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King III and Retirement Funds

The King III Code of Conduct published in September 2009, will become effective from 1 March 2010. The code will apply to all entities regardless of the manner and form of incorporation or establishment. It will therefore not only apply to companies, but also to retirement funds.

The code will be enforced on an “apply or explain” basis. This means that the board of trustees could resolve that it is not in the best interests of the fund to follow a particular recommendation contained in the code. In such a situation, the board can apply the recommendation differently or employ another practice as long as it still achieves the objective of the overarching corporate governance principles of fairness, accountability, responsibility and transparency. By explaining the reasons for not applying the recommendation, a board may in this manner still achieve compliance.

The code will not constitute law. The difference between the law and the code is explained as follows: “Criteria for good governance helps determine what is regarded as an appropriate standard of conduct for directors (trustees). The more established certain governance practices become, the more likely a court would regard conduct that conforms with these practices as meeting the required standard of care. Corporate governance practices, codes and guidelines such as King III therefore lift the bar of what are regarded as appropriate standards of conduct. Any failure to meet such a recognised standard, even if it is not legislated, may render a board liable at law.”

All listed companies are required to comply with King III, because compliance is compulsory in terms of the listing requirements of the Johannesburg Stock Exchange.

Many of the principles contained in King III are already contained in PF130. However, the requirements of PF130 constitute guidelines and are not enforceable. We understand that the FSB will revise PF130 to incorporate the requirements of King III and issue the revised document in the form of a directive. At this stage, it is not clear when the revised PF130 will be published. The revised draft will be very important for the retirement fund industry in as much as it will provide guidance on the way in which retirement funds will comply with problematic requirements, such as the ‘independence’ requirements of the new code.

The code states that “each principle is of equal importance and together forms

a holistic approach to governance. Consequently, ‘substantial’ application of the code and the report does not achieve compliance” and “all entities should by way of explanation make a positive statement about how the principles have been applied or have not been applied. This level of disclosure will allow stakeholders to comment on and challenge the board on the quality of its governance”.

The principle of fairness is effectively extended to incorporate ethical management, the protection, investment and enhancement in the wellbeing of the economy, society and the environment – the triple bottom-line. This may require the revision of aspects of the fund’s investment policy statement such as corporate social investment and shareholder activism.

Accountability and responsibility are achieved by formalising guidelines related to management structures and relationships on various levels. Every process and function is subject to an annual assessment, overseen by an audit committee controlling an internal audit function. All risks and all legal requirements must be identified and managed in terms of written plans. A new requirement that was not contained in previous King reports, is the governance of Information Technology. Funds should review their trustee code of conduct, the terms of reference of each committee, the year planner and their fund governance and risk management plan.

According to the code, transparency is achieved by prescribing a balance of power on the board and its committees. It is also achieved by fulfilling the requirement of producing an integrated report in which many sensitive issues, such as the reports on annual performance assessments and sustainability, are included. Retirement funds may be required to prepare an integrated annual trustee report and review their communication policies.

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The nine governance elements of the code are discussed in more detail in the next article.

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