GEPF 2018 ANNUAL REPORT (AR) REVIEW

ALL THE ELEPHANTS IN ONE ROOM

In the 2018 AR the GEPF refers to the elephant in the room and then elaborates on certain investments which made headlines during 2017/8. They however do not deal with the biggest elephant in the room namely the PIC, its external investment manager.

My review will shine the light on a couple of other Elephants, who also has been in the room for a while but do not get honorable mentions in the AR. Discrimination against the older Elephants cannot be supported. For completeness sake, they need to be mentioned.

The framework for the review

- 🐘 First glance
- 🐘 Vision : Global leader & Reputable Pension Fund
- 🐘 Mission 1: Sustainability
- 🐘 Mission 2: Delivery of benefits
- 🐘 Mission 3: Empowerment thru communication
- 🐘 Total recall
- 🐘 The future: the next 4 years

MISSION 1: SUSTAINABILITY

WHEN THE GEPF'S MISSION REFERS TO SUSTAINABILITY OF THE FUND, IT REFERS TO THE LONG TERM FINANCIAL SUSTAINABILITY AND IN PARTICULAR HOW THE ASSETS WILL MEET THE FUND'S PENSION LIABILITIES.

MISSION

As the Government Employees Pension Fund is the custodian of a significant portion of the wealth of public servants, our mission is to:

- ensure the sustainability of the Fund;
- provide for efficient delivery of benefits; and
- empower our beneficiaries through effective communication.

THIS IS CONFIRMED IN THE GEPF'S INVESTMENT BELIEFS (GEPF 2018 AR PAGE 38)
WITH THE LONG TERM NATURE OF INVESTMENTS WE NEED TO CONTRAST THE LONG TERM LIABILITIES AND

OUR INVESTMENT BELIEFS

- The GEPF's investment strategy considers the Fund's risk profile, assets and liabilities. Risk is considered at the asset class, portfolio, and investment levels.
- Taking well-considered risks is necessary to earn the returns required to meet the Fund's pension obligations, provided that appropriate risk management processes are followed.
- The Fund's strategic asset allocation is the key determinant of portfolio risk and return, and it may be implemented through a combination of active and passive management.
- The GEPF integrates Environmental, Social and Governance factors into its investment policies as they are material to the long-term sustainability of the Fund.

RECOMMENDED RESERVES AGAINST IT. THE RISK MANAGEMENT STATEMENT ALSO CONFIRMS THE LONG-TERM OBJECTIVE. (GEPF 2018 AR PAGE 54)

RISK MANAGEMENT STATEMENT

for the year ended 31 March 2018

INTRODUCTION

The GEPF is committed to establishing a sound system of risk oversight; management and internal control to identify, assess, monitor and manage material risks related to the conduct of the fund's activities. The risk management process assists the Board to execute its fiduciary duty to actively manage risks that would otherwise affect or prevent the GEPF from achieving its strategic objectives and to ensure the long-term sustainability of fund. The Board, through the FA-C, ensures that effective risk management processes and procedures are in place to actively manage risks that affect the fund's performance.

THE PENSION LIABILITIES AND RESERVES ARE CALCULATED BY AN ACTUARY. UNFORTUNATELY, THE GEPF DID NOT SECURE THE COMPLETION OF THE UPDATED ACTUARIAL VALUATION IN TIME TO BE INCLUDED IN THE 2018 ANNUAL REPORT.

AS SUCH, THE USEFULNESS OF THE 2018 AR DROPS DRAMATICALLY, CONSIDERING THAT THE OTHER INDEPENDENT PROFESSIONAL PARTY, THE AUDITORS, NOW HAD TO COMMENT ABOUT KEY AUDIT MATTERS OF WHICH THE UNDERLYING INFORMATION, SPECIFICALLY ABOUT THE PENSION LIABILITIES AND AN UPDATED CALCULATION OF THE REQUIRED RESERVES WAS ALREADY TWO YEARS OUTDATED AT THE TIME OF THE AUDIT.

FURTHERMORE, THE GEPF'S ANNUAL REPORT IS SILENT AS TO WHY THE UPDATED VALUATION COULD NOT BE FINALIZED IN TIME TO BE INCORPORATED INTO THE 2018 ANNUAL REPORT. NO EXPLANATION. NO APOLOGY!

FUNDING LEVELS

THE FUNDING LEVELS DETAIL IS PROVIDED IN THE GEPF 2018 AR PAGE 48.

ACTUARIAL VALUATION

FUNDING OF LIABILITIES

In terms of the GEP Law and the Rules of the Fund, an actuarial valuation must be carried out at least once every three years. Twelve statutory actuarial valuations have been undertaken since the establishment of the pension fund in May 1996.

The most recent valuation was undertaken on 31 March 2016. This valuation was performed based on the Funding Policy that was adopted by the GEPF Board of Trustees in consultation with the Minister of Finance. The policy provides for the comparison of the assets held by the pension fund with the valuation of the liabilities on a long-term best-estimate basis.

The actuarial results of the March 2016 valuation show that the Government Employees Pension Fund is 115.8% funded. There are sufficient assets to cover the actuarial liabilities in full.

Funding level of liabilities

Date	Funding level	Valuator
1 May 1996	72.3	Ginsberg, Malan, Carson
31 March 1998	96.5	NBC Employee Benefits
31 March 2000	96.1	NBC Employee Benefits
31 March 2001	98.1	NBC Employee Benefits
31 March 2003	89.4	Alexander Forbes Financial Services
31 March 2004	103.9	Alexander Forbes Financial Services
31 March 2006	128.2	Alexander Forbes Financial Services
31 March 2008	115.2	Alexander Forbes Financial Services
31 March 2010	108.7	Alexander Forbes Financial Services
31 March 2012	102.7	Towers Watson
31 March 2014	121.5	Towers Watson
31 March 2016	115.8	Willis Towers Watson

FUNDING OF LIABILITIES AND RESERVES

The Funding Policy also provides for the establishment of reserves to protect against mortality and investment risk in the future and to increase the target for future pension increases from 75% to 100% of headline inflation.

The valuation reports since 31 March 2004 have reported on the comparison of the assets held by the pension fund to the valuation of the liabilities on a long-term, best-estimate basis together with the additional contingency reserves recommended by the valuator.

The actuarial results of the March 2016 valuation show that 79.3% of the liabilities and the recommended reserves could be afforded at that date.

Funding level of liabilities and recommended reserves

Date	Funding level*	Valuator
31 March 2004	96.5	Alexander Forbes Financial Services
31 March 2006	101.7	Alexander Forbes Financial Services
31 March 2008	85.3	Alexander Forbes Financial Services
31 March 2010	74.1	Alexander Forbes Financial Services
31 March 2012	70.4	Towers Watson
31 March 2014	83.1	Towers Watson
31 March 2016	79.3	Willis Towers Watson

* *The funding level has been determined with reference to the full reserves as recommended by the valuator at that time*

HOWEVER, BY PURELY FOCUSSING ON THE “GROWTH” IN ASSETS, WITHOUT CONTRASTING THIS AGAINST THE LIABILITIES CREATES MISALIGNMENT AND DISTORTION.

SECONDLY, THERE IS A RATHER WIDE INTERPRETATION OF THE TERM “GROWTH” IE. THE TOTAL INCREASE IN THE ASSET BALANCE YEAR ON YEAR, IN PART IS WALK IN CASH FROM CONTRIBUTIONS WHICH IS ADDED TO INVESTMENTS. THE REMAINDER IS ACTUAL CAPITAL GROWTH.

THE GEPF DOES NOT DIFFERENTIATE BETWEEN THESE TWO PARTS.

IN ADDITION, WHEN FUNDING LEVELS ARE DISCUSSED BY THE GEPF, REFERENCE IS MADE TO THE MINIMUM FUNDING LEVEL.

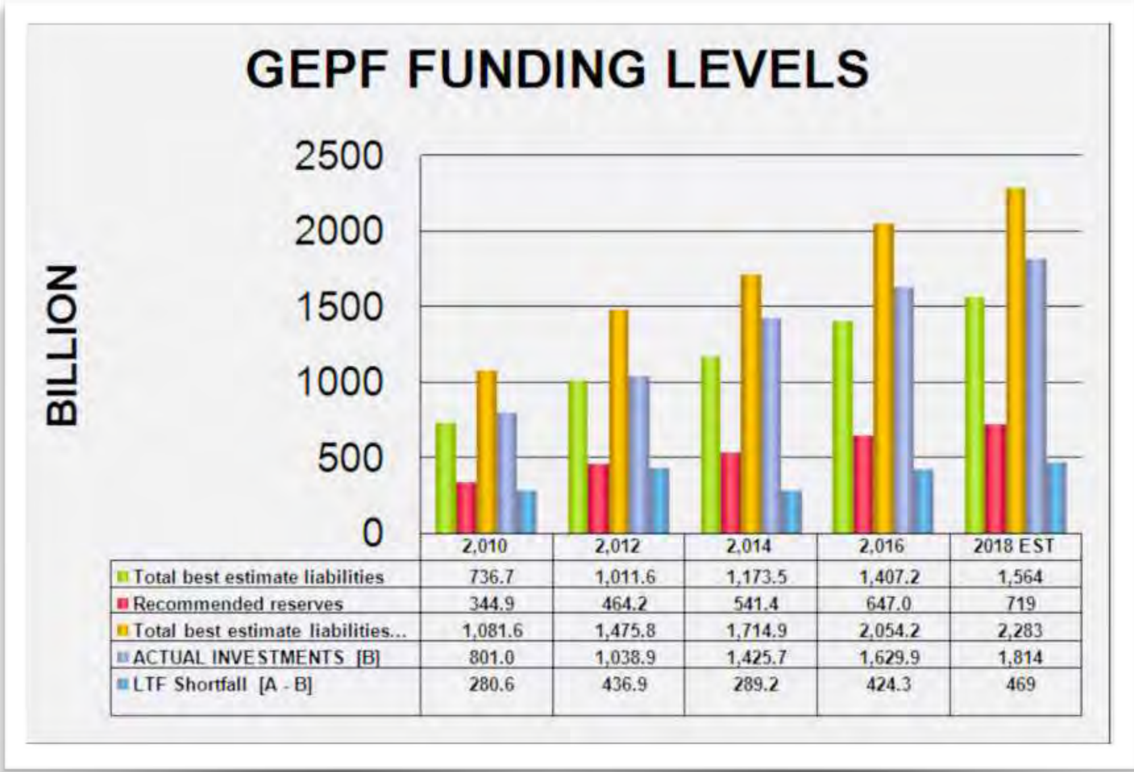
VERY SELDOM ANY COMMENT IS MADE ABOUT THE LTF LEVEL. THE REASON FOR THIS WILL BECOME EVIDENT IN THE NEXT SECTION.

LONG-TERM FUNDING (LTF) LEVEL

FOR THE 12TH YEAR IN A ROW, THE LONGTERM FUNDING (LTF) RATIO IS LESS THAN 100%, THE GEPF BOT’S OWN TARGET.

BASED ON THE NOW OUTDATED 2016 PENSION LIABILITY VALUATION, THE SHORTFALL BETWEEN THE 2018 ASSETS OF R1,8TRILLION AND THE 2016 LTF REQUIREMENT OF R2TRILLION WOULD BE R200BN AT LEAST.

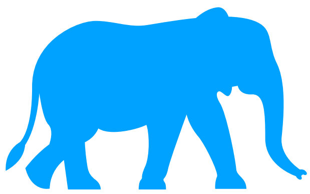
BASED ON THE TRENDS OBSERVED SINCE 2010, THE SHORTFALL MAY ACTUALLY BE VERY CLOSE TO R469BN! (OWN ROUGH ESTIMATE)



	2,010	2,012	2,014	2,016	2018 EST
Total best estimate liabilities	736.7	1,011.6	1,173.5	1,407.2	1,564
Recommended reserves	344.9	464.2	541.4	647.0	719
Total best estimate liabilities...	1,081.6	1,475.8	1,714.9	2,054.2	2,283
ACTUAL INVESTMENTS [B]	801.0	1,038.9	1,425.7	1,629.9	1,814
LTF Shortfall [A - B]	280.6	436.9	289.2	424.3	469

THE CONTINUED FAILURE OF THE GEPF TO ACHIEVE THE TRUSTEES OWN TARGET, AND THE ABSENCE OF A CLEAR JOURNEY PLAN VISIBLE TO MEMBERS TO RESTORE THE LONG TERM FUNDING RATIO TO ITS 2006 LEVEL OF 101%, RAISES THE QUESTION OF.....

EXACTLY HOW COMMITTED AND ALIGNED ARE THE ACTIONS AND EFFORTS OF THE VARIOUS COMPONENTS OF THE GEPF ACTUALLY TO ACHIEVE THIS GOAL.



THE GEPF HAS CONSISTENTLY CLAIMED THAT THEIR BLUEPRINT WORKS.

THIS MESSAGE RECEIVE GOOD COVERAGE IN THE MEDIA. HTTPS://WWW.GEORGEHERALD.COM/NEWS/ARTICLE/LIFESTYLE/GOVERNMENT-EMPLOYEES-PENSION-FUND-BLUEPRINT-WORKS-201805031142

IF THE BLUEPRINT WORKS AS WELL AS THE GEPF CLAIMS:

- **WHY HAS THE LTF RATIO NOT BEEN RESTORED BY NOW?**
- **WHY HAS THERE BEEN A DETERIORATION IN THE FUNDING LEVELS OVER TIME?**

THE 2016 ACTUARIAL VALUATION - CAUSES OF STRAIN TO THE FUND

ALTHOUGH OUTDATED BY NOW, THE 2016 VALUATION DID PROVIDE FOREWARNING IN SO FAR AS THE ACTUARY REPORTED THE AREAS THAT CAUSE STRAIN TO THE FUND.

THE HIGHEST RAND VALUE OF STRAIN ON THE FUND CAME FROM TWO ISSUES NAMELY THE INVESTMENT RETURNS AND ECONOMIC ASSUMPTIONS.

	Inter-valuation Period R'm
Previous surplus above minimum funding basis liabilities	**252 203**
Interest on opening surplus	47 292
Change in opening surplus	(5 948)
Investment returns	(62 774)
Economic assumptions	(22 180)
Member contributions	(338)
Employer contributions	(4 825)
Expense allowance	(273)
Salaries	14 077
Pension increases	(574)
Withdrawal profits	5 005
Retirement strains	(3 450)
Death in service profits	1 427
Other benefit profits	(88)
Pensioner movements	(3 249)
Benefits payable impact	6 092
Release from the data reserve	102
Miscellaneous items	248
Current surplus above minimum funding basis liabilities	**222 747**

STRAIN TO THE FUND : INVESTMENT RETURNS

ACCORDING TO THE ACTUARY, A "SUBSTANTIAL STRAIN" TO THE FUND RELATES TO THE BELOW EXPECTED INVESTMENT RETURNS.

AS FAR BACK AS IN 2016 ALREADY, THE ACTUAL INVESTMENT RETURNS WERE LESS THAN THE ASSUMED AND EXPECTED RATES USED TO UNDERPIN THE ACTUARY'S VALUATIONS. A DIFFERENCE OF 2.43% PA

Investment returns: R62,7 billion strain

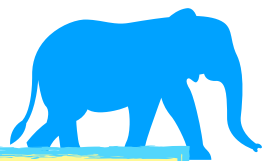
A strain has arisen to the extent that the investment return achieved on the fair value of the assets was lower than that assumed. The Fund has earned an approximate return, net of management fees, of 8.97% per annum over the two years ending 31 March 2016. This is lower than the assumed discount rate (11.4% per annum) and has resulted in a substantial strain to the Fund.

IN SHORT, THE ASSETS DID NOT PRODUCE AS EXPECTED.

ITS FORESEEN THAT THE 2018 ACTUARIAL REPORT WILL REPEAT THIS OBSERVATION.

WHAT OBVIOUSLY IS A CONCERN IS THAT THE ANNUAL REPORTS SINCE 2016 DO NOT DISCLOSE THIS MATERIAL FACT.

IN FACT, MEDIA REPORTS RELEASED BY THE ASSET MANAGER, THE PIC, CLAIMS INVESTMENT RETURNS THAT IS PHENOMENAL.



THE PIC'S CLAIM TO FAME: STATISTICS SHOWS WE ARE PHENOMENAL ! "SAKE RAPPORT" OF 17 JUNE 2018 CARRIED THIS BYLINE AND THE STORY BASICALLY QUOTES DR DAN MATJILA FROM THE PIC AS HE MADE COMMENTS IN RESPONSE TO THE CRITICISMS THE PIC HAS RECEIVED TO DATE REGARDING SOME SUBPAR INVESTMENTS

AS THESE PUBLIC CLAIMS HAVE NOT BEEN CORRECTED BY THE GEPF, THE ASSUMPTION IS THAT THEY ARE IN AGREEMENT WITH IT.

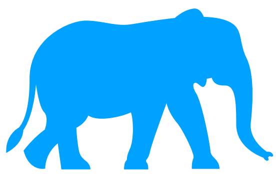
THE STATUS PER THE 2018 ANNUAL REPORT

IN 2018 THE INVESTMENT BALANCE INCREASED FROM 1,6TR TO 1,8TR, AN INCREASE OF 137BILLION OR 8.2%*

THIS AMOUNT/% IS **NOT ALL GROWTH**, BECAUSE THE ACTUAL GROWTH FOR THE YEAR WAS 137 - 56 = 81BN. THE ACTUAL Y-ON-Y CAPITAL GROWTH IS 4.6%.
56BN WAS CONTRIBUTIONS RECEIVED FROM MEMBERS AND SIMPLY INVESTED.

ASSETS ARE VALUED IN TERMS OF ITS INHERENT CAPABILITY TO PRODUCE FUTURE INCOME/CASH INFLOW. THE HIGHER THE PRODUCTION RATE, THE HIGHER THE PERCEIVED VALUE. UNFORTUNATELY THE INVERSE IS ALSO TRUE.

(* THIS RATE IS 3.2% LESS THAN THE 11.4% USED BY THE ACTUARY IN HIS ASSUMPTIONS IN 2016. FOR 2018 ONLY THE STRAIN TO THE FUND AMOUNTS TO R53BN {1670 X 3.2%})



PRODUCTION OF CASH INFLOW

THE QUALITY OF THE ASSETS ITO PRODUCTION CAPABILITY HAS DETERIORATED COMPARED TO 10 YEARS AGO. SEE THE CALCULATION HEREWITH USING THE CASH IN FLOWS FROM INVESTMENTS.

Cash inflow	**FY2008**	**FY2018**	**Compa**
Interest	21,2	45,1	2,1
Dividends	11,7	29,9	2,6
Total Cash	**32,9**	**75**	**2,3**
Investments	715,5	1814	2,5
Benefits	24,0	95,0	4,0
Percentages			
Cash/Investments	4,6%	4,1%	89,9%
Cash/Benefits	137,1%	78,9%	56,7%

INTEREST ON INVESTMENTS HAS NOT KEPT PACE WITH THE GROWTH OF INVESTMENTS OVERALL.

TO ILLUSTRATE THE DETERIORATION.... IF THE FY2008 4,6% CASH/INVESTMENT RATE WAS REPEATED IN FY2018, THE AMOUNT OF CASH SHOULD HAVE BEEN R8BN MORE (75+8=83BN)
THIS IS ALSO THE AMOUNT WHICH INTEREST IS LAGGING IN FY2018 COMPARED TO FY2008.

BUT EVEN SO, THE CASH INFLOW IN FY2018 COULD NOT COVER BENEFIT PAYMENTS FULLY. THE CASH INFLOWS FROM INVESTMENT ARE RAPIDLY FALLING BEHIND BENEFIT REQUIREMENTS.
THE CAUSE IS THE DETERIORATING LEVELS OF CASH PRODUCED BY THE UNDERLYING ASSETS AS ALSO HIGHLIGHTED BY THE ACTUARY.

SOMETHING TO CONSIDER - INTEREST IS PRIMARILY COMING FROM BILLS AND BONDS, AND A SIGNIFICANT AMOUNT COMING FROM ESKOM WHERE IN RECENT YEARS, THE UPTAKE OF BONDS WAS DONE AS PRIVATE PLACEMENTS AND NOT IN THE OPEN MARKET.

ESCALATING INVESTMENT EXPENSES VS REDUCED RETURNS

R'bn	FY2008	FY2018	Compa
Investment expenses	0,76	4,92	6,51
Cash Interest & dividends	32,90	75,00	2,28
Investments	715,50	1814,00	2,54
Percentages Investment expenses TO			
Cash Interest & dividends	2,3%	6,6%	2,86
Investments	0,1%	0,3%	2,57

THE FOLLOWING CALCULATION INDICATES THE GROWING COSTS OF INVESTMENT EXPENSES COMPARED TO 10 YEARS AGO.
THE FUND IS CARRYING HIGHER INVESTMENT COSTS FOR COMPARATIVE REDUCED RETURNS. (INEFFICIENCY)

ON FACE VALUE THIS MAY VERY WELL BE A CASE OF TRYING TO FLOG TOO MANY DEAD HORSES?

CONSIDERING THE INCREASED INVESTMENT EXPENSES COMPARED WITH THE CASH PRODUCED AS INDICATED ABOVE, IT DOES APPEAR THAT THE INVESTMENTS HAS ALREADY REACHED THE POINT OF DIMINISHING RETURNS IE. A POINT AT WHICH THE LEVEL OF PROFITS OR BENEFITS GAINED IS LESS THAN THE AMOUNT OF MONEY OR ENERGY INVESTED.

STRAIN TO THE FUND - ECONOMIC ASSUMPTIONS

THE 2016 VALUATION COMMENTED ON THE CHANGES IN THE DISCOUNT RATES USED WHICH CAUSED A R22BN STRAIN TO THE FUND...

Economic assumptions: R22 billion strain

This item relates to the changes in the actuarial valuation basis, in particular, the change in the net pre-retirement and post-retirement discount rates. There is a material decrease in the net pre-retirement discount rate and a slight decrease in the net post-retirement discount rates, which will result in, all else being equal, an increase in liabilities and a strain to the Fund.

IT DOES APPEAR AS THOUGH A FURTHER DECREASE IN THE NET PRE-RETIREMENT DISCOUNT RATE WAS

9. Details of the actuarial basis adopted (including that in respect of any contingency reserve) and details of any changes since the previous summary of report.
   - Net pre-retirement discount rate: 2.93% per annum (previously 3.24% per annum).
   - Post-retirement net discount rate: 5.53% per annum for actives and current pensioners (previously 5.59% per annum).
   - Post-retirement mortality: Rates based on experience of GEPF mortality over 1 April 2008 to 31 March 2012. These rates are the same as those used for the 2014 statutory valuation.
   - Salary increases: 9.30% per annum (previously 7.90% per annum). It is assumed that salaries will increase at an average rate of 1% in excess of the long-term inflation assumption of 8.30% per annum (previously 6.90% per annum). In addition, an allowance is made for merit salary increments.
   - Proportion married: Assumptions have been made regarding proportions of members who are married at each age. The age difference between males and females is assumed to be four years, with males older than their female counterparts.
   - Expenses: An allowance for future administration expenses of 0.3% of annual pensionable salary was made.

REQUIRED FOR THE 2018 VALUATION IE. FROM 3.24% TO 2.93%. (GEPF 2018 AR PAGE 61 REFERS)

THE IMPACT OF THIS, ALL ELSE BEING EQUAL, WILL BE ANOTHER INCREASE IN LIABILITIES, WHICH IN TURN WILL REDUCE THE FUNDING RATIOS.

IN SUMMARY - SUSTAINABILITY OF THE GEPF

THE LONGTERM FUNDING RATIO IS LESS THAN 100% FOR 12 YEARS IN A ROW

PENSION LIABILITIES INCREASES CANNOT BE QUANTIFIED BECAUSE THE 2018 ACTUARY VALUATION WAS NOT COMPLETED IN TIME

THE PRODUCTION CAPACITY OF INVESTMENTS HAS REDUCED

INTEREST ON INVESTMENTS HAS NOT KEPT PACE WITH THE GROWTH OF INVESTMENTS OVERALL

ESCALATING INVESTMENT EXPENSES VS REDUCED RETURNS...

THE ACTUARY REGARDED THE BELOW EXPECTED INVESTMENT RETURNS IN 2016 ALREADY AS A SIGNIFICANT STRAIN TO THE FUND

IT DOES APPEAR THAT THE INVESTMENTS HAS ALREADY REACHED THE POINT OF DIMINISHING RETURNS

THE NET PRE RETIREMENT DISCOUNT RATE WAS REDUCED AGAIN, THIS IMPACTS (INCREASES) PENSION LIABILITIES