PRESENTATION TO THE PORFOLIO COMMITTEE ON PUBLIC ENTERPRISES

28 JULY 2010

BACKGROUND TO THE TSDBF

- The Transnet Pension Fund ("TPF") was established in 1990 on corporatisation of Transnet out of Government, with a deficit of R17.2 billion; only 22% of its liabilities were funded.
- In November 2000 the TPF was restructured to create three funds, one of which was the TSDBF.
  - All pensioners at that date (101 635) were transferred to the TSDBF with a related pension liability of R17.8 billion.
  - The TSDBF was allocated 56.9% of the assets, or R19.9 billion.
- The TSDBF is therefore a closed fund; no new members are able to join, other than qualifying pensioner dependants. Closed funds have no income streams from future contributions.
- The core problems underlying the previous deficit pattern- principally an inappropriate asset base to meet the defined benefit liability profile - carried through.
- The actuarial surplus of R2 billion at inception of the TSDBF was not sustainable as it depended heavily on a high proportion of equity and property assets and was therefore very vulnerable to market changes and falling interest rates.
- Since inception of the TSDBF, the deficit has increased substantially each year up to 2005.
- The TSDBF moved to, and has remained in, a surplus position since 2006.
- The TPF contained a number of historical inequities along racial and gender lines which carried through to the TSDBF, the impact of which remain evident in the TSDBF today.
- Historically, there has been large pay discrepancies between racial groups, and in addition, there were also large discrepancies in the amount of contributions paid to pension funds between workers from different racial groups.

BACKGROUND TO THE TSDBF

- An individual with a short period of pensionable service or a low pensionable salary will continue to have a low pension, all else being equal, irrespective of the increases granted.

- In this regard, it must be noted that approximately 34 000 TSDBF pensioners potentially qualify to receive a State grant.

- The financial eligibility for the grant is determined by a means test, which is based on the income and assets of the applicant and their spouse.

- Since 1990, many reports have been prepared by Transnet:

  - setting out why these pensioner obligations were an obligation of Government; and

  - advising that taking on this obligation was affecting the funding position of Transnet.

- Transnet worked closely with the Department of Public Enterprises to try and obtain Government support fro additional funding of the TSDBF in 2005, but these discussions were terminated.

- Consequently, Transnet and the TSDBF have worked hard together to improve the financial position of the TSDBF, to rebalance the TSDBF's asset portfolio to make it more sustainable, and to improve the returns to beneficiaries of the TSDBF.

ASSET MANAGEMENT

T011 BONDS

- During the early 1990s, Transnet issued approximately R10 billion of T011 bonds at no cost to the TPF.
- Whilst there was no obligation to place funds in the TSDBF Transnet, acting as guarantor with Government, made a decision to inject funds at the height of the interest rate cycle, utilising bonds with a high coupon to close the deficit in the fund.
- In hindsight, this was not a sound decision, as it is generally not wise to issue bonds at the height of an interest rate cycle.
- This injection addressed the security needs of the “better off” pensioners, but did not deal at all with the Previously Disadvantaged members, who were excluded from membership of the TPF.
- On 1 November 2000 the TSDBF held R4.8 billion of the T011 bonds.
- A subsequent review of the funding in an objective way found the bonds to be unsustainable and to have a very negative impact in the guarantor’s cash flows, hampering Transnet’s ability to deliver on its obligation to the Government to invest in the infrastructure of South Africa.
- In early 2001 the T011’s were cancelled by the Trustees of the TSDBF and, in combination with actuarial changes based largely on interest rates, resulted in the TSDBF recording a deficit in 2001 of R3.5 billion.
- In return the TSDBF received from Transnet the beneficial interest in the capital of 75 million MTN shares held in a trust, at no cost to the TSDBF.
- Importantly, the pensioner entitlements have never been affected by this transaction; their entitlements are determined by the rules of the TSDBF and not by the funding position of the TSDBF.

ASSET MANAGEMENT

V&A WATERFRONT

- The TSDBF's investment in the V&A Waterfront highlight a structural weakness of the asset base of the TSDBF in that there was a disproportionate investment in a single asset.
- Transnet coordinated the disposal process, together with the Trustees of the funds, to reduce the funds' high risk exposure to a single asset.
- The V&A Waterfront was sold at the height of the property market, at what all experts have stated to be an excellent transaction for its shareholders.
- The proceeds were split, without deductions, according to ownership by the respective funds.
- This resulted in the TSDBF receiving more than R3 billion in cash, it being the single largest shareholder (44%) in the V&A Waterfront.

MTN INVESTMENT

- The MTN investment subsequently performed very well and in January 2006 was sold at an opportune time, realising R5 billion in cash for the TSDBF.

ASSET MANAGEMENT

ASSET ALLOCATION

- Transnet and the Trustees of the TSDBF have worked hard together to determine an appropriate asset allocation strategy for the TSDBF; this strategy was implemented in 2007.

- Because closed funds have no future income streams, it is good practice to ‘immunise’ them to avoid the risk of future calls on the guarantor.

- The transaction implemented resulted in a matching, at the time, of 85% of the TSDBF’s pension cash flows until 2021.

- The benefit of this is evident in the value of the TSDBF, which unlike many other funds, escaped relatively unscathed from the effects of the economic turmoil, both locally and globally, in financial and investment markets.

- The TSDBF has also matched further of its cash flows to provide greater certainty around the TSDBF’s ability to continue with its current bonus policy.

INITIATIVES

PREVIOUSLY DISADVANTAGED WIDOWS

- The Previously Disadvantaged Widows refer to those spouses of black pensioners who retired from Transnet during the period 16 December 1974 to 1 April 1986 and who are not entitled to a spouse's pension from the Transnet funds.

- The widows of these pensioners were not entitled to a widow's pension in terms of the Rules of the Transnet Pension Fund or in terms of the rules of the predecessor pension funds, and therefore were not receiving any pension benefits from any of the Transnet pension funds.

- In 2007, Transnet procured that the TPF Act was amended to provide for the transfer of these Previously Disadvantaged Widows into the TSDBF in order to legalise their benefit.

- As a result, at 31 March 2007, over 3 000 Previously Disadvantaged Widows were transferred to the TSDBF.

- Transnet paid R77 million to the TSDBF, equating to a funding level of 112% of this liability at 31 March 2007, providing them with pensioner rights for the first time.

EX GRATIA PAYMENTS

- Transnet has, in its sole discretion, made certain *ex gratia* payments to beneficiaries of the TSDBF.

- When determining the allocation of the *ex gratia* bonus, the previously disadvantaged pensioners where the prime focus, but pensioners with long service, pensioners who are over the age of 65 and, for obvious reasons, that of the pensioners who have very low pensions, have also taken priority.

- In 2007 all pensioners received a minimum bonus of 1% of their annual benefit; most received 2% of their annual pension and those pensioners earning less than R1 000 per month received amounts up to approximately R9 000 as a bonus.

- In 2008 all pensioners received a minimum bonus of 1% of their annual benefit; most received 2.5% of their annual pension and those pensioners earning less than R700 per month received amounts up to approximately R8 400 as a bonus.

INITIATIVES

- In 2010 those pensioners earning less than R815 per month (mainly previously disadvantaged pensioners) received amounts up to approximately R6 800 as a bonus.

AD-HOC BONUSES

- In order not to negatively impact the financial soundness of the TSDBF, nor reduce the income of the pensioners from both the TSDBF and the State, Transnet and the TSDBF proposed the rule providing for ad hoc bonuses to be paid by the TSDBF, which was approved by the Minister of Public Enterprises with the concurrence of the Minister of Finance.

- As the bonuses do not vest they do not result in the TSDBF moving into a actuarial deficit position and they are not taken into account in the means test in calculating an older persons entitlement to a State grant.

- Rule amendments approved in June 2007, enabling trustees to pay pensioners bonuses. Since then, the following bonuses have been paid by the TSDBF:

    - 1.5% of pensioners annual pension benefit paid in November 2007;

    - 3% of pensioners annual pension benefit paid in July 2008;

    - 5.5% of pensioners annual pension benefit paid in November 2008;

    - 7% of pensioners annual pension benefit paid in November 2009; and

    - 8.33% of pensioners annual pension benefit paid in February 2010.

- It is worth noting that the TSDBF and Transnet bonuses paid have resulted in pensioners of the TSDBF receiving benefit improvements of at least 70% of inflation since 2007. The weighted average increase in pensions over 2008, 2009 and 2010 has in fact been 13.4%.

LEGAL IMPLICATIONS

GENERAL

- The funding position of the TSDBF is a historical legacy dating back to the R17.2 billion deficit inherited from the South African Transport Services.
- There is an open legal issue as to whether Government's original guarantee of the pension fund is still valid; if so, Government has a direct guarantee liability for the TSDBF.
- This is a complex legal issue, and as it is based on interpretation of the law's intent, it may not be possible to get a definitive answer short of a court decision.
- There does seem to be at least a prima facie case to suggest that the State's guarantee is valid for the entirety of the current deficit on the TSDBF.
- If no mechanism is provided for to get the TSDBF back to a fully funded position, no pension increases would be recommended by the actuaries of the TSDBF.

TRANSNET

- Any rule amendment recommended by Transnet for approval by the Minister of Public Enterprises with the concurrence of the Minister of Finance, cannot prejudice the financial soundness or stability of the TSDBF.
- In the absence of a funding commitment from the State, Transnet and the Trustees of the TSDBF have managed the TSDBF within the constraints of the levels of funding, through appropriate asset management, rule amendments and direct payments by Transnet.

LEGAL IMPLICATIONS

TSDBF

- Any proposed amendment must be consistent with the Board's fiduciary duty to act in the best interest of the TSDBF and its members to the exclusion of all other interests.

- Any proposed amendment must be necessary to achieve the objects of the TSDBF:

  - "to provide benefits exclusively for pensioners from the TP"; and

  - "to maintain and regulate a fund, from which benefits to pensioners, or their dependants shall be paid, and for whose benefit this fund is established".

- Sustainability of the TSDBF is a critical factor for consideration of the TSDBF Board.

- The TSDBF could only properly amend rule 24 if it is:

  - necessary do to so to achieve the objects of the fund (provision of benefits to pensioners);

  - in the best interests of the fund and its pensioners to do so; and

  - approved by Transnet and the Minister of Public Enterprises, with the concurrence of the Minister of Finance.

FUNDING POSITION

	2000*	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010**
Assets (R bn)	19.9	16.5	16.0	13.2	15.1	16.4	19.2	21.6	19.9	19.6	19.6
Liabilities (R bn)	17.9	20.1	19.0	18.4	18.5	21.9	22.2	20.4	17.9	17.9	16.2
Funding %	111.4	81.9	84.5	72.1	81.4	74.8	86.5	105.7	111.1	109.5	116.05
No. of members	101 635	100 959	97 662	90 174	90 798	87 352	84 222	82 771	82 044	78 434	75 114

* At inception on 1 November 2000

** Draft report for Board approval

- From 2000 to 2005, the impact of market changes and falling interest rates on the TSDBF's asset value, being a high proportion of equity and property assets, is evident.
- The disposal of the MTN shares in 2006, at the height of the equity markets, and the V&A Waterfront in 2007, at the height of the property boom, is visible in the increase of the TSDBF's asset values in these years.
- The impact of the implementation of the cash flow matching strategy in 2007 is also evident in subsequent years, as the asset value, and actuarial surplus in the TSDBF, has remained relatively constant, despite the payment of increased bonuses by the TSDBF.

FINANCIAL IMPLICATIONS

TRANSNET

- The proposal before the Committee is for an inflation related annual increase.
- The impact of the increase on the TSDBF, were this proposal to be implemented, is illustrated below.

	Net Assets as at 31 March 2009	Liabilities	Excess Assets	Funding level
	R' million	R' million	R' million	%
2% fixed increase	19,614	17,919	1,695	109.5%
50% of inflation targeted	19,614	19,555	59	100,3%
75% of inflation targeted	19,614	22,146	(2,532)	88,6%
100% of inflation targeted	19,614	25,347	(5,733)	77.4%

The results above are based on the data used for the valuation report as at 31 March 2009.

The basis and methodology to determine the results above is consistent with that used for valuation purposes as at 31 March 2009.

The liabilities includes the provision for the full solvency reserve.

- While a 50% inflation targeted increase is affordable based on the above, in the next ten years, the pensioners will actually receive less cash than under the current 2% statutory plus ad-hoc bonus dispensation.
- Under the current policy, the average change in pension cash flow would be estimated at approximately 3.5%, which, based on an inflation target of 6% maximum, translates to an improvement of at least 58% of inflation.
- Pensioners receiving the State grant will receive even less cash.

FINANCIAL IMPLICATIONS

- To illustrate the impact of the market’s expectation of inflation on the valuation, the information has been updated to 31 March 2010, based on the Valuation report as at 31 March 2010, which is still to be approved by the TSDBF Board.

	2009	**2010**
	100% CPI	**100% CPI**
	R' million	**R' million**
Assets	19,614	19,597
Liabilities	24,079	21,514
Deficit	(4,465)	(1,917)

The results above are based on the data used for the valuation report as at 31 March 2009, and the draft valuation report as at 31 March 2010.

The basis and methodology to determine the results above is consistent with that used for valuation purposes as at 31 March 2009.

The liabilities includes the provision for the full solvency reserve.

ANALYSIS

RETAIN THE STATUS QUO

- The financial eligibility of those pensioners in receipt of the State grant will not be negatively affected.
- The financial position of the TSDBF, and the surplus, should provide pensioners with some confidence about the continued payment of ad hoc bonuses.
- Transnet will be in a position to continue with *ex gratia* payments to Previously Disadvantaged pensioners.
- Pensioners will always receive at least the guaranteed statutory 2% increase per annum.
- Those pensioners not receiving State grants may not find the security they need, as the ad hoc bonuses are dependant on the financial affordability of the TSDBF.

INFLATION LINKED INCREASES

- Will provide those pensioners not receiving State grants with greater security.
- Many pensioners receiving the State grant may lose their financial eligibility, significantly reducing their cash flows.
- Increases remain subject to the financial affordability of the TSDBF.
- If the TSDBF moves into a deficit, no increases can be given.

PROPOSAL

- Based on the previous slides, Transnet has amply demonstrated its commitment to the TSDBF and, more importantly, its pensioners.
- The progress made by the management team since 2005 has been significant, and improved the position of the pensioners significantly too.
- The executive of Transnet is now in a position, given the soundness of the TSDBF, to consider amendments to the increase rules of the TSDBF.
- In the first instance, retention of the status quo – this protects the benefits of pensioners receiving the State grant, retaining the ad hoc bonus rule
- In the second, the provision of inflation-linked increases, subject to affordability.
- Any proposed amendment would be subject to the approval of the Board of Trustees of the TSDBF, and the Transnet Board.
- The amendment would also require the approval of the Minister of Public Enterprises, together with the concurrence of the Minister of Finance.