

The Investment Decision-Making Structures and Processes of the EPPF

3 October 2019

Private Equity Women Investor Network

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Introduction



- The Eskom Pension and Provident Fund (“**EPPF**” or “**the Fund**”) is a self-administered defined benefit (DB) pension fund that has over 80 000 members (actives and pensioners) and assets worth about R145 billion (approx. \$10 billion).
- It is the second-largest pension fund in South Africa by asset size and but is the largest pension fund that is regulated by Financial Sector Conduct Authority (FSCA) under the Pension Fund Act of 1956.
- The Fund is governed by the Board of Trustees (14 members), which sets the governance framework, investment beliefs, risk budget, and the investment policy statement (“IPS”) – including the strategic asset allocation and the risk budget of the Fund.
 - The Board of Trustees is led by Ms. Mantuka Maisela
 - Seven Board Members appointed by the principal employer, Eskom SOC Holdings Limited;
 - Two Board Members elected by pensioners;
 - Two Board Members elected by non-unionised in-service members;
 - Three Board Members elected by unionised in-service members.
- The day-to-day management of the Fund is the responsibility of the Executive Committee, which is led by Ms. Linda Mateza



- The investment activities of the Fund are conducted through the Investment Management Unit (“IMU”).
- The IMU can be sub-divided into three main niches:
 1. In-house public markets;
 2. Private markets; and
 3. External public markets.
- About R45bn of the assets are managed by an in-house team within the Investment Management Unit (IMU) while the balance (R100bn) is managed by external asset managers.
- Services procured by the Fund comprise asset management, stockbroking, legal due diligence, actuarial, auditing, ALM, *et cetera*.



Key achievements during the 2019 calendar year

- **Hosted a successful EPPF Transformation Breakfast** in June 2019 where EPPF:
 - Announced the appointment of a manager for the EPPF Private Markets Manager Development Programme capitalised at R2bn – covering private equity, infrastructure and direct real estate.
 - Announced an over-arching strategy to begin the transformation of international mandates to reflect diversity and inclusion by:
 - Developing existing South African black asset managers to manage global investment mandates in listed securities;
 - Ensuring diversity and inclusion in other international mandates that are not managed by South African black asset managers (in both listed and private markets).
- **In June 2019 EPPF received the inaugural Obama-Mandela Bridgebuilder Award** at the 30th NASP Pension and Financial Services Conference in Baltimore, USA.
- EPPF was included in the inaugural **PRI's Leaders Group for 2019** at the PRI In-Person Conference in Paris in September



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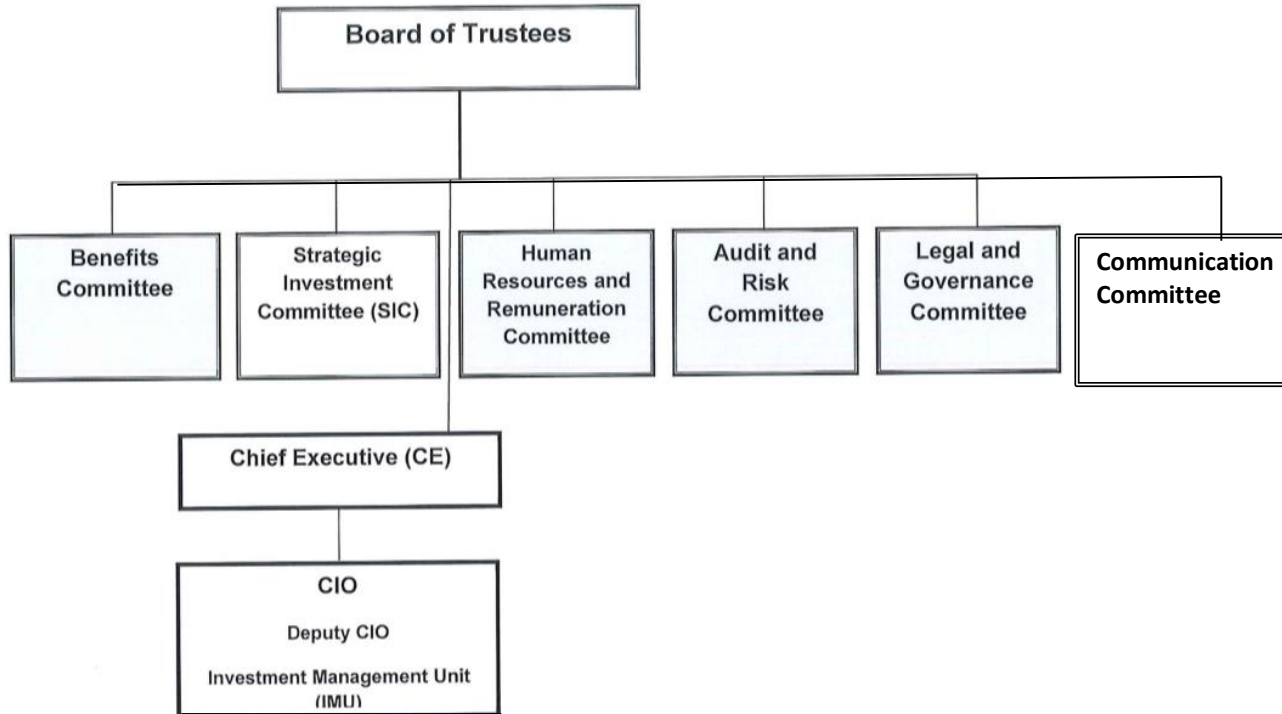


Key achievements during the 2019 calendar year

- Appointing senior female investment professionals and having 40% (36%) of the investment management unit being composed of women (female investment professionals).
- In-house core equity portfolios posted positive alpha and outperformed the median of external asset managers
- In-house listed delivered property positive alpha and exceeded alpha targets
- The in-house team is highly transformed in terms of race and gender and continues to attract and/or mint fresh CFA charter holders.
- Enhanced existing stockbroking allocation policies and continued to hold asset managers accountable when it comes to allocating stockbroking spend to Black stockbrokers.
- The percentage of domestic externally-managed assets that are managed by Black asset managers (at least 51% Black owned) was over 60% in 2019
- The percentage of funds committed to Black general partners (private equity asset managers) exceeded 50% of the commitments made in 2019.



Governance and the investment decision-making framework



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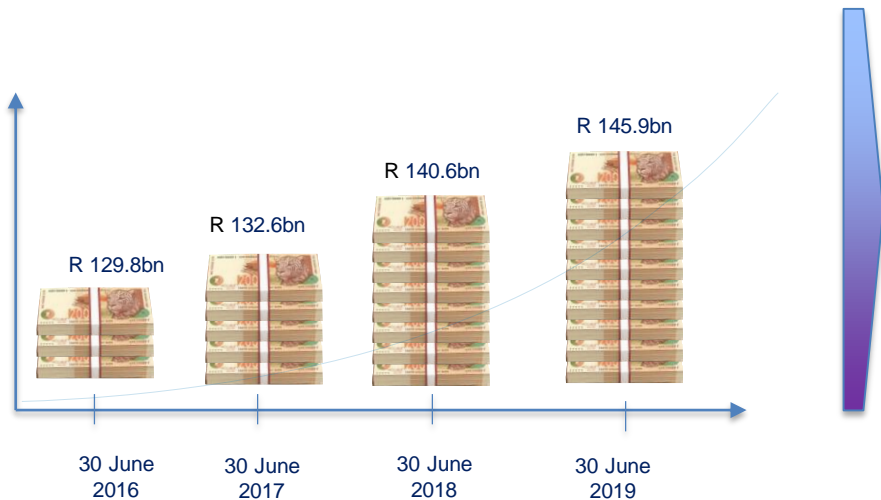
Funding Ratio and Management Actions



The financial health of the Fund

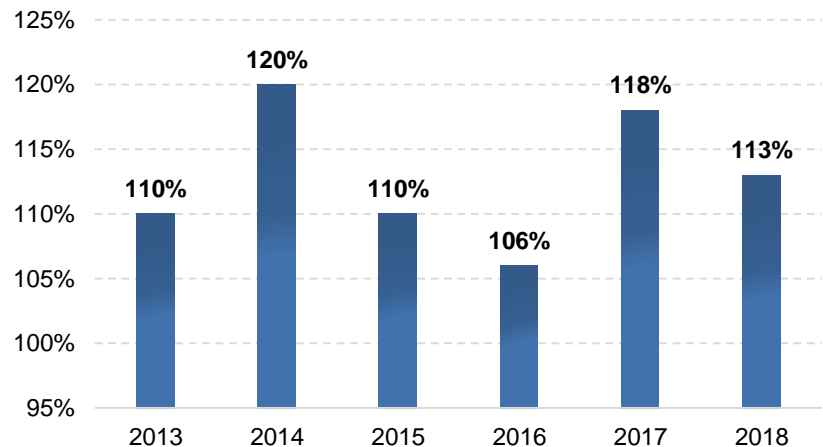
Assets Under Management

The Fund continued to grow the assets under management notwithstanding the **volatility** in global and local capital markets.



The EPPF Funding Ratio

The ratio of assets to liabilities (including contingency reserves) is known as the funding ratio. EPPF's funding ratio is one of the **highest in South Africa and worldwide.**



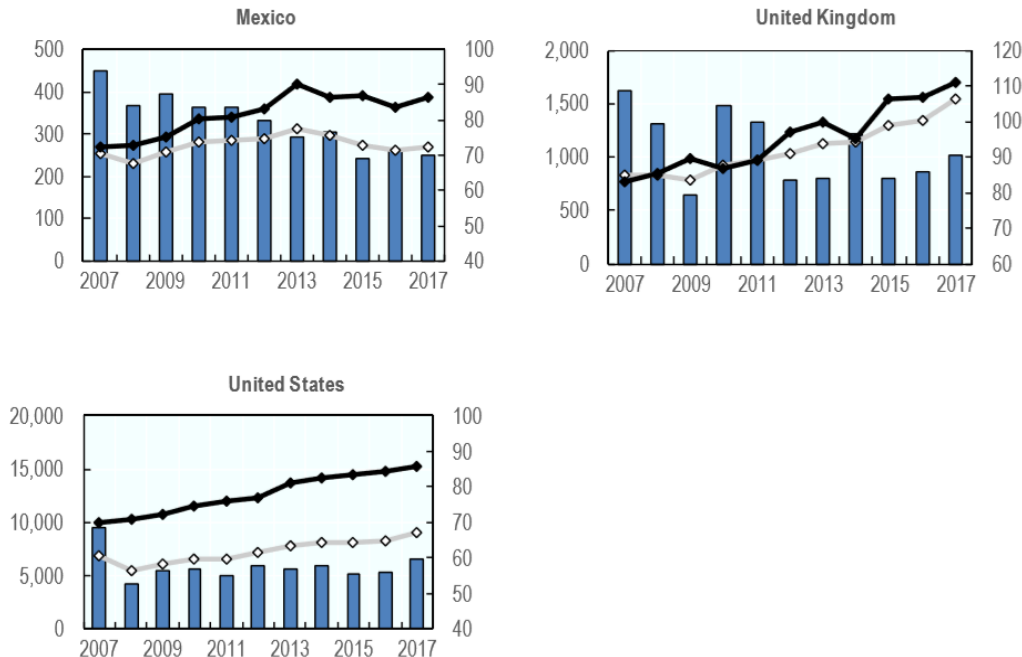
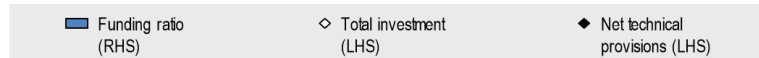
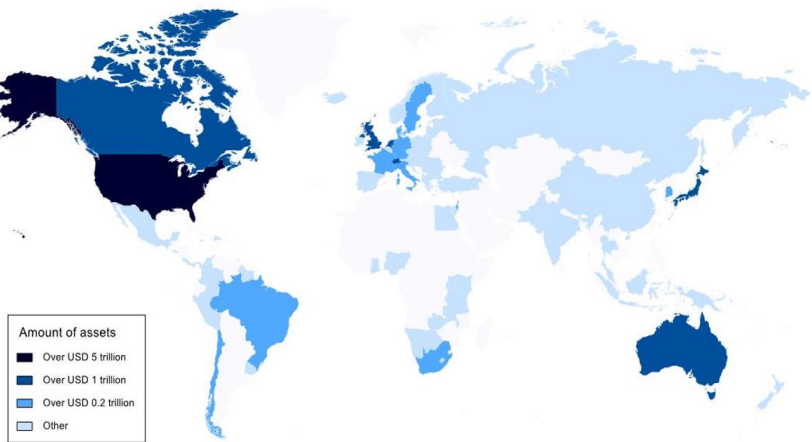
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Funding ratios of some OECD countries

Figure 1. Size of assets in funded and private pension arrangements, 2017

A. In USD trillion



Technical provisions represents the amount that must be held to pay the actuarial valuation of the benefits that members are entitled to. This is the minimum obligation (liability) for all DB pension funds in all countries. These technical provisions may be valued differently across many countries. Regulators may also require pension funds to more as a buffer to cover adverse scenarios and/or the cost of securing the transfer of full benefit payments to an insurer (i.e. solvency or buy-out) like in the Netherlands. (Source: OECD Pension Markets In Focus 2018)

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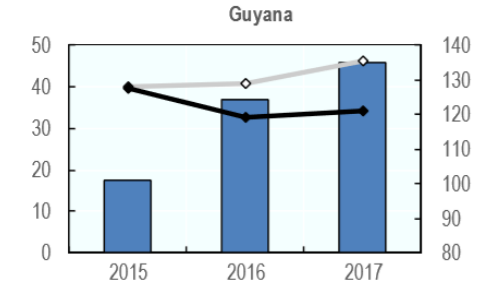
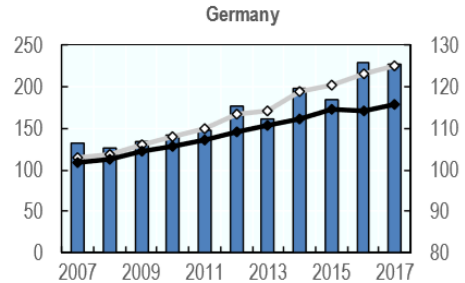
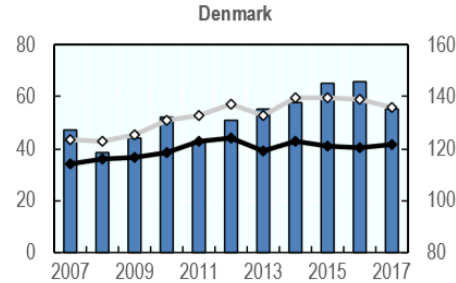
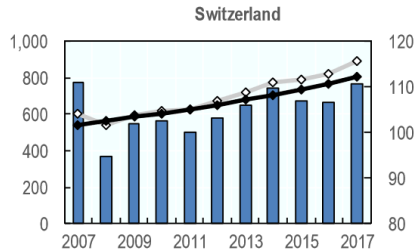
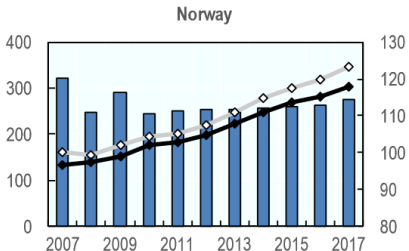
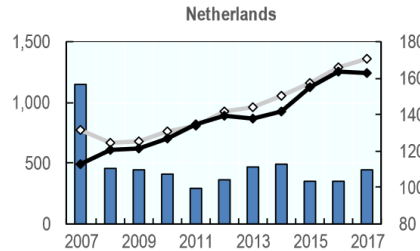
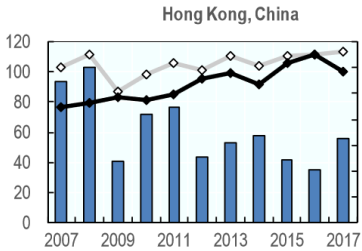


Asset and liabilities of DB plans (in billions of national currency) and their funding ratios (in per cent) in selected jurisdictions, 2007 -2017

■ Funding ratio (RHS) ◇ Total investment (LHS) ◆ Net technical provisions (LHS)

B. Declining funding ratio

B1. Funding ratio above 100% in the last year available



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EPPF's marked-to-market Funding Ratio

Movement in Marked-to-Market Funding Ratio* from 31 May 2019 to 30 June 2019

	31/05/2019	30/06/2019
Market Value	141,693,288,850.88	144,788,724,881.20
Money Purchases	10,294,438,494.58	10,517,773,453.71
Liabilities	99,369,480,488.45	99,150,410,176.20
Funding Ratio	132.23%	135.42%

Movement in Real Zero-Coupon Rate Curve Data from 30 June 2018 to 30 June 2019

Real Return Curve Data					
<Date>	30/06/2018	31/03/2019	30/04/2019	31/05/2019	30/06/2019
1Y	2.60675	3.08042	2.47398	2.32895	2.49578
2Y	2.60675	3.08042	2.47398	2.32895	2.49578
3Y	2.60675	3.09266	2.53596	2.41388	2.59083
4Y	2.63601	3.15812	2.73502	2.6223	2.77456
5Y	2.70003	3.20558	2.86905	2.77397	2.90539
7Y	2.80143	3.2664	3.02631	2.9724	3.07173
10Y	2.9069	3.31296	3.13523	3.13394	3.20208
20Y	3.07042	3.36084	3.2428	3.32535	3.35082
30Y	3.13215	3.3752	3.27629	3.38886	3.39959

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* Marked-to-Market Funding Ratio excludes Contribution Shortfall and Pensioners Bonus Reserves and other actuarially-determined liabilities (e.g. those driven by salary increases)

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Fund Performance



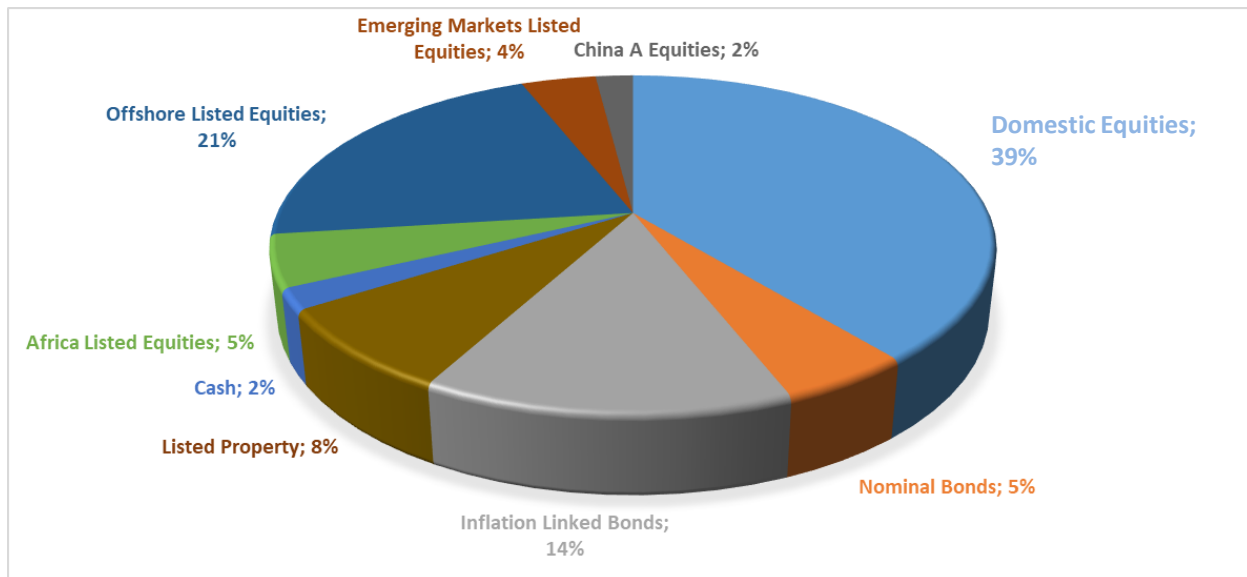
Strategic Asset Allocation

	Approved Aug 2012	Approved Mar 2016	Approved Nov 2017	Approved Nov 2018	Approved Feb 2019
Domestic Equities (Listed and Private)	38.1	43.0	41.0	39.0	39.0
Nominal Bonds	-	5.0	5.0	5.0	5.0
Inflation Linked Bonds	25.0	12.0	14.0	14.0	14.0
Listed Property	5.0	8.0	8.0	8.0	8.0
Cash	2.0	2.0	2.0	2.0	2.0
Africa Equities (Listed and Private)	5.0	5.0	5.0	5.0	5.0
Offshore Listed Equities	24.9	23.0	21.0	21.0	21.0
Emerging Markets Listed Equities	-	2.0	4.0	6.0	4.0
China A Equities	-	-	-	0.0	2.0

- Allocation to China A shares is a recent addition to the SAA
- Management in process of finalising appointment of asset managers in the China A category



Strategic Asset Allocation (SAA) and Regulatory Limits



Private Equity mandates already included in allocations to Domestic Equities and Africa Equities



Expected shifts in 1-3 years

- Real Assets (infrastructure & real estate) across ALL geographies
- Growth in Africa ex ZA private markets off a low base, mainly funded from allocations to Domestic or Global listed assets
- Added China-A Equities to SAA

Geographies	SAA	CAA	Limits: Exchange Controls
Domestic	68%	68%	
Global	27%	29.3%	Maximum of 30%
Africa ex ZA	5%	2.7%	Maximum of 10%

Private Markets Asset Classes	Limits: Regulation 28 of Pension Fund Act
Real Estate (Direct Property)	20% of Total Pension Fund
Private Equity	10%
All Alternative Assets excl. Real Estate	15%

Investment-related management actions

- Shifting towards Real Assets (direct property and infrastructure assets) in order to
 - Earn a positive and inflation-sensitive return that exceeds the target CPI+4.5% net of fees and taxes;
 - Lower downside volatility of the overall portfolio;
 - Enhance the stability and the predictability of investment returns; and
 - Better match the duration of the funds assets to the liabilities.
- Strengthening our investment teams by attracting and retaining high-calibre staff across the three segments of the Investment Management Unit (IMU)
 - Investment Multi-Management team
 - Private Markets team
 - In-house Asset Manager
- Reviewing the long-term performance of our asset managers to take corrective action where necessary
- Using a appropriate downside protective strategies as the markets recover
 - Hedging (e.g. zero-cost short fences)
 - Equity Linked Notes
- Diversified exposure to offshore equities – Added China-A equities to DM and EM equities



How EPPF invests in Real Assets capital



Schools



Roads



Water



Housing



Healthcare

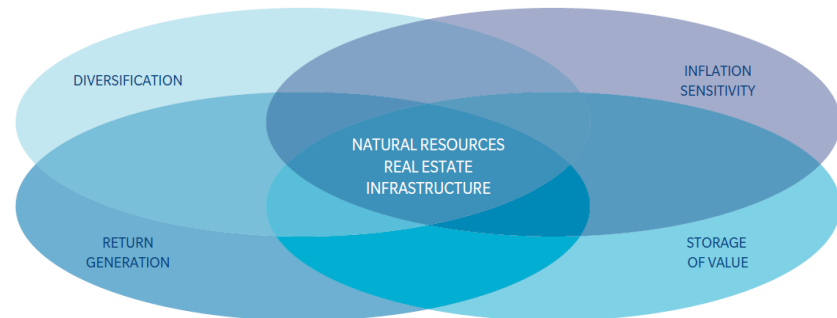


Transport



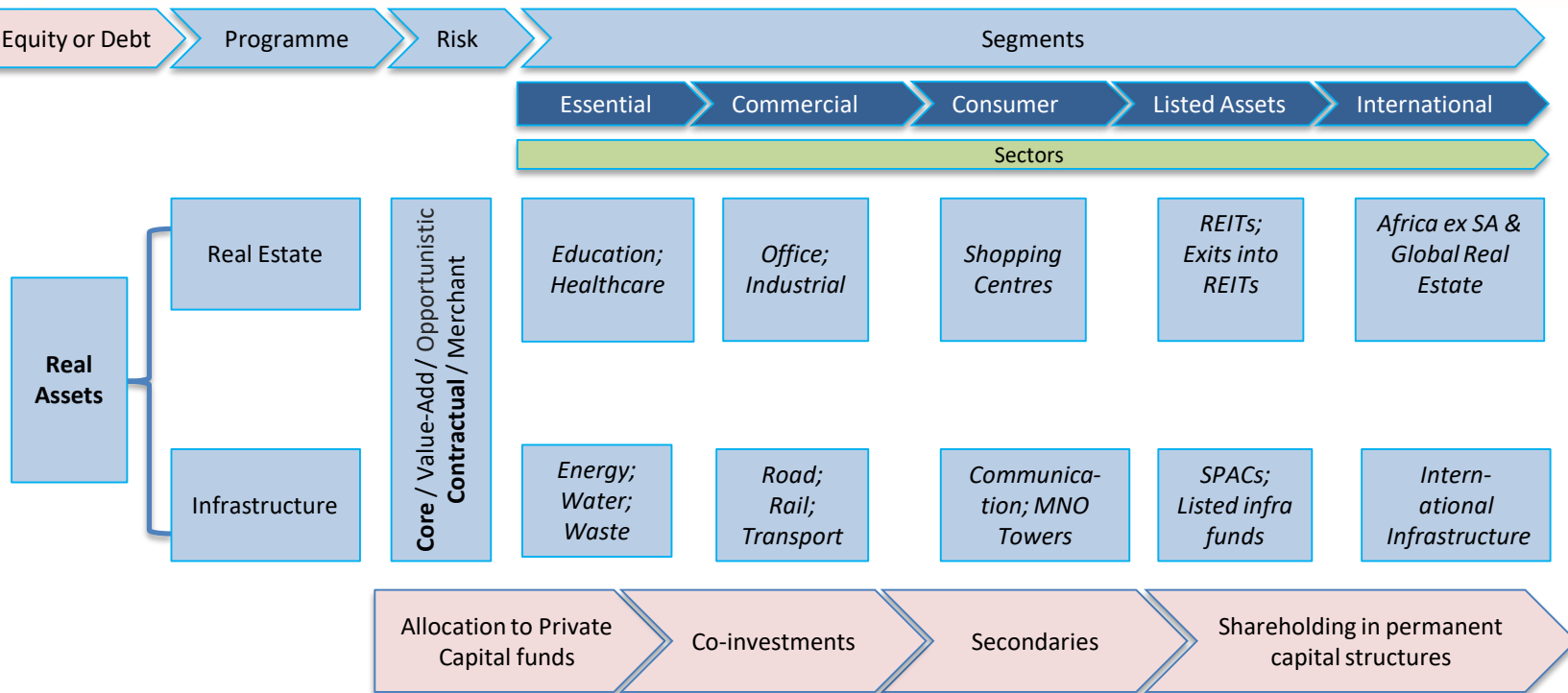
Renewable
energy

- Stable and predictable cash yield
- Diversification of equity risk
- Inflation protection and liability hedging
- Return enhancement as an ILB replacement strategy
- R7.9bn allocation with ample dry powder



Source: Mercer

How EPPF invests in infrastructure and real estate



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How EPPF invests in Development Impact assets



Agriculture



Schools



Housing



Healthcare



**Renewable
energy**



Rural/Township Retail Property

- Wider risk budget and tolerance for lower returns in exchange for impact
- Includes SME such as a portfolio of food/fuel franchises
- Invests in both equity and debt instruments
- R3 billion total allocation with about R1.2bn in dry powder

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Risk management

- ❖ Primary method of risk assessment is due diligence:
 - Track record of the management team (including reference checks)
 - Strength of the investment committee and the advisory committee
 - Site visits – cultural dimensions, supply and demand, political risk
 - Asset valuations and margin-of-safety
 - Presence of other institutional investors

- ❖ Risk management approaches:
 - Diversification (geography, manager, type of risk, type of technology)
 - Hedging (currency hedging where possible)
 - Insurance (MIGA, etc.)
 - Terms (side letters, scaled carried interest, etc.)
 - Limit the use of excessive financial gearing
 - Limit exposure to capital raised (prefer a limit of 20% - 30%)

- ❖ Risk-adjusted returns net of risk management costs



The Manager Development Programme in Private Markets

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The rationale for a private markets Manager Development Programme

- The Fund has established a private markets Manager Development Programme, *inter alia*, for the following reasons:
 - To create and/or support start-up Black asset managers in the private markets investment arena in manner that:
 - Operates within a wider risk budget;
 - Employs the resources and the intellectual capital of an experienced private markets operator/incubator in order to mitigate the risk of this programme; and
 - Imposes no inordinate constraints on the (time) resources of the EPPF internal private markets team.
 - To meet the other objectives of investments in Private Equity, Real Assets, and Development Impact investments. For example, to obtain:
 - Attractive risk-adjusted returns relative to listed equities;
 - Improve the matching of EPPF assets with the liability profile of the Fund
 - Earn a stable and predictable cash yield; and
 - Obtain long-term protection against inflation.



Private Markets – Incubation Programme

R2bn Allocation



Limited to first-time Black asset Managers with relevant experience, viable business models, and a preference for tangible pipeline



SA investment focus (African exposure capped at 30%)

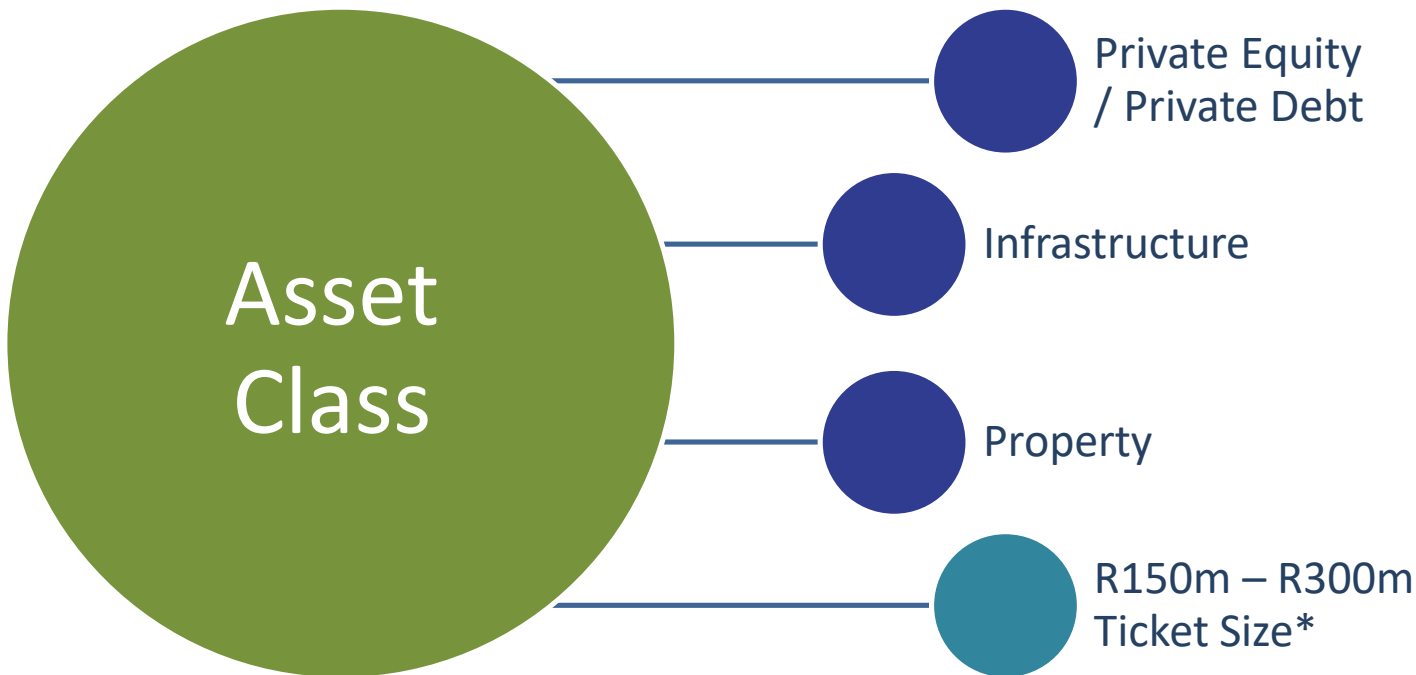


Real Assets (60%) /
Private Equity
(40%)

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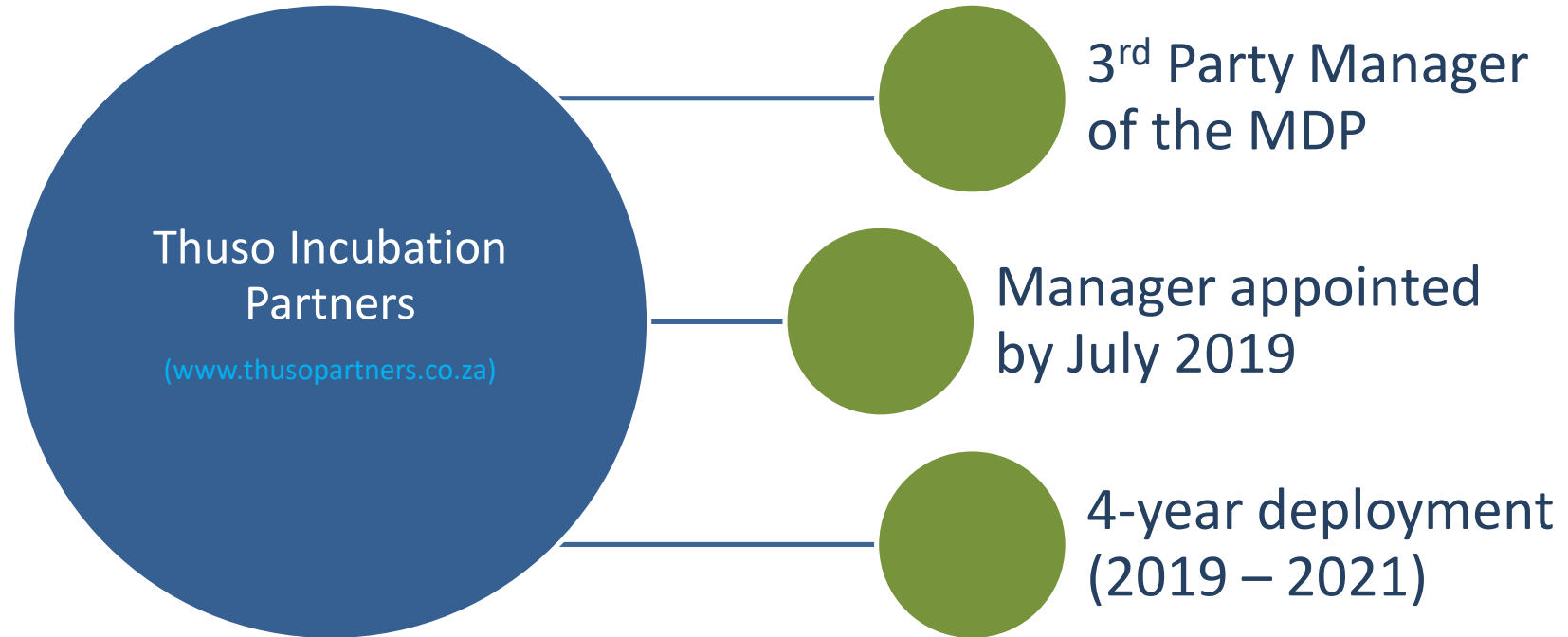
Private Markets – Manager Development Programme (MDP)



*Can be first to commit and comprise 100% of the fund.
Would encourage other investors to join

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Goal is to increase pool of experienced Black owned GPs /
MANCOS for EPPF's and industry benefit.

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Other important features of the mandate

- The Incubation mandate in private markets will consider the following structures:
 - Limited life fund with a GP/LP structure; external mancos; permanent capital; and investment holding companies
- The manager incubation will not purport to be a vehicle for facilitating BEE transactions.
 - It is aimed at growing credible start-up Black asset managers to operate in the private markets arena
- No manager or GP or investment will account for more than 25% of the private markets incubation programme
- Returns are expected to be commensurate with the risk taken



Critical success factors - MDP

FACTOR	SUCCESS	FAILURE
Access to capital for talented Black investment professionals	✓	
Incubation structure allows team to focus on investment decisions - Allows team to build a track record	✓	
Institutionalisation of Black businesses in the asset class - Build and implement governance processes	✓	
Incubated managers are sustainable enough to raise subsequent funds from investors other than EPPF	✓	
Incubated teams produce high, sustainable returns from a defined, consistent investment philosophy	✓	



Critical success factors - Incubation

FACTOR	SUCCESS	FAILURE
Recruit and retain high quality staff – Increase number of Black professionals	✓	
Build skills across the value chain – Origination, Structuring and Execution	✓	
Allocate EPPF pensioners' capital to teams lacking investment ability		✗
Circumvent investment processes and encourage lack of accountability		✗
Tolerate unsatisfactory investment returns		✗





Questions?

