The process of ethical decision-making in South African retirement funds

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Please start filling in page 1 of your survey now!
Agenda

1. Looking back
2. Introducing ethical theory
3. An ethical decision-making framework
4. Considering the framework in action: investments
5. Looking forward
6. Your questions
Looking back
Once upon a time...

- See Davis & Kendal (2012) for details
- There were defined benefit and defined contribution funds with about R80bn in surplus assets.
- The government decided that it was unfair that the people who were members when this surplus was generated but had left the funds would not get any of these surplus assets.
- So, they passed legislation that meant that actuaries would need to establish what the surplus was at the next valuation and distribute it appropriately. Measures were introduced to ensure no excess asset build-up going forward.
But there was more to this

• Some of this surplus had arisen from DB to DC conversions
  • Members took on considerably more risk
• Actuarial reputation had been tarnished
• “Trade-union representatives do not trust the actuary to treat members fairly; on the contrary, they expect the actuary to act in concert with the employer.” – Andrew (2004)
A second chance?

“The [PFSAA] legislation has given the profession a second chance. It must do it right this time. The profession must ensure that the surplus apportionment is conducted within the spirit of the Act as well as within the guidelines drawn up by ASSA. Actuaries must now be seen to be impartial, to be managing the conflicts of interest, and to be communicating better.” – Andrew (2004)
So what happened?

• Previously, actuaries could use prudent assumptions. Now actuaries had to use best estimate assumptions with explicit contingency reserves.

• So, on the AOS at SAD, one would not expect a dramatic increase in reserves.

• And R10bn promptly disappeared in strengthened bases and a further R22bn was used up in various ways.
A closer look at the AOS

- Surplus reduced to 31% of previous valn level
- More than half went to members and pensioners
- But “basis change” consumed a chunk...

<table>
<thead>
<tr>
<th></th>
<th>Rm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Previous surplus</td>
<td>15 266</td>
</tr>
<tr>
<td>Interest</td>
<td>5 372</td>
</tr>
<tr>
<td>Pension increases</td>
<td>-5 297</td>
</tr>
<tr>
<td>Benefit improvements</td>
<td>-2 210</td>
</tr>
<tr>
<td>Contributions</td>
<td>-1 955</td>
</tr>
<tr>
<td>Other 'controllable'</td>
<td>-929</td>
</tr>
<tr>
<td>Improper use</td>
<td>381</td>
</tr>
<tr>
<td>Experience</td>
<td>4 372</td>
</tr>
<tr>
<td>Change in basis</td>
<td>-9 928</td>
</tr>
<tr>
<td>Expense reserves</td>
<td>-272</td>
</tr>
<tr>
<td>Distributable surplus</td>
<td>4 800</td>
</tr>
</tbody>
</table>
What (if anything) went wrong?

Please turn to Q5 on your survey form. You will be asked to share the option you thought was most correct electronically.
What (if anything) went wrong?

What is your top-ranked option?

1) Too much of the surplus disappeared due to actuarial discretion.

2) Actuaries could not have been applying the professional guidance properly.

3) We didn’t demonstrate the values of impartiality, integrity, transparency and accountability.

4) The interests of many member groups were not met.

5) There were some problems but many actuaries did the right thing and we’ll do better next time.
Actuaries behaving badly
Ethical theory
Theory of right action

• There is a right thing to do
  • Consequentialist theories
    • There are right and wrong outcomes and the end justifies the means
    • “Too much of the surplus disappeared due to actuarial discretion.”
  • Non-consequentialist theories (Deontology)
    • There are right and wrong ways of doing things and the process is more important than the outcome
    • “Actuaries could not have been applying the professional guidance properly.”
Virtue ethics and the ethics of care

• Virtue ethics
  • There is a right way to be
    • A virtuous person would always behave ethically so we need to work on developing the right virtues
    • “What would Mother Teresa do?”
    • “We didn’t demonstrate the values of impartiality, integrity, transparency and accountability.”

• Ethics of care
  • There is a right way to treat people
    • To what extent are needs met in relationships?
    • “The interests of many member groups were not met.”
Justice in ethics

- Justice underpins ethical theory
- Fairness and equality
- Balancing individual rights and needs of the collective
- Ethics = morality (individuals) + regulation (society)
Why behave ethically?

• Trustee duties (deontological)
  • Impartiality (treating equals equally) - virtue
  • Avoid and manage conflicts of interest – virtue
  • Duty of care – ethics of care
  • Act in accordance with the purpose of the fund – justice
  • Accountability – ethics of care

• Note that outcome is less important than the decision-making process.
And actuaries?

- Support trustees in carrying out their duties

- Actuaries’ Code

“an ability to avoid conflicts of interest and comply with legislation and professional guidance as well as the values of integrity, objectivity, confidentiality, due care, independence, scepticism, accountability, courage, reflection and a commitment to the public interest, social responsibility, ethical business, whistle-blowing and ethical judgement”
Framework for ethical judgement

1. Specify the problem (Step 1)
2. Understand the environment (Step 3)
3. Develop the solution (Step 2, 4, 5)
4. Monitor the solution (Step 6)
Step 1: Recognise the ethical issue

- If you are carrying out any duty on a fund, there are by definition ethical issues
- Even doing nothing presents an ethical issue
- Once the issue is identified, consider magnitude (intensity and number affected)
Step 2: Gather information

• Be diligent
  • Apply mind to all relevant facts
  • “Duty to know”

• May be helpful to explicitly agree on facts
Step 3: Consider the “rules”

- Legislation, regulation and professional guidance
- Recognise that morality becomes more important where there are few or no rules
Step 4: Evaluate all options

- 1st test: Does it comply with “the rules”?
- 2nd test: Is it consistent with the purpose of the fund?
- 3rd test: What is just?
- 4th test: How are the relationships between stakeholders affected?
- 5th test: Does it reflect the right virtues?
Step 5: Make a decision

- Make the decision
- Action the decision
- Communicate the decision which raises ethical issues again!
Step 6: Monitor the decision

- Both in terms of the outcome and the process
- Decide when and how to review the decision
How well do we do?

- Please refer to questions 9 and 10 on your survey forms.
- In question 9, you will be asked to rank our performance in each of the 6-steps. You will be asked to share your best- and worst-ranked options electronically.
- In question 10, you will be asked to evaluate the actuarial profession as a whole.
Which step do we do best?

1. Step 1: Identify the ethical issue
2. Step 2: Gather information
3. Step 3: Consider “the rules”
4. Step 4: Evaluate all options
5. Step 5: Make a decision
6. Step 6: Monitor the decision
7. None: bad at everything
Which step do we do worst?

1. Step 1: Identify the ethical issue
2. Step 2: Gather information
3. Step 3: Consider “the rules”
4. Step 4: Evaluate all options
5. Step 5: Make a decision
6. Step 6: Monitor the decision
7. None: good at everything
Investment case study
Background

- Consider a DC fund
- No member investment choice
- Trustees need to select a one-size fits all strategy
Step 1: Recognise the ethical issue

• Identify the ethical issues
  • Was the IPS determined ethically?
  • Risks to various stakeholders
Steps 2 and 3

• Gather information
  • Nature of the liabilities and risk tolerances
    • How do you gather demographic info ethically?
  • Liquidity requirements
  • Funding level
  • Available assets

• Consider “the rules”
  • Regulation 28 vs PF130
Step 4: Evaluate all options

- 1st test: Does it comply with “the rules”? 
- 2nd test: Is it consistent with the purpose of the fund? 
- 3rd test: What is just? 
- 4th test: How are the relationships between stakeholders affected? 
- 5th test: Does it reflect the right virtues?
Steps 5 and 6

• Make a decision
  • Does the strategy reflect an ethical process was followed?
  • Is the outcome ethical?
  • Was expert advice free from conflicts of interest?
  • Communicate the decision and the risks

• Monitor the solution
  • What other ethical issues arise?
Looking forward
Have we missed our next chance?

- Death benefit distributions?
- Annuitisation?
- Benefit illustrations?
- Advice to members?
- Retirement reform?
- F104 overhaul?
- Please give input on questions 11 and 12
Your questions or comments?

Please complete your survey form and hand to an assistant on your way out.