

STATUTORY AND CORPORATE GOVERNANCE CONCERNS ON INVESTMENTS BY PENSION FUNDS IN BOTSWANA

Barati Lekone

Accounting & Finance Finalist,
Botswana Accountancy College/University of Derby

Dr. John Mukuna

Senior Lecturer in Law and Corporate Governance,
Botswana Accountancy College

Abstract

This article explores the statutory underpinnings and corporate governance perspectives of investments by pension funds in Botswana. Specifically, the article evaluates the scope of the Non-Bank Financial Institutions Regulatory Authority Act (NBFIRA Act); Pension and Provident Funds Act (PPFA) and attendant delegated legislation in the context of investment considerations by pension funds. It examines the extent to which the country's corporate governance terrain and laws regulating investments by pension funds embrace the concept of good corporate governance. The enquiry is motivated by the critical role played by effective corporate governance in a company's corporate strategy, endeavour for longevity and its role as a good corporate citizen. Thus it becomes critical to investigate the legal framework and corporate governance perspectives of pension funds, a critical sector in the economy of Botswana. The article finds that the Botswana's statutory infrastructure and corporate governance environment fail to create an effective platform which would incorporate and inculcate a culture of good corporate governance as pension funds deliberate on how to invest the billions of Pula entrusted to them as fiduciaries. Defaulting to adopt a cogent and forceful re-examination of the relevant law and good governance is disaster in waiting which the findings of this article strive to forestall.

Keywords: Statute, corporate governance, fiduciary, pension fund

Introduction

The article explores statutory and corporate governance factors in investments decisions of pension funds in Botswana. It examines NBFIRA

Act, the PPFA, subsidiary legislation and investment paradigms of pension funds in the country in search of good corporate governance practices. The aim is to interrogate whether, as regards investments, this critical sector in the economy of the country is enveloped by effective corporate governance principles and a robust legal architecture. We contend that the sector is critical in two ways. Firstly, in 2013, the total membership of the ninety-five stand-alone pension funds licensed by NBFIRA stood at 166,500 and secondly, investment assets of these funds amounted to P47.4 billion (NBFIRA, 2013). The need to ensure that investments on behalf of the members is made prudently and with an eye on good corporate governance is driven by the fact Pension Funds in the country are allowed to invest a maximum of 70% of their assets offshore (NBFIRA, 2013). It is therefore salient that investment in various institutions around the world and in the country should be underpinned by good governance considerations so as to avert a crisis in the country's principal social security system.

Changes in the financial environment are a major threat to pension funds in that they are highly risk centred organizations that are sensitive to the changes in financial markets. The 2007/2008 financial crises affected pension funds significantly because of their investments in the capital markets (Franzen, 2010).

Fiduciary duties of pension schemes put them in the pressure of high valuation of return on investment in making investment decisions. The temptation of a high and quick return on investment, pushed by performance-based remuneration of executives may lead to relegating good corporate governance considerations to the background. Focus on pension fund's short-term investments undermines "intergenerational wealth maximization...and can create market volatility and undermine sustainable wealth" (Hawley, Johnson & Waitzer, 2011:7).

The investigation adopts an interpretivist philosophy because it is based on what is depicted by the statutory law which regulates pension funds. Our enquiry adopts a qualitative research method. Krauss (2005) argues that many qualitative researchers are of the view that a problem is well grasped when its examined in its context and for this to happen, the researcher is immersed in the subject of his study. The approach is inductive in which theory is built from observation of reality which enables general conclusions to be made from certain instances (Collis & Hussey, 2009).

An Overview of Corporate Governance and Pension Funds

The OECD (2004: 23) report defines corporate governance as the 'rules and practices that govern the relationship between the managers and shareholders of corporations, as well as stakeholders like employees and creditors'. Kaufman (1999) argues that there is ample empirical evidence of

a causal link between good governance and better development outcomes. Globally, corporate governance reforms have essentially been triggered by scandals in corporations (Afsharipour, 2009).

Corporate governance goes beyond rules and regulations governing a company anchored merely on economic agenda of a company. Social and environmental considerations should also be integrated in a company's formulation of strategy. On this approach, South Africa's King III Report (Institute of Directors,2009:11) states that:

The proliferation of initiatives, tools and guidelines on sustainability is evidence of the growing awareness of sustainability issues. Because the company is so integral to society, it is considered as much a citizen of a country as is a natural person who has citizenship. It is expected that the company will be and will be seen to be a responsible citizen. This involves social, environmental and economic issues – the triple context in which companies in fact operate. Boards should no longer make decisions based only on the needs of the present because this may compromise the ability of future generations to meet their own needs.

It is on the foregoing triple-bottom line philosophy that pension funds' investments law and governance in Botswana are examined. Olaboda (2012) describes pension funds as a pool of resources in which people trust their possessions, money or assets with a view to having enough to support their needs after retirement. To NBFIRA (2013), pension funds exist so as to protect members' investments so that they can retire with dignity which can only be realised if there are safeguards to protect their savings. This view has motivated the enquiry in this paper because without a robust governance and statutory mechanism, the very aim of pension funds would be wholly undermined.

It is for the above reason that members' resources should be invested by their fiduciaries bearing in mind the state of corporate governance in organisations where investments are made. We argue that the central role of a fiduciary is not necessarily to operate within a particular legal framework or policy but to adopt an approach which in the long term ensures that the interests of the principal are cushioned against caving-in. Our contention is that there is no better approach than incorporating good corporate governance into the process and decision of investing members' resources by pension funds.

Richardson (2009) explains the fiduciary as a person with the character of trustee and being charged to mainly act in the benefit of another with respect to property or affairs. Our submission is that investments by trustees or fiduciaries should embrace social, ethical and environmental factors as opposed to merely taking into account the conservative or

conventional trajectory of focusing on the economic dimension of their investments. We are therefore proposing for Botswana pension funds what Sandberg (2010) refers to as Socially Responsible Investment (SRI) also called Environmental, Social and Governance (ESG).

Undoubtedly, economic or financial elements of investing by institutional investors and in our case pension funds cannot be treated lightly. However, our view is that this central factor and social and ESG concerns should be mutually reinforcing so as to intensely safeguard the long term investments of the principals. We further contend that if pension funds and other institutional investors who are the main players in financial markets (Sandberg, 2010) do not adopt the suggested approach, then some of the objectives of sustainable development and the United Nation's Millennium Development Goals (MDGs), values and principles will not be achieved especially in a developing country like Botswana. These include respect for nature, protecting our common environment and promotion of human rights and good governance (UN Millennium Declaration, 2000). This is in agreement with the United Nations Environment Programme's 'Freshfields Report' (UNEP, 2005) on responsible investment by institutional investors of which pension funds are unarguably key leaders.

It is by adopting this approach that meaningful and sustainable investments will be realised. The 'Freshfield's Report (UNEP, 2005:3) notes that:

In our business, the investment business, ethical conduct extends beyond not breaking the law to properly interpreting what is in the best interests of the savers who are the ultimate beneficiaries of the institutional pools of money we are engaged to oversee or manage. This is where the interesting questions concerning fiduciary responsibility come to the fore: are the best interests of savers only to be defined as their financial interest? If so in respect to which horizon? Are not the social and environmental interests of savers also to be taken into account? Indeed, many people wonder what good an extra per cent or three of patrimony are worth if the society in which they are to enjoy retirement and in which their descendents will live deteriorates. Quality of life and quality of the environment are worth something, even if not, or particularly because, they are not reducible to financial percentages.

Some scholars are also of this view. Anthony and Mustafa (2010) cited by Emmanuel and Umar (2011) explain that decision making of investment choices should be more than anchored on arithmetic view of expected returns on various risk investments but more on factors affecting political, economic and social means. Good governance is increasingly vital

for the national welfare in the global financial markets (Clark & Urvin, 2009).

Girdwood (2013) notes that a better understanding by pension funds fiduciaries of climate change and its negative impact on the global business environment will prompt fiduciaries to incorporate ESG considerations in their investment decisions. This is a relatively new concept and we hope that our paper will trigger debates and hopefully reform the *status quo* on investments by pension funds in Botswana. We now turn to the statutory provisions on pension funds' investment in Botswana.

The Statutory Tone of Pension Funds' Investments in Botswana

The supervisory authority of pension funds is vested in the Registrar of Pension and Provident Funds by section 11 of the Pension and Provident Funds Act (PPFA), 1987. In terms of section 11 of this Act, the functions and duties of the Registrar (which section 2 of the Act refers to as the Non-Bank Financial Regulatory Authority), shall, to quote verbatim, include:

- a. *the licence and superintendence of the conduct of pensions and provident funds;*
- b. *the formulation and enforcement of standards in the conduct of the business of pensions and provident funds with which the management of such funds must comply;*
- c. *the recommendation to the Minister to make regulations for the carrying out of Government policies relating to the funds;*
- d. *such other functions as are assigned to the Registrar by this Act or regulations made thereunder or such other duties as the Minister may assign to him.*

It is therefore apparent from the PPFA perspective that its aim is not to vest the Registrar with jurisdiction to question or determine whether good governance considerations as elucidated above are the linchpin of pension funds' investments decisions. It can be argued that on a literal interpretation of the above provision, the Registrar would be acting *ultra vires* were he to require pension and provident funds to report on good governance considerations in their investment decisions, much as that would be the pivotal question to ask from a sustainability and ESG perspective.

It is worth noting that under the common law of Botswana, and as held by the High Court in the case of *Aubrey J Molatlhwe & Others v The Diocese of the Church of the Province of Central Africa*¹, a literal interpretation of statutes is the preferred approach so as to restrain judicial discretion in statutory interpretation. The expressions 'conduct of pensions'

¹ *Aubrey J Molatlhwe & Others v The Diocese of the Church of the Province of Central Africa* [2008] 3 BLR 317.

and ‘standards in the conduct of business’ as captured in section 2 above cannot be construed to mean contemporary corporate governance, especially ESG factors, without serious and justified accusations of usurpation of the role of the legislature by the Registrar.

The overarching legislation governing pension funds in Botswana is the NBFIRA Act 2007. The Act is an integral part of the country’s commendable initiative of reforming the legal and regulatory mechanisms of its financial sector, what Bojosi (2012) calls a ‘metamorphosis.’ While the banking sector is under the regulation of the Bank of Botswana (the Central Bank), there was before the NBFIRA Act’s promulgation a major legal and regulatory lacuna in the regulation of non-banking institutions. Among others, the NBFIRA Act’s main aim is to safeguard the stability, fairness and efficiency of the Non-Bank Financial Institutions (NBFIA, 2014).

In particular, there was a public outcry over misdeeds of the so called ‘loan sharks’ (Bojosi, 2012) who exploited the skeletal financial knowledge of their customers. The preamble of the NBFIRA Act posits that the Act enhances soundness of non-bank financial institutions; high standards of conduct of business; the stability of the non-bank financial system; and reducing and deterring financial crime. Clearly, these objectives apply to pension funds all which fall within the statutory powers of Non-Bank Financial Institutions Regulatory Authority (‘the authority’) pursuant to section 2 of the NBFIRA Act.

The authority is established under section 8 of the NBFIRA Act. The said section states the principal objects of the authority as:

- a. *safety and soundness of non-bank financial institutions;*
- b. *highest standards of conduct of business by non-bank financial institutions;*
- c. *fairness, efficiency and orderliness of the non-bank financial institutions;*
- d. *fairness, efficiency and orderliness of the non-bank financial sector;*
- e. *stability of the financial system, and*
- f. *reduction and deterrence of financial crime.*

While the authority may be critiqued on its institutional structure with a view to reforming it, the focus of this article is on its mandate as pertains to investment decisions by non-bank financial institutions from a corporate governance approach as submitted in part 2 above. As with the PPFA, the NBFIRA Act is not categorical that pension funds should take on board the now cutting-edge considerations of corporate governance. It is when such considerations fall within the statutory powers of the authority that significant assurance of longevity of pension funds would become pronounced and near indisputable.

As is common with many enabling legislation like the NBFIRA Act, power may be delegated to a person or entity for a steady operationalisation of the objectives of the Act. Thus section 50(1) of the NBFIRA Act provides delegated power to the authority to make rules for the prudentially regulated non-bank financial institutions in particular their management and conduct of business. In exercise of the foregoing power, the authority has established 10 Prudential Financial Rules (PFR) on retirement funds. The aim is to minimise or prevent financial risks in this sector (NBFIRA, 2013). Our focus is on PFR2 and PFR 10.

PFR 2 provides direction on the contents of a fund's investment strategy. In so far as is relevant to our investigation, PFR2 states that the fund's investment strategy shall take into account the need to diversify the assets of the fund; the risks to which the assets and liabilities of the fund will be exposed and that investment managers or the board itself is expected to consult experts with ample skills, experience and knowledge to advice on a proper investment strategy unless the board includes such members to perform those functions. NBFIRA Act and rules have therefore not embraced the current corporate governance philosophy as one of the central factors to be taken into account in the formulation of investment strategy for pension funds.

To consolidate our view that the entire NBFIRA Act and delegated legislation as in the PFR rules are not intended to prescribe central tenets of ESG, PFR 10 which stipulates the code of conduct of the Board of Trustees, the entity in a pension fund entrusted with the management of the fund, is silent on the mainstream corporate governance issues. PFR 10 mainly provides for ethical conduct of trustees especially to act with honesty, in good faith and with the highest standard of care, diligence and skill; managing conflicts of interest; acting with impartiality and not to disclose or make use of confidential information obtained by virtue of their office for the advantage of themselves or anyone else. Frenzen (2010) and Richardson (2009) concur that these duties of a pension fund's fiduciary ensure that loyalty to the beneficiary is maintained and that the fiduciary acts in the best interests of the member. Regarding investments PFR 10 states that trustees should identify and manage risk related to the fund pursuant to a risk management policy and to review that policy at least once every 2 years.

Fiduciary Duties of Trustees: Enlarging the Scope

Because of the failure by the statutory law of Botswana to integrate ESG considerations in investment decisions by pension funds, it would then appear that only trustees of pension funds can decide to invest their members' funds in companies with a good culture and record of corporate governance. That becomes a discretionary exercise of power as opposed to a

legal obligation. The problem is that taking into account ESG factors might be interpreted by critics as a departure from the historical and legal duties of a fiduciary which deem non-financial issues as moral and religious questions rather than strategic concerns (Hoepner, Rezac & Siegl, 2011). This is more so in a common law country like Botswana which generally adopts a literal approach to statutory interpretation as seen in the High Court decision in the case of *Molathlwe*. It is this narrow interpretation of fiduciary duty which prevents fiduciaries from looking beyond the narrow view of short term economic gains for members who are the beneficiaries of these funds (Waitzer & Sarro, 2013).

Some common law countries are boldly moving from the conservative understanding of the role of a fiduciary as regards trustees of pension funds. In Canada, the role of trustees of pension funds as fiduciaries is evolving towards incorporating ESG considerations (Waitzer & Sarro, 2012). In that country, the Canada Pension Plan Investment Board (CPPIB) Policy on Responsible Investing requires that social and environmental factors be taken into account when making investments (Waitzer & Sarro, 2012; CPPIB, 2014). Clearly, this is a commendable approach which pension funds and their trustees in Botswana should adopt because of the myriad benefits derived from integrating ESG considerations when making investments.

In South Africa, statutory reforms made in 2011 enlarged the scope of fiduciaries of pension funds so as to contribute towards mitigating the effects of global corporate scandals. Regulation 28 issued under the Pension Funds Act, 1956 now adopts the principle of prudent investing. The shift was necessitated by what the Government in the Explanatory Memorandum of 2010 called ‘recent financial crisis’ (National Treasury, 2010). The preamble to the regulation provides that:

A fund has a fiduciary duty to act in the best interest of its members whose benefits depend on the responsible management of fund assets. This duty supports the adoption of a responsible investment approach to deploying capital into markets that will earn adequate risk adjusted returns suitable for the fund’s specific member profile, liquidity needs and liabilities. Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social and governance character. This concept applies across all assets and categories of assets and should promote the interests of a fund in a stable and transparent environment.

Conclusion

This article has examined statutory law and corporate governance dynamics of investments decisions of pension funds in Botswana. It has been seen that the relevant legislation namely the Pension and Provident Funds Act, the NBFIRA Act and delegated legislation in force do not encompass ESG factors as key in investment decision-making by pension funds' trustees who are members' fiduciaries. In addition, the common law scope of the duties of a fiduciary do not extend to taking into account non-financial matters as they are viewed by critics as religious or moral considerations. It has been argued that a literal interpretation of statutes in Botswana would most probably deter the inclusion of ESG factors in investments by pension funds.

The position in Botswana does not augur well for intergenerational sustainability of pension funds neither does it promote the international community's clamour for protection of the environment, social justice and human rights. On investments by pension funds, it is proposed that the NBFIRA Act, the Pension and Provident Funds Act and delegated legislation made thereunder should integrate ESG elements, an emerging trend which has expanded the scope of fiduciaries in Canada and South Africa which are common law jurisdictions like Botswana.

References:

- Afsharipour, A. (2009). Corporate governance convergence. *Northwestern Journal of International Law & Business*, 29(2), 335-402.
- Aras, G. & Crowther, D. (2008). Governance and sustainability: An investigation into the relationship between corporate governance and corporate sustainability. *Journal of Management Decision*. 43(3), 433-448.
- Bojosi, K.N.,(2012). An appraisal of the new legal framework for the regulation of non-banking financial institutions in Botswana. *University of Botswana Law Journal* (30) 29-52.
- Caplan, L., John, S.G. and Jarvis, W.F. (2013). From SRI to ESG the changing world of responsible investing. *Common Fund Institute*.
- Clark, L.G. and Urwin, R. (2009). *Innovative models of pension fund governance in the context of the global financial crises*. Retrieved from:<http://ssrn.com/abstract=1359037>.
- Emmanuel, T. And Umar, G. (2011). Analysis of investment decisions by Nigerian pension fund administrators (PFAs), *International business and management*, 133-140.
- Franzen, D. (2010). Managing investment risk in defined benefit pension funds, OECD working paper on insurance and private pensions. No. 8 OECD. Retrieved from <http://dx.doi.org/10.1787/5kmjnr3sr2f3-en>.

- Girdwood, A., (2013). Responsible Investment for pension fund trustees: A work in progress?. Retrieved from www.wwf.org.za/responsible_investment_pension_fund_trustees.
- Hawley, J. Johnson, K. & Waitzer, E. (2011). Reclaiming fiduciary duty balance. *Rotman International Journal of Pension Management*, 4(2) 4-16.
- Hoepner, A.G.F., Rezac, M., Siegl,K.,S. (2011). Does pension funds‘ fiduciary duty prohibit the integration of environmental responsibility criteria in investment processes?: A realistic prudent investment test. Retrieved from <http://dx.doi.org/org/10.2139>.
- Institute of Directors in Southern Africa (2009). King III report.
- Krauss, S.E. (2005). Research paradigms and meaning-making: A primer,” *The Qualitative Report* 758-770 p758.
- Non Bank Financial Institution Regulatory Authority (NBFIRA). (2012) *Pension prudential rules in terms of Section 50 of the NBFIRA Act PR2*.
- Non-Bank Financial Institutions Regulatory Authority (2012.) *Pension Prudential Rules PFR10 Conduct Expected of the Board Trustees*. NBFIRA.
- Olabode, J., Umar, G. and Emmanuel, T. (2012). Determinants of pension fund investment in Nigeria, *International Journal of Human Resource Studies* 1-13.
- Sandberg, J. (2010) Socially responsible investment and fiduciary duty: Putting the freshfields report in perspective. *Journal of Business Ethics*, (101)143-162.
- United Nations Development Programme (2005). A legal framework for the integration of environmental, social and governance issues into institutional investment. Retrieved from www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.
- Waitzer, E.J., & Sarro, D. (2012). The public fiduciary: Emerging themes in Canadian fiduciary law for pension trustees. *The Canadian Bar Review*, (9) 163-209.