income for the benefit of the Fund. The SLP is reviewed at least annually or as and when there is a material change in the programme.

11. REVIEW OF THE IPS

The Board of Trustees shall review the IPS as well as other complimentary Policies on at least an annual basis or when there is a material change to the Fund or in anticipation of a major change. A material change to the Fund includes a significant change in the membership of the Fund or a significant change in the benefit structure or a significant change in the asset and / or liability values as a result of movement in the market or the transfer of assets and / or liabilities between funds.