



Challenges Trends Opportunities

# Institutional Insights



Investments

# 'Fit and Proper' Requirements and Trustee Liability Issues

⌵ TASHIA JITHOO, PARTNER  
BOWMAN GILFILLAN INC



# INCREASED FOCUS ON GOVERNANCE



- Different countries & regions are at different stages of governance development but have been some observable trends
- Between 2003 – 2008 more studies around links between fund performance & fund governance
- From 2008 (US, Europe & Australia) focus is on how best to achieve proper governance. Looking at:
  - Structure of governing body
  - Qualities, skill & competencies needed of trustees
  - Governance in context of shift from DB to DC
  - Cost/value proposition to members
  - Identifying risks to proper governance

# What does fund governance entail?

<b>Organizational Coherence</b> <ul style="list-style-type: none"><li>• Clarity of purpose</li><li>• Structure of the governing board</li><li>• Proper allocation &amp; deployment of resources</li></ul>	<b>People</b> <ul style="list-style-type: none"><li>• Qualities</li><li>• Skills</li><li>• Competencies</li><li>• Recruitment</li><li>• Remuneration Practices</li><li>• Protection</li></ul>
<b>Processes</b> <ul style="list-style-type: none"><li>• General decision-making processes</li><li>• Investment decision-making</li></ul>	<b>Accountability Mechanisms</b> <ul style="list-style-type: none"><li>• Whistle-blowing</li><li>• Service-provider mandates &amp; agreements</li></ul>

# ‘PEOPLE’ AS CENTRAL TO PROPER FUND GOVERNANCE



“Trusteeship today requires significant expertise, yet many have identified trustees as being the weakest link in the value chain”

(NAPF Discussion Paper, 2005)

“Trustees are a mass of well-intentioned but not necessarily expert folk” and have represented a “residual enclave of amateurism in . . . business life”

(John Plender, Financial Times, January 2005)

“If standards around trustee tables are to rise more quickly, then recruitment, selection and reward need to be addressed”

(NAPF Discussion Paper, 2005)

# The Broad Notion of ‘Fit & Proper’



- Fitness: **Ability** to fulfil the role - knowledge, skill, experience, competence
- Propriety: Suitable **character** to occupy a position of trust – eg integrity, honesty, good faith
- Amendment to s7A of PFA – trustees to acquire level of skill and training as ‘may be prescribed’ by the registrar within 6 months from appointment & retain through term of appointment (fitness)
- Amendments to s7C of PFA – act independently, fiduciary duties & ‘comply with any other prescribed requirements’ (propriety)



SA environment :

- Low levels of financial literacy
- Large pool without formal qualifications
- Small pool of experienced trustees
- At least 50% member elected trustees in occupational funds
- High turnover of trustees
- Remunerative incentives generally only for independent trustees

How do we put in place standards that are appropriate but not unnecessarily exclusionary or burdensome for funds and individual trustees?



*Let's take a tour . . .*





*Trustees “should be subject to **minimum suitability (or non-suitability) standards** in order to ensure a **high level of integrity, competence, experience and professionalism** in the administration of the pension fund. The **governing body should collectively have the necessary skills and knowledge** to oversee all the functions performed by a pension fund, and to monitor those delegates and advisors to whom such functions have been delegated.”*

[\*Organisation for Economic Co-orporation and Development]



*Law on the Organisation and Operation of Pension Funds (1997)* – fit & proper requirements include:

- Propriety requirements apply to all trustees
- Management Board
  - At least 2/3 must have 7 year employment history
  - At least 2/3 must speak Polish
  - At least 1/3 must have degree in law, economics or be on a list of investment advisors
- Supervisory Board (50% member elected)
  - As above BUT ½ must have degree in law or economics



- “Duties imposed by law on fiduciaries have been viewed as sufficiently rigorous to ensure, in most cases, that qualified individuals are appointees”
- Prescribing specific degrees or training viewed as unnecessary because trustees usually drawn from senior company management or delegated experts & advisors

[Stewart & Yermo, *Pension Fund Governance: Challenges and Potential Solutions*, 2008]



## *German Insurance Supervision Act*

- qualified, reliable & suitable for job
- “sufficient theoretical & practical knowledge”

Usually means managers having management experience within insurance co or pension fund for at least three years & knowledge of their portfolio



- “Appropriate knowledge & understanding of the law relating to pensions & trusts, principles relating to funding and investment of assets”
- “Conversant” with certain specified scheme documents (trust deed, rules, IPS, most recent financials) & other documents regarding current policy on administration
- Applicable to all trustees and any individual that represents a corporate trustee
- Code of Practice and Trustee Knowledge and Understanding
- Trustee Toolkit



- 2006 - Fit & Proper requirements became part of the licensing requirement for funds as overseen by APRA
- Fitness requirements met on collective basis
  - Working knowledge of law & its application
  - Basic investment knowledge
  - Proven professional & managerial competence
- Proper requirements met on individual level
  - Honesty, integrity etc



- Focus is on ensuring adequate skill while performing function instead of ensuring they meet set of expectations before appointment.
- If don't have expertise, knowledge or experience initially, APRA expects them to undergo sufficient training within 'reasonable period of time' (usually not more than one year)
- Core skills required:
  - Understanding & ability to implement certain specified docs
  - Working knowledge of relevant legislation & basic knowledge of trust law
  - Working knowledge of accounting, auditing & operating processes
  - Basic investment knowledge
  - Awareness of which areas additional technical, professional or expert advice could be sought



Must adopt a Fit and Proper Policy which must deal with the following:

- Identify & articulate skills & competencies required at board level & individually
- Processes to identify & remedy skill gaps
- Who will conduct fit & proper assessments and how done
- Process to ensure compliance with policy
- Process for regular review
- Self-assessments
- Training needs
- Whistle-blowing obligations



# ISSUES FOR EACH FUND TO CONSIDER



- Nature of fund & membership
- Available skills
- Necessary skills at time of appointment
- Core skills & specialized skills
- Training
- Performance assessments
- Risk matrix
- Fit & Proper Policy

\*\* Of course any prescribed minimum requirements will apply



Affirm Marketing (Pty) Ltd & others v IF Umbrella Pension Fund & others (PFA)

- Former trustees jointly and severally liable for amount of R20 mill (less settlement amount obtained from Dynamique Consultants & Actuaries)
- A new state of uneasy?



## 7F Liability of board member

In any proceedings against a board member in terms of this Act, **other than for wilful misconduct or wilful breach of trust**, the court **may relieve the board member** from any liability, either wholly or partly, on terms that the court considers just, if it appears to the court that –

- (a) the board member has acted **independently, honestly and reasonably**,  
OR
- (b) having regard to all the circumstances of the case, including those connected with the appointment of the board member, it would be **fair to excuse the board member**.

# WHAT IS JOINT & SEVERAL LIABILITY?



- Personal liability vs fund liability
- Joint & several liability - each liable for whole
- Joint liability – each liable for proportionate share

# IS SECTION 7F THE ANSWER?



- Court has discretion to excuse from liability
- Need to prove case in court
- Time and cost
- Outcome unpredictable
- Should be fallback position not means of first resort !

Note: Does not mean that no liability in first 6 months when ‘attaining prescribed level of skill and training’ (Adams & others v ES Group Pension Scheme (2009) UK)

# OTHER PROTECTION AGAINST PERSONAL LIABILITY



- Indemnities
- Exoneration clauses
- Trustee Insurance
- But how are these different from each other and which to use when?

# DIFFERENCE BETWEEN AN INDEMNITY, EXONERATION & INSURANCE



- Indemnity - Third party covers the liability
- Insurance
  - A form of indemnity but received in exchange for premiums
  - Fidelity insurance
- Exoneration
  - Excuses person from liability
  - Express exonerations in rules vs statutory exonerations (eg s7F of PFA or s34(4) of UK Pensions Act)



## Indemnities

- Only as good as the person giving it otherwise liability remains

## Exoneration clauses

- No action required by the trustee
- Excused from liability but not if bad faith, reckless, wilful neglect, dishonesty or fraud
- Does not cover certain criminal liability or civil penalties
- Better for trustees but can leave fund out of pocket
- No protection from third party claims

## Insurance

- Cost, exclusions, excess,
- Limits on liability



# FACTORS TO CONSIDER



- Consider types of protection mechanisms, which is appropriate when, gaps in cover & how to ensure protection for all parties (trustees, members and fund)
- Necessary also to encourage people to accept positions as trustees when they may not do so otherwise
- Ensures effective and efficient decision-making

END



Your thoughts and questions?