NEGs

perspectives on corporate governance



Neels Kilian (Managing Editor)
Grietjie Verhoef, Nicola Jägers
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New Perspectives on Corporate Governance

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Abbreviations and acronyms

AGM	Annual general meeting
AHT	African Homes Trust
APEC	Asia-Pacific Economic Cooperation
CAFTA	DR Central American Dominican Republic Free Trade Agreement
CIPC	Companies and Intellectual Property Commission
CSR	Corporate social responsibility
DB	Board of directors
EMS	Environmental management system
EPS	Environmental policy statement
ESG	Economic, social and [corporate] governance
EU	European Union
FAIS Act	Financial Advisory Intermediary Services Act
FAIS	Financial Advisory Intermediary Services
FIPA	Foreign Investment Promotion and Protection Agreement
FSB	Financial Services Board
FSCA	Financial Sector Conduct Authority
G20	Group of Twenty
HRDD	Human rights due diligence
IBNR	Claims incurred but not reported (by the underwriting manager)
ILO	International Labour Organisation
JSE	Johannesburg Stock Exchange Ltd
King IV	King IV: Report on Corporate Governance for South Africa
LTRR	Long-term rate of return
MOI	Memorandum of Incorporation

NEMA	National Environmental Management Act 1998
NFRD	Non-Financial Reporting Directive
NZX	New Zealand Exchange
OECD	Organisation for Economic Co-operation and Development
OHCHR	Office of the High Commissioner for Human Rights
PAIA	Promotion of Access to Information Act
RF	Ring-fenced (company)
SADC	Southern African Development Community
Sanlam	Suid-Afrikaanse Nasionale Lewens Assuransie Maatskappij
Santam	Suid-Afrikaanse Nasionale Trust en Assuransie Maatskappij
SDM	Sanlam Developing Markets
SEM	Sanlam Emerging Markets
SPF	Sanlam Personal Finance
SWX	Switzerland stock exchange
TNC	Transnational corporation
UNGPs	United Nations Guiding Principles on Business and Human Rights
USMCA	United States-Mexico Canada Agreement

Authors

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Foreword

Trustees of the PA and Alize Malan Memorial Trust

This textbook, *New Perspectives on Corporate Governance*, benefitted from the sponsorship of the PA and Alize Malan Memorial Trust. PA Malan was a remarkable South African businessman and served as a founding director of the South African Trust and Assurance Company (Santam) and the South African Life Assurance Company (Sanlam) from their establishment in 1918 until 1960. Although WA Hofmeyr was the driving force behind the registration of the first truly South African insurance companies, Santam and Sanlam, the vision to establish these companies originated from a former insurance company – *De Protecteur* – which was established by Hofmeyr's uncle and other local Dutch-speaking entrepreneurs in the Cape Colony in the 1850s. The idea to establish a local insurance company, Santam/Sanlam, was first raised by Alfred McDowall. In 1890, he observed that foreign insurance companies dominated the local insurance industry. At the time, the industry offered primarily fire and casualty insurance to a client base consisting of Afrikaans-speaking farmers and rural inhabitants. In 1890, nearly 40% of the Afrikaans-speaking population lived on farms (or in the rural areas), however, by 1920, only 3% of this population still lived on farms, with a growing proportion of urbanised Afrikaners. This demographic change presented a market opportunity local leaders would be unwise to ignore.

The first meeting of prospective directors of Santam/Sanlam took place in the famous Royal Hotel in Cape Town. The venue was chosen as it was a well-known English-associated hotel, with a certain social inclusivity. Many board members did not support South Africa's participation on the side of the Allied Powers in the First World War. Others were negatively disposed

towards the German language and associated the Afrikaans language with German. The two languages are considered sister languages and Germany enjoyed wide support among the Afrikaans-speaking community. McDowall, an English-speaking Scotsman, was sympathetic to the cause of Afrikaans-speaking members of South African society. Consequently, to circumvent a potential language dispute, the meeting was held at the Royal Hotel. There is strong evidence that PA Malan, a qualified attorney, was intricately involved in drafting the Santam/Sanlam prospectus to attract investors to the local insurance initiative. The prospectus offered one share at one pound, with all shares enjoying equal voting rights. At the time, company law was unconsolidated and registering such a prospectus was difficult. Different company statutes were in force in the four provinces constituting the Union of South Africa. In the Transvaal, the Companies Act of 1909 was still in force but differed from that of other provinces concerning legal principles and processes. The consolidated South African Companies Act 46 of 1926 only delivered uniformity to the country towards the late 1920s.

PA Malan, one of the founders of Santam/Sanlam in 1918, also played a leading role, directly or indirectly, in the establishment of other well-known South African companies. These included KWV wines (*Ko-Operatiewe Wijnbouers Vereeniging*), the tobacco company Rembrandt, *Nasionale Pers*, later known as NASPERS, the South African Institute of Trade, the synthetic oil and gas company, South African Oil and Gas Corporation, known as SASOL, Volkskas Bank, Trust Bank (both banks merged into the current banking group, ABSA), as well as the famous Helpmekaar fund. His leadership was marked by sound business practice and corporate governance.

Santam/Sanlam was established during exceptionally difficult times – nearly 70 insurance companies operating in Cape Town were foreign insurance companies. Their operations could be interpreted as a form of foreign direct investment in South Africa to take advantage of the reconstruction of the economy after the Anglo-Boer War of 1899–1902. However, the aftermath

of the economic disruption and devastation caused by this war was soon further disrupted by the First World War. Then followed the adverse effects of the 1929 world depression. In these unstable conditions, Santam/Sanlam once again practised inclusivity. These companies served as the vehicles to offer financial independence to all South Africans and presented a variety of insurance products to suit the needs and abilities of the entire population. The current insurance company, Metropolitan Life, developed from the Santam/Sanlam industrial insurance.

In 1920, the 'industrialist department' of Sanlam was largely concerned with the wellbeing of the majority of the wage-earning or low-income population, such as wage earners of European descent, the people of the coloured community, and the people of the Zulu, Sotho and Xhosa-speaking communities who entered the insurance market as policyholders for the first time. Santam/Sanlam did not only employ men and these companies also targeted women of all groups as a market segment marginalised in financial services. Mrs Goldblatt, a Jewish immigrant with no understanding of Afrikaans, was employed by Santam/Sanlam as an agent and later, in an executive capacity during the 1920s, as manager of the companies' internal and external communication with policyholders. Santam, and later Sanlam, constituted the platform from which a diversity of other enterprises developed to participate in the industrialising South African economy. This strategy promoted the inclusive participation of all the companies' policyholders in the wider economy.

Santam/Sanlam valued the contribution of its founding fathers. PA Malan served as a director until his late 80s. His presence in the companies he had helped to establish offered him the opportunity to live the values he embraced as a person and as a businessman. However, once the King Report on Corporate Governance for South Africa, proposed a retirement age limit for directors of listed South African companies (for example, serving more than a specific number of years on the board of directors), corporations

gradually amended their rules to adopt a retirement age for their directors. Today, a director normally remains on the board of a listed corporation in South Africa until the age of 60 or 70. To be older than this is an exception.

The purpose of this study is to focus on new concepts in the law of corporate governance and identify how these influence the current legal system in South Africa with reference to Chapter 1. Although other chapters do not specifically refer to Chapter 1, the chapter could be used as a background to understand a specific later chapter more clearly. See, in this regard, the introductory chapter which explains the relevance of each chapter.

In Chapter 1, King IV explains the golden rule to treat others as you would like to be treated. For this reason, a new fiduciary duty for directors is proposed, namely, the duty of best practice. Directors should actively promote social relations or human rights in the business or commercial world (business human rights). This duty is relevant not only to the public but to company stakeholders, prospective employees and or employees. South African statutes about companies and businesses are aligned (to some extent) with international corporate governance principles and/or international law.

We anticipate that in the future, South Africa will be increasingly influenced by these international law principles. One such aspect of the impact of international law is the growing interaction between human rights and companies. In this respect, the example of Mrs Goldblatt may be considered a case of non-discrimination and inclusivity, acknowledging employees' dignity and human rights in the business environment, as a matter to be observed more closely in future to protect the business human rights of employees and prospective employees.

Cape Town, 29 August 2021

Introduction

Neels Kilian

A new fiduciary duty for company directors – A duty of best practice?

In South Africa, before the introduction of the Companies Act of 2008, company directors had common law fiduciary duties. These duties entailed that each director should act honestly (with care or skill) and in the best interests of the company. These duties were not created or explained by the Memorandum of Incorporation (MOI) and/or the articles of association in the Companies Act 61 of 1973, since the MOI was not a contract between the company and its directors, but a contract between the shareholders themselves and between the company and its shareholders.[1] The South African common law previously regulated fiduciary duties for directors only and a shareholder has no fiduciary duty to act in the best interests of the company or enterprise. This may be difficult to comprehend as, generally, shareholders appoint and/or remove directors and this appointment or removal of directors does not have to be in the best interests of the company. However, the appointed director should always act in the company's best interests.[2] Although a company consists of two organs in the common law – the board of directors

1 M Bekink 'An historical overview of the director's duty of care and skill: From the nineteenth century to the Companies Bill of 2007' (2008) *SA Merc Law Journal* 95.

2 J Cassidy 'Models for reform: The directors' duty of care in a modern commercial world' (2009) *Stellenbosch Law Review* (2009) 373; D le Roux and G Hammond 'Directors owe a duty to the company, not to shareholders' (2018) *Without Prejudice* 2018 12.

on the one hand and the general meeting of shareholders on the other – when the board of directors acts or when the general meeting of shareholders acts, it is for all practical purposes the company that has acted. Nevertheless, fiduciary duties exist only for the board of directors.[3]

In the Companies Act 71 of 2008, the South African legislature codified director fiduciary duties and tried to rectify director appointments. The 2008 Act is flexible and provides an option to regulate director appointments in the MOI, for example, a person may be nominated to appoint directors. In addition, the Act uses new phrases to explain fiduciary duties in contemporary times.[4] These phrases are statutory duties and include, amongst others, the duty to act for a proper purpose and with diligence, subject to the business judgement rule to avoid director liability.[5] These new phrases are only defined by case law. For this reason, this introduction focuses only on (due) diligence and an additional fiduciary duty recommended by the United Nations Fiduciary Duties for Directors in the 21st Century – a duty of best practice. This duty is different from the traditional fiduciary duty, namely, to act in the best interests of the company.[6] Instead, this duty of best practice explains that directors should actively promote social relations or human rights.

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3 J du Toit 'Fiduciary duties towards shareholders?' (2017) *Without Prejudice* 8.

4 JL van Tonder 'An analysis of the directors' duty to act in the best interests of the company, through the lens of the business judgment rule' (2015) *Obiter* 702; CB Ncube 'You're fired! The removal of directors under the Companies Act 71 of 2008' (2011) *South African Law Journal* 33.

5 N Bowman 'Individual director due diligence' (2012) *Without Prejudice* 31; BM Mupangavanhu 'Fiduciary duty and duty of care under the Companies Act 2008: Does South African law insist on the two duties being kept separate?' (2017) *Stellenbosch Law Review* 148.

6 United Nations Fiduciary Duties for Directors in the 21st Century (2015) 14-16, 63 and 69; D le Roux and G Hammond 'Directors owe a duty to the company, not to shareholders' (2018) *Without Prejudice* 12.

They should not discriminate against any member of the public, employee, prospective employee and or stakeholders. (See, for example, chapters 5, 6 and 7).

United Nations Guiding Principles on Business and Human rights explanation of best practices

The United Nations Guiding Principles on Business and Human Rights (UNGPs) does not definine the fiduciary duties of directors. It does, however, refer to best practices and how such practices should be interpreted, for example, by keeping business human rights or social relations in mind.[7] In other words, a director should not only act in the best interests of the company but should also act in the best interests of company employees and or other company stakeholders and/or the public. Therefore, 'best practices' as a phrase is broader than best interests. In the United Kingdom (UK), the Slavery Act of 2015 was promulgated to avoid the human rights violations found in the business activities or practices of companies. Therefore, instead of adding best practices to existing company law fiduciary duties in the UK, company boards must adhere to this legislation to prevent any form of human rights violations. (This is explained further in Chapter 5).

In South Africa, no fiduciary duty exists between directors and company employees and/or other stakeholders of the company. In other words, no duty exists to act in their best interests.[8] The best interests of employees are

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7 United Nations Fiduciary Duties for Directors in the 21st Century (2015) 14-16, 63 and 69; Guiding Principles on Business and Human Rights: Implementing the Protect, Respect and Remedy Framework HR/PUB/11/04 (2011) https://www.ohchr.org/documents/publications/GuidingprinciplesBusinesshr_eN.pdf (accessed 11 January 2021).

8 L Coetzee and JL van Tonder 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2016) *Journal for Juridical Science* 1.

regulated separately, for example, in the South African labour law (Labour Relations Act 66 of 1995), which provides guidelines or regulations on how a company should be acting in the employees' best interests. To overcome this limited application, it is possible to add a fiduciary duty of best practice for directors (or even shareholders) to the MOI and how to deal with employees, prospective employees, the public and or other stakeholders in future to comply with social relations or business human rights.[9] This duty is, therefore, more contractual and the directors (or shareholders) will at least have a contractual fiduciary duty to decide on matters that promote stakeholders' best interest.

The United Nations Guiding Principles on Business and Human Rights is a declaration between the United Nations and different states to ensure that companies (or enterprises) respect and/or promote business human rights.[10] The declaration is not a treaty; it is rather a document that explains the United Nations Charter (Constitution) more clearly regarding human rights. Although the UNGPs is not a signed treaty, it remains part of the normative rules of international law – it explains the United Nations' stance on eliminating human rights violations. In other words, although South Africa may lawfully limit business human rights for prospective employees, the UNGPs do not allow for different best practice interpretations.

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9 I Esser and JJ du Plessis 'The stakeholder debate and directors' fiduciary duties' (2007) *SA Merc Journal* 346; L Conradie 'More indulgent approach to directors' duties' (2008) *Without Prejudice* 14; D le Roux and G Hammond 'Directors owe a duty to the company, not to shareholders' (2018) *Without Prejudice* 12

10 P Muchlinski 'Beyond the guiding principles: Examining new calls for a legally binding instrument on business and human rights' http://www.ihrb.or/ommentar/ues/eyond-the-guiding-principles.html (accessed 1 July 2020); TY Shan 'What is sustainable development' https://sustainabilityx.co/what-is-sustainable-development-part-ii-1f514849de10 (accessed 15 December 2020).

To explain this more clearly, the European Parliament has issued a note on the UNGPs stating that the principle of best practice is soft law. While the note expresses the opinion that companies in other jurisdictions (or even member states of the European Union) will not be implementing best practices,[11] the United Nations Guiding Principles on Business and Human Rights, nevertheless, is a constitutive document of the UN Charter or Constitution. It should, therefore, not be interpreted as soft law but, at the very least, as persuasive law on why companies should be implementing best practices in their business activities.

Voluntary and mandatory commitment to include best practices as a fiduciary duty for directors in South Africa

To explain voluntary commitments, we will briefly refer to South Africa's Constitution. In the event that South Africa signs a treaty, it is, in customary international law, for all practical purposes bound by that treaty because of the principle of *pacta sunt servanda.* However, although South Africa signed the treaty on an international level (and South Africa is bound to that treaty on an international level), the treaty may have no legal effect as a result of its domestic or municipal law. Section 231(2) of the South African Constitution requires that a signed treaty be sent to Parliament (National Assembly) for final approval. This allows an opportunity for the National Assembly to

11 United Nations Guiding Principles on Human Rights, Principle 17 states: 'In order to identify, prevent, mitigate and account for how they address their adverse human rights impacts, business enterprises should carry out human rights due diligence. The process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed…'; O Martin-Ortega 'Human rights due diligence for corporations: From voluntary standards to hard law at last' (2014) *NETH. Q. HUM. Rts.* 49.

reconsider the legal implications of the signed treaty. It is, therefore, possible to reject a signed treaty. However, it could be argued that the UNGPs (or in other words, best practices) is part of *ius cogens*, the implication being that it cannot be rejected or amended by South Africa on a domestic level.[12]

Although reservations are also a valid method for rejecting part of a signed treaty, a reservation cannot be made on *ius cogens*. Accordingly, on an international level, all states must accept and promote the principles of business human rights. Although, on a domestic level, South Africa could use Section 36 of the Constitution to limit business human rights, the South African judiciary should take note of the application of the European Convention on Human Rights, where the European Court of Human Rights refused to accept reservations made by European Union member states as they frustrated the application of business human rights in practice.[13] In this regard, the UNGPs could be interpreted similarly by the Constitutional Court in South Africa to recognise the importance of best practices regarding business human rights.[14] Although the European Union was reluctant to negotiate on the legal terms of the UNGPs, the European Union did acknowledge that it should apply to all European Union companies, including, for example, insurance

12 J Dugard et al. Dugard's *International law, A South African perspective* (Juta 2020) 49-55 and 678.

13 J Bonnitcha and R McCorquodale 'The concept of due diligence in the UN Guiding Principles on Business and Human Rights' (2017) *European Journal of International Law* 899; Office of the High Commissioner for Human Rights (OHCHR) The Corporate Responsibility to Respect Human Rights: An Interpretive Guide, HR/PUB/12/02 (2012) https://www.ohchr.org/Documents/Publications/HR.PUB.12.2_En.pdf at 4 (accessed 1 March 2021).

14 R Moloney 'Incompatible reservations to human rights treaties: Severability and the problem of state consent' (2004) *Melbourne Journal of International Law* https://law.unimelb.edu.au/__data/assets/pdf_file/0010/1680427/Moloney.pdf (accessed 18 August 2021).

companies. Although an insurance company may sound irrelevant in the context of the protection of human rights, France has enacted law to hold French companies or their subsidiaries liable for (business) human rights violations committed in other jurisdictions.[15]

The following insurance company example explains the holding company–subsidiary implications in more detail (see also Chapter 3).

South Africa acknowledges Lloyd's of London as an insurer doing business in South Africa.[16] In this introduction, we will not discuss the legal requirements for Lloyd's to participate in regulated insurance business activities, for example, the requirements to obtain an insurance licence to operate as a Lloyd's insurer in South Africa.[17] Rather, in operating as an insurer in South Africa, Lloyd's uses a business model whereby a 'subsidiary', commonly known as a cover holder, is appointed to act as an 'insurer'. The cover holder performs certain cover holder functions on behalf of Lloyd's, for example, it collects monthly premiums from South African policy holders and accepts or rejects the payment of claims. As the Lloyd's cover holder could be classified as a type of 'subsidiary', it implies that Lloyd's in the UK would be responsible for any (business) human rights violations resulting from the business activities of the cover holder. However, this would only be possible if the UK had a similar approach to France in terms of which it held companies liable for human rights violations – even if those occurred in South Africa. (Chapter 3 discusses the relevance of Corporate Duty of Vigilance relevant to loss ratios).

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15 Duty of Vigilance of Parent and Instructing Companies, France. Law No. 2017-399 (27 March 2017).

16 Insurance Act 18 of 2017 s 1 defines Lloyd's of London; Duty of Vigilance of Parent and Instructing Companies, France. Law No. 2017-399 (27 March 2017).

17 S 6(2)(a).

In South Africa, why is it possible that a cover holder may violate human rights? The answer to this question is technical: Section 1 of the South African Insurance Act 18 of 2017 requires the transformation of the insurance sector in South Africa. Bearing in mind that transformation has included the dismissal (or non-appointment) of employees and directors based on their racial profile, can this be considered as best practice? Transformation may be done with good intentions, but when a French subsidiary company focuses on the Duty of Corporate Vigilance 2017, one could argue that transformation is contrary to the normative rules of international law. Although the UK where Lloyd's is situated has no similar Duty of Corporate Vigilance, there is still a possibility that the South African judiciary could take note of the UNGPs. It is doubtful whether a French holding company would be successful in raising a defence as to why it should not be liable to pay a 30 million euro fine to the French authorities because of lawful transformation practices in South Africa. Therefore, France leads European Union member states in showing commitment to the regulation of (business) human rights violations in the future.

Duty of care and due diligence from an international perspective

The United Nations Guiding Principles on Human Rights is simply an instrument that explains how human rights violations occur and how to report on those violations as part of financial integrated reporting.[18] Although the UNGPs is not a treaty per se, it remains an international standard for the way companies and their directors should be acting in promoting human rights. As explained earlier, best interests as a fiduciary duty are different from best practices. The UNGPs explain that companies should share their

18 J Bonnitcha and R McCorquodale 'The concept of due diligence in the UN Guiding Principles on Business and Human Rights' (2017) *European Journal of International Law* 899.

best practices with other companies – through integrated financial reporting – thus explaining to other companies how they could protect business human rights in their businesses and how they could remedy violations in the event of their occurrence. (See chapters 6 and 7 for examples).[19] This is possible if directors exercise their duty of (due) diligence to understand the legal framework of a state and how it relates to the UNGPs. (See Chapter 5 for a further example).[20]

One may argue that it is not necessary to include best practices as part of fiduciary duties in South Africa. Although South Africa is not yet a full member of the Organisation for Economic Co-operation and Development (OECD), the OECD Responsible Corporate Conduct explains how companies should apply due diligence in practice: 'Due diligence can help banks – as an example – prevent or address adverse impacts related to human and labour rights, the environment, and corruption associated with their clients as well as avoid financial and reputational risks.'[21]

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19 United Nations Fiduciary Duties for Directors in the 21st Century (2015) 14-16, 63 and 69; Guiding Principles on Business and Human Rights: Implementing the Protect, Respect and Remedy Framework HR/PUB/11/04 (2011) https://www.ohchr.org/documents/publications/GuidingprinciplesBusinesshr_eN.pdf (accessed 11 January 2021).

20 P Muchlinski 'Beyond the guiding principles: Examining new calls for a legally binding instrument on business and human rights' http://www.ihrb.or/ommentar/ues/eyond-the-guiding-principles.html (accessed 1 July 2020); TY Shan 'What is sustainable development' https://sustainabilityx.co/what-is-sustainable-development-part-ii-1f514849de10 (accessed 15 December 2020). BM Mupangavanhu 'Fiduciary duty and duty of care under the Companies Act 2008: Does South African law insist on the two duties being kept separate?' (2017) *Stellenbosch Law Review* 148.

21 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 3; J Calitz 'Section 417 and 418 of the Companies Act 61 of 1973 – Relevance prevailing over the right to privacy in *Gumede v Subel*

It would appear that this OECD document purposefully ignores the word 'care' since care is referred to only once when it is used in the following example: banks should take care not to disclose confidential client information.[22] It is, therefore, clear that this OECD document considers due diligence to be a phrase that does not include care or duty of care, although it does recommend how to interpret and apply due diligence in practice. For example, if an OECD financial institution (a bank) asks questions about whether a Lloyds' cover holder participates in transformation prior to transacting, in terms of the OECD's duty of due diligence the financial institution (bank) should not be conducting any business activities with that insurer or cover holder.[23] This illustrates the OECD's commitment to the way its financial institutions should respect human rights; that is, by implementing a required due diligence process, and how to avoid any business activities that violate business human rights.[24] Because South Africa is not yet a full member of the OECD, it could

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no 2006 3 SA 498(SCA)' (2006) *Obiter* 403; D Bilchitz 'The necessity for a business and human rights treaty' (2016) *Business and Human Rights Journal* 203-227; E de Wet and A du Plessis 'The meaning of certain substantive obligations distilled from international human rights instruments for constitutional environmental rights in South Africa' (2010) *African Human Rights Law Journal* 1.

22 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 57; BM Mupangavanhu 'Fiduciary duty and duty of care under the Companies Act 2008: Does South African law insist on the two duties being kept separate?' (2017) *Stellenbosch Law Review* 148.

23 D Bilchitz 'The necessity for a business and human rights treaty' (2016) *Business and Human Rights Journal* 203; E De Wet and A du Plessis 'The meaning of certain substantive obligations distilled from international human rights instruments for constitutional environmental rights in South Africa' (2010) *African Human Rights Law Journal* 1.

24 JL van Tonder 'A primer on the directors' oversight function as a standard of directors' conduct under the Companies Act 71 of 2008' (2018) *Obiter* 302.

be argued that due diligence in South Africa is only achieved when boards comply with South African laws –the Companies Act 2008. Nevertheless, Chapter 5 explains how due diligence could be achieved in practice.

United Nations report – Fiduciary Duty in the 21st Century

On reading the Foreword to the United Nations report, Fiduciary Duty in the 21st Century, written by the chair, Ms Corien Wortmann-Kool, of one of the world's largest pension funds – ABP Pension Fund – one finds an immediate reference to the importance of ESG (economic, social and [corporate] governance) as a method to explain the concept of fiduciary duties for directors in the 21st century. This pension fund (ABP) administers approximately 350 billion euros; to protect this fund it is important to invest in listed companies (or listed companies in other jurisdictions) that operate in stable state economies and/or in states with healthy sustainable social governance practices. The promotion of ESG principles is largely based on the explanation that companies (including listed companies) should be protecting their environment and their social relations, which includes company employees and their business human rights.

The United Nations *Fiduciary Duty in the 21st Century* explains fiduciary duties as follows: To avoid conflict of interest, balance the conflicting views of different beneficiaries, and act to the benefit of the company with care, skill and due diligence. This explanation is very similar to the explanation of fiduciary duties in the 2008 Act. What is interesting is the balancing duty – to balance the different views or interests of beneficiaries as a fiduciary duty. In this regard, beneficiaries could be pension fund beneficiaries (contributors to a fund) or company shareholders and perhaps also company employees or other stakeholders. In its simplest explanation of a balancing duty, if the contributor to a pension fund believes that the pension fund board should

invest in companies that promote ESG principles, the board must balance that view with its own investment views (see, for example, Chapter 6).

It is further generally assumed that companies whose business activities destroy the environment will not be sustainable in the long term; pension funds should, therefore, avoid investing in those companies since the beneficiaries' investments would have no future value. It could also imply that should a beneficiary die there could be conflicting views on the choice of successor or the recipient of their pension benefits. For example, a beneficiary lists his spouse on the beneficiary pension fund form to receive his benefits in the event of his death. Years later, the beneficiary marries a new spouse and neglects to amend the beneficiary form. Who then is entitled to receive the proceeds? Under these circumstances, the pension fund board may exercise a balancing act to accommodate both the previous and current spouse as beneficiaries. The South African pension fund legislation, the Pension Fund Act of 1956, stipulates the fiduciary duties of board members; these duties differ from the company fiduciary duties. In terms of the 1956 Act sections 7C and 7C(2)(F) requires the pension fund board members to act with care, skill, diligence, best interest, good faith (honesty); to act with impartiality towards beneficiaries; and to act independently and comply with any other prescribed requirement.[25] The other prescribed requirement could be a balancing duty included in the pension fund rules. It is more difficult to think of suitable examples in company law on how directors should balance the conflicting views of shareholders, company employees or public – different classes of shareholders exist in the same company and companies may have more than one employee trade union or other stakeholders. In this regard, see chapters 2, 3 and 4.[26]

25 United Nations Fiduciary Duties for Directors in the 21st Century (2015) 7.

26 M Sigwadi 'The personal liability of pension fund trustees for breach of fiduciary duties' (2008) *SA Merc Journal* 331.

Generally, the 2008 Act provides for the regulation of oppressive conduct between minority and majority shareholders and labour legislation to resolve conflicts between companies and trade unions. It is not necessary to add a balancing duty as a fiduciary duty owing to the application of different legislation. However, one may argue that the balancing of different views could also be similar to the duty of best practices.

The United Nations *Fiduciary Duty in the 21st Century* poses the following questions pertaining to the balancing duty: Should shareholders or beneficiaries (or company employees) take account of ESG disclosures before investing? Should shareholders or beneficiaries (or company employees) encourage companies or pension funds to comply with the higher standards of ESG? Should shareholders or beneficiaries (or company employees) have a duty to support the stability of an economy? Should shareholders or beneficiaries (or company employees) respond to climate change? To answer these questions, the report contains brief state-specific observations on the above questions. Their survey included South Africa. We will focus briefly on two questions and possible answers to those questions from a best practice perspective.

Firstly, should shareholders or beneficiaries (or company employees) take account of ESG disclosures before investing?

Shareholders have no fiduciary duty towards the company. A shareholder can buy and sell shares in a company purely for speculative purposes, regardless of whether that company complies with ESG. The question posed by the United Nations *Fiduciary Duty in the 21st Century* is actually whether shareholders have a duty to take note of ESG or more specifically the social relations leg of ESG that relates to human rights abuses or violations (see Chapter 7). In cases where the shareholder is a company, the board of directors of that company must complete a due diligence process to ascertain whether the company to be invested in respects human rights (social relations) and the environment, among other things. In this regard, a shareholder has a duty

which is the result of fiduciary duty. The same applies to pension funds that are shareholders in various listed companies. In this case, the pension board must consider whether or not a company to be invested in understands the purpose of ESG disclosures. If not, the pension fund should not invest in that company. The same could be relevant to shareholders who are not companies. The UNGPs use best practices, that is, not to act in the best interests of the company but in the 'best interests' of the public. In other words, it could be part of a fiduciary duty that companies should only sell shares to human beings or natural persons if their business activities meet the best practices requirement. For example, only companies that are protecting the environment and other business human rights should be selling shares to those shareholders. In this way, a natural person would be buying shares from a company that acts in his or her best interests. If this interpretation of best practices is correct, it means that companies that are destroying the environment, for example, should not be selling shares to natural persons in future because they breached the duty of best practices.

The second question is whether shareholders or beneficiaries (or company employees) have a duty to support the stability of an economy.

What is important here is the best practices explained in the UNGPs on Human Rights. As stated previously, this duty entails the interests of the public or what practices will benefit the public. (Chapter 2 discusses possible remedies for violations of business human rights). Accordingly, if a company complies with best practices then it is possible to argue that the shareholders or company employees will be transacting with a company that looks after their interests. To explain it differently, if an employee is employed by a company that follows the principles of best practice(s), the employee is supporting a stable economy. If the employee refuses to work for a company

that does not follow the principles of best practices, then the employee is also supporting a sustainable economy in the long run.[27]

Final remarks and the relevance of best practices to the chapters in this book

On page 24 of *Fiduciary Duty in the 21st Century*, an emphasis is placed on public interest that could be explained by the duty of best practices. Both listed companies and other companies will be required to disclose more ESG information in future. The United Nations' report is the first step towards understanding the relevance of best practices as a future fiduciary duty. Only time will tell how local jurisdictions such as South Africa should be applying this duty to promote acceptable social relations as part of ESG.[28]

Overview of the book chapters

This section provides an overview of the book chapters.

Chapter 1 describes how Santam/Sanlam promoted the South African economy by applying the principles of good corporate governance. The board of directors held daily meetings with employees as a way of overseeing its business operations in the company and making decisions in the company's best interests. At the time, Santam was not successful in selling policies in either the Free State or Transvaal. However, it subsequently acquired a 60% control in the South African Board of Executors and Trust Company, allowing it to sell its policies directly to the Free State public. A few years later the South African Board of Executors and Trust Company

27 United Nations Fiduciary Duties for Directors in the 21st Century (2015) 7.

28 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 3. King refers to ESG as ESE – economy, society and the environment.

suffered severe financial losses, and a shareholder proposed liquidation for Santam. This did not happen, but Santam took the unprecedented decision to repay shareholders' share investments; in other words, to refund Santam shareholders as a result of this poor business decision. It is clear that Santam recognised social relations in the 1920s and sought to protect them. This repayment could also be viewed as part of best practices.

Chapter 2 deals with the Organisation for Economic and Cooperation Development (OECD) reports and documents and whether the South African domestic law complies with these reports. Although this chapter focuses on relevant OECD documents, South Africa is not yet an OECD member. Nevertheless, the OECD documents are relevant to our discussion. It should be borne in mind that there is currently no OECD report available for instances where a company is listed on more than one exchange – dual listing. In this regard, Switzerland's exchange (SWX) requires listed companies to explain whether companies have contravened the law relevant to another exchange. G20 countries can enter into treaties on how exchanges should be communicating with each other and how listed companies should be reported on. An example would be investigations initiated by a state relevant to the business activities of a dual-listed company. This form of transparency will allow the market to value the shares of a dual-listed company fairly. It often happens that the share price of a company decreases as a result of state investigations on one exchange but remains unaffected on another. Since the Johannesburg Stock Exchange Ltd (JSE) is a public company, it could be argued that the directors of the JSE are also subject to the duty of best practices – it is in the interests of the public to read transparent information about companies' dual listing business activities/investigations.

Chapter 3 focuses on cell captive insurance from a South African perspective. A cell captive insurer could be a binder holder, for example, an underwriting manager, who obtains shares in an insurer that are ring-fenced. In this respect, the underwriting manager will receive a dividend from the insurer based on

the profitability of the underwriting manager evidenced by the ring-fenced shares. If the insurer were unprofitable, it would not affect the profitability of that underwriting manager. On the other hand, an underwriting manager can share in the profits of the insurer without having any shares – a normal binder-holder relationship. It is also possible to require an underwriting manager to contribute to the financial losses suffered by the insurer as a result of poor underwriting performance. The determination of poor financial performance is based on a loss ratio formula, a formula that is also relevant to cell captive insurers. When an insurer wishes to include a cell captive relationship or underwriting manager relationship, due diligence is required to understand the profitability of these relationships. If the insurer continues with the relationship and the underwriting manager is ultimately extremely unprofitable, best practice requires that the insurer or its board assist the underwriting manager to become profitable in future.

Pension funds in South Africa are very large and are comparable to or even larger than such funds in most European countries in fund value. Pension funds are also complex businesses since most make use of fund managers to invest fund money in appropriate listed companies. For this reason, a clear contract should exist between the pension fund and the fund manager to invest only in ESG-compliant companies. It is recommended that the fund rules between the pension fund and its contributors also contain a clause that the pension fund will only invest in ESG listed companies. From a legal perspective, these two separate contracts – between the fund and the fund manager and between the fund and its contributors – promote best practices. As Chapter 4 points out, frequent communication between the fund and its contributors is required to complement the best practices duty.

Chapter 5 deals with the duty of due diligence and uses a practical example of a Norwegian company. A newly appointed CEO, who had experience in financial markets only, tried to make the Norwegian company corruption-free and introduced more sustainable business practices. Those employees

or stakeholders who did not agree with the new business activities either resigned or rejected their business relationships. Keeping best practice in mind, it should be expected that the Norwegian company would eventually dismiss employees not willing to work for a company that uses sustainable practices or to terminate relationships with other stakeholders who are unable to accept these new practices. Although this chapter does not explain best practices, it refers to new international developments and instruments to promote sustainable business practices in future.

Chapter 6 is one of the first publications in South Africa on ESG. To quote directly from the chapter:

> Having undertaken empirical research on ESG reporting in China, Weber concluded that [t]he combination of high ESG performance and transparent reporting leads to higher market returns for sustainable corporations and therefore creates a win-win situation for both shareholders and sustainable development.

In future, we believe that ESG will be part of mandatory legislation, and not merely part of King IV on corporate governance as part of voluntary compliance. The future requires more and more companies to be ESG compliant – climate change is a major reason of why boards of directors should consider ESG disclosures to attract future investors (either shareholders as natural persons or pension funds as legal persons). If a listed company is not ESG compliant, a pension fund may refuse to invest in that company owing to its unsustainable business practices. This chapter uses relevant case law to explain the difficult concept in an understandable way.

In the case of *BP Southern Africa (Pty) Ltd v MEC for Agriculture, Conservation and Land Affairs* (*BP Southern Africa*) 2004 (5) SA 124 (W) at 125, the court held the following:

> [P]ure economic principles will no longer determine in an unbridled fashion whether a development is acceptable. Development, which may be regarded as economically and financially sound, will in future be balanced by its environmental impact, taking coherent cognisance of the principle of intergenerational equity and sustainable use of resources to arrive at integrated management of the environment, sustainable development and socioeconomic concerns.

Chapter 7 is based on the explanation of director duties as presented in Chapter 6 and explains the concept of best practices as a future director's duty to promote the significant arguments as proposed in that chapter.

The chapter states that 'while they set principles for environmental governance, international environmental agreements are yet to settle the issue of where international environmental liability lies, as the practice is that state laws apply. This failure to have an international framework that regulates environmental liability for corporations mirrors the status quo in the general human rights system, where piercing the corporate veil is seemingly impossible as companies have their subsidiaries registered/ incorporated where they operate. That is not to say national systems cannot play a role in at least regulating or punishing corporations that violate environmental laws or renege on environmental responsibilities.'

This is a clear indication that states may punish companies even if international instruments are not regarded as law in that particular state. Accordingly, a state should show a willingness to ratify ESG principles since this will benefit any state in the long term. A practical explanation could be France and how the French government has produced civil law to promote ESG, specifically social relations. France has consequently avoided an international debate while many other states are arguing why they should not be implementing international instruments promoting ESG (social relations leg relevant to business human rights) because they are not law.

CHAPTER 1

Foundations for the future: Corporate citizenship, sustainability, and the national economic advancement of businesses

Grietjie Verhoef

1.1 Introduction to Santam and Sanlam from 1918-2018

Santam commenced trading on 1 May 1918 and established Sanlam as a subsidiary a month later. From the start, the company championed a framework of corporate citizenship, corporate governance, and stakeholder and national economic sustainability. This chapter examines the inclusion of the principles associated with good corporate governance reflected in the *King IV: Report on Corporate Governance for South Africa* (King IV)[1] during the Santam/Sanlam formative years. These principles are followed voluntarily by contemporary businesses and integrated into their business strategies. It will be seen that from their inception Santam/Sanlam embraced the principles of good corporate governance long before they were promoted by any code or document. This historical investigation of the Santam/Sanlam business model explains the foundation of successful early South African businesses and how their strategies promoted the economy of the Union of South Africa and the needs of their policyholders.

1 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016).

King IV describes the changing world of the 21st century as being characterised by financial instability, environmental abuse and the explosion of mass communication technology requiring full transparency of disclosures for investors; for example, the publication of documentation confirming for instance their environmentally friendly practices as investment risk decisions.[2] This context is remarkably similar to the business attitude displayed by Santam/Sanlam in the early decades of the 20th century. At the time of the company's establishment in 1918, the international community had entered the slump that followed the First World War and investors needed complex information to make informed investment decisions. Total war expenditure amounted to $208.5 billion. This cost, as well as the loss of 20 million military and civilian lives and a similar number of people disabled, made any investment a high-risk decision. Reconstruction of the devastated national economies and the human and natural environments progressed slowly, as the post-war depression delayed recovery from the man-made destruction. Then followed the Great Depression of 1929–1933, the greatest peacetime breakdown in the world economy since the start of the Second Industrial Revolution in 1870.[3]

In 1920, the Union of South Africa became one of the original sixty signatories in the formation of the international community known as the League of Nations, which was superseded by the United Nations following the Second World War. The international status of South Africa may be inferred by its status as a member of the Security Council of the League of Nations, just as today France, China, Russia, the United States and the United Kingdom comprise the Security Council of the United Nations.

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2 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 3.

3 R Skidelsky 'The growth of a world economy' in M Howard and WR Louis (eds) *The Oxford history of the twentieth century* (Oxford University Press 1998) 52-53 and 56; N Ferguson *The pity of war* (Penguin Books London 1999) 337.

The Union of South Africa had lost 12 452 lives in combat during the First World War. This economic disruption was also preceded by persistent droughts after the Anglo-Boer War of 1899–1902.

The cumulative effect of these two wars, separated by roughly two decades, called for responsible, dedicated business leadership to promote any form of economic activity in South Africa. The resultant national impact of the two wars can be seen in the abject poverty of 300 000 members of the Afrikaans-speaking community. The Afrikaner reconstruction strategy was to choose free enterprise capitalism as a method to rebuild the future. The credo back then was 'business is good because it creates value, it is ethical because it is based on voluntary exchange, it is noble because it can elevate our existence, and it is heroic because it lifts people out of poverty and creates prosperity.' This was echoed in the community's business strategy for reconstruction.[4] From within this demoralised community, the community leaders implemented a business strategy that would pull the community out of its financial misery.[5]

As part of a comprehensive economic recovery strategy, Afrikaans-speaking community leaders provided the capital to establish several businesses owned by Afrikaans-speaking South Africans. These included *De Nasionale Pers* (National Press) in 1915, today known as Naspers, which published the newspaper *De Burger* (*The Citizen*), followed by Santam (Suid-Afrikaanse Nasionale Trust en Assuransie Maatskappij) in March 1918 and Sanlam (Suid-Afrikaanse Nasionale Lewens Assuransie Maatskappij) in June 1918.

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4 J Mackey and R Sisodia *Conscious capitalism* (Harvard Business Review Press Boston 2013) 273; Union of South Africa, Official Year Book: Various Years 1910–1925 (Government Printers Pretoria 1925); Western Cape Archives *WCA CCP/189-1909 Official Year Book 1910-1924*, 1935.

5 J Mackey and R Sisodia *Conscious capitalism* (Harvard Business Review Press Boston 2013) 47; H Giliomee *The Afrikaners: A biography of a people* (Cape Town Tafelberg 2003) 99.

The emphasis on 'free enterprise capitalism' governed the fundamental principles associated with sound corporate governance to sustain the economic viability of a business. In 1915, these business leaders adopted the values of accountability, corporate governance, fairness, ethics and integrity in their management and oversight of their businesses. As a direct result of the Ekonomiese Volkskongres (People's Economic Congress) of 1939, businesses diversified into a broader range of the Union's economic sectors. This congress promoted an initiative to create various business enterprises in several key sectors of the economy; for example, Federale Volksbeleggings (Federal People's Investment), Federale Mynboumaatskappy (Federal Mining Company), Saambou Bank/Saambou Bouvereniging (Saambou Bank/Saambou Building Society) and numerous retail enterprises including Uniewinkels, Marine Products, Voorbrand Tabakkorporasie (the forerunner of Rembrandt Tobacco) and the agricultural cooperative, Koöperatiwe Wijnbouersvereniging (Cape Wine Farmers' Cooperative), which was destined to become the internationally renowned KWV.[6] Within the Afrikaans-speaking community, this shared strategy motivated a general drive to recover financially from the economic effects of the two wars through creative entrepreneurship.

These initiatives positioned the Afrikaans-speaking community at the heart of the emergent post-World War Two South African economy. Certain politicians and commentators expressed widespread criticism and distrust of these business initiatives, claiming that the Afrikaans-speaking community was inherently a community of farmers and was, therefore, qualified to

6 H Giliomee *The Afrikaners: A biography of a people* (Cape Town Tafelberg 2003) 434-438; E Domisse *Anton Rupert: 'n Lewensverhaal* (Cape Town Tafelberg 2005) 67-71; G Verhoef *The power of your life: The Sanlam century of insurance empowerment* 1918-2018 (Oxford University Press Oxford 2018) 48-51, 80-86.

succeed only in agricultural commerce.[7] The successful implementation of creative strategies to address poverty through various entrepreneurial business enterprises in selected economic sectors is testimony to the sound business skills and leadership that had emerged in the community. For example, the far-sighted management and operational practices of Santam/ Sanlam a century ago illustrate the organisational values and principles underlying good corporate governance practices as a business tool to achieve socioeconomic development by promoting sustainable insurance and an economy attracting investment in South Africa. This chapter illustrates contemporary good corporate governance principles as they pertain to Santam and Sanlam.

1.2 The business purpose

At the beginning of the third decade of the 20th century, a large portion of the white population of the Union of South Africa, particularly the Afrikaans-speaking community, was confronted by a dire socioeconomic situation. Private enterprises served a dual economic purpose: firstly, to offer sound investment opportunities to individuals as proposed 'shareholders', and secondly, to improve the prospects for economic growth and the achievement of economic prosperity for the Union.[8] As editor of the newspaper, *De Burger*, a future prime minister, Dr DF Malan, advocated economic empowerment. He argued that if a group of people could secure economic sustainability, those strategies would also enable political and

7 H Giliomee *The Afrikaners: A biography of a people (*Cape Town Tafelberg 2003) 348, 435; G. Verhoef *The power of your life: The Sanlam century of insurance empowerment* 1918-2018 (Oxford University Press Oxford 2018) 113.

8 NJ le Roux *WA Hofmeyr: Sy werk en waarde* (Nasionale Boekhandel Cape Town 1953) 199.

social sustainability for the whole nation.[9] Growing pressure for the recognition of Afrikaans as an official national language was an important aspect incorporated into the shaping of the new insurance company as it strove to promote the power of savings among citizens as the means for national economic growth and prosperity. Leaders in commerce embraced the underlying principles of the present King IV, namely that business organisations form an integral part of society through the promotion of active stakeholder inclusivity and corporate citizenship.[10] The first newspaper advertisement referred to the establishment of Santam as 'a triumph for South Africa', because a truly South African company offered all classes of insurance and trust products to all South Africans. MacDowall motivated the Santam call in the following words:

> *Een van ons sterkste punte is dat die Maatskappij suiwer Suid-Afrikaans is. Ons leuse is 'Suid-Afrika eerste'. Ons streef na gesonde besigheidsmetodes, eerlike rondborstige behandeling teenoor ons kliënte. Onse beste dienste en advies word altijd aan iedereen wat daarvan gebruik wil maak, toegestaan.*[11]
>
> (One of our strongest points is that the company is purely South African. Our motto is 'South Africa first'. We strive for sound business practices and honest, straightforward treatment of our customers. We offer our best service and advice to anyone who wants to make use of it).

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9 N J Le Roux *W A Hofmeyr: Sy werk en waarde* (Nasionale Boekhandel Cape Town 1953) 123.

10 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 23.

11 Sanlam Archives *Sanlam's Chairman Report* 6/5/1991; Sanlam Archives *MacDowall letter to PWA de Klerk* 23/10/1919.

Santam's purpose was to insure South Africa's citizens:

> It is our aim, not only to build [the economy] rapidly but to build a solid [economic] foundation … it is our aim to assist in the development of our country using the money entrusted to us. What a pleasant thought to policyholders that they contribute to the development of the country.[12]

1.3 The business vehicle

By 1918, a vibrant insurance market existed in South Africa. In 1910, the date of the formation of the Union of South Africa, there were 74 insurance companies in operation across the country, 15 of which were exclusively South African-owned or locally registered.[13] Between 1911 and 1915, insurance policy premiums collected in the Cape Province rose by 26.6%. This growth was experienced primarily by the five local insurance companies in the Cape Province, which collectively accounted for 60.7% of that growth. In 1918, the year of the opening of Santam/Sanlam, foreign-registered short-term insurers collected almost 73% of insurance premiums, with 44 of the overall 74 companies preferring to position their head offices in the Union. While the conventional view suggests that this scenario posed a market risk, here was a golden marketing opportunity for the true entrepreneurial spirit. The industry was highly profitable with an average loss ratio of approximately 69%.[14] As Santam/Sanlam entered the market, the success of the company

12 Sanlam Archives *Sanlam's Chairman Report* 22/12/1920; Sanlam Archives *Sanlam's Chairman Report* 21/12/1921, 30/09/1934 and 30/09/1925.

13 Western Cape Archives *CCP/1890-1909 Official Year Book 1910-1924*, 1935; Western Cape Archives *CCP/1890-1909>Annual Submissions by Insurance Companies*; Union of South Africa, Official Year Book 1910: Various Years 1910-1925 (Government Printer Pretoria 1925).

14 Western Cape Archives *CCP/1890-1909>Annual Submissions by Insurance Companies*; Union of South Africa, Official Year Book 1910: Various Years 1910-1925 (Government Printer Pretoria 1925) 841.

was dependent on two risks: attaining the necessary capital to float an insurance venture successfully, and the uncovering of directors with the insights and skills to achieve sustainability in the highly competitive business of insurance.

The founding members (incorporators) of Santam addressed the quality of directors by focusing on their occupational backgrounds.[15] Appointments to the initial board of directors comprised several lawyers and an accountant, all possessing sound business sensibilities. WA Hofmeyr, the son of a Dutch Reformed Church (DRC) dominee (church minister) practised as a lawyer. PA Malan was also a lawyer, practising in Bloemfontein, and had raised the idea of an Afrikaans-owned insurance company to Hofmeyr, who operated as his attorney-correspondent in Cape Town. Hofmeyr in turn had recruited FH Dormehl, a local Cape accountant, businessman and activist for the recognition of the Afrikaans language. Dormehl had obtained valuable local market insurance experience from his professional activities on behalf of several foreign insurance companies operating at the Cape at that time. The final appointment to the initial board, Hofmeyr, engaged AFJ Benning, a Dutch immigrant, businessman, and owner of a construction company. A third lawyer, CR Louw, also the son of a DRC dominee, had a practice in Pretoria but had relocated to the Cape after the Anglo-Boer War to set up a new business.[16] Thereafter, Alfred MacDowall, a Scottish immigrant to the Cape, who had married Miss de Vaal (an Afrikaans woman) and had been employed by Standard Bank and the General Accident Insurance Company as an accountant, was appointed as an additional member of the board of directors. As a businessman, MacDowall had been impressed by the ability

15 JG Verhoef 'Nationalism, social capital and economic empowerment: SANLAM and the economic upliftment of the Afrikaner people, 1918–1960' (2008) *Business History, Special Issue: Putting Social Capital to Work* 694-713.

16 J Venter and CJ Louw *South African biographical dictionary* (Pretoria Human Sciences Research Council 1987) 495-497.

of members of the Helpmekaar (Support One Another) movement to obtain deposits from the Afrikaans-speaking community to support the financial needs of families of prisoners serving time for their participation in the rebellion of 1914 that opposed the Union's active support of Great Britain in the First World War.[17]

Several founding Santam leaders studied at Victoria College (forerunner of the University of Stellenbosch); namely, WA Hofmeyr, CR Louw, PA Malan, and the company's first Afrikaans-speaking actuary, MS Louw. Several shared a similar religious affiliation; in addition to Hofmeyr and Louw being sons of DRC dominees, FH Dormehl had married a DRC dominee's daughter, and Louw's maternal grandfather was the Rev. Andrew Murray Jr, a prominent founder of the DRC in the Cape.[18]

On a historical and socio-cultural level, WA Hofmeyr, CR Louw, and CG Fichardt, a prominent Free State business leader active in the groundwork to establish Santam nationally, had all fought in the Anglo-Boer War under General JBM (Barry) Hertzog and chose to remain faithful to supporting Hertzog's declaration of neutrality, based on the need to consider the economic needs of the Union of South Africa first. Such socioeconomic values served Santam as the principles relevant to good corporate governance. For example, the sharing of common religious practices is captured to a degree in the King IV definition of business ethics as follows: 'Considering what is good and right for the self and the other and can be expressed in terms of the golden rule, namely, to treat others as you would like to be treated yourself.' In the context of organisations, 'ethics' refers to ethical values applied to

17 Sanlam Archives *Biography of MacDowall* 6/6/1; Sanlam Archives *Interview with P A Malan* 6/1/5.

18 Y Hagedorn-Hansen 'The transformation of the South African short-term insurance industry: The case of Santam 1919-2011' Unpublished PhD thesis, University of Johannesburg, 2016 75; JH Hofmeyr *Het leven van Jan Hendrik Hofmeyr (Onze Jan)* (Van de Sandt Villiers Publishers Cape Town 1913) 44.

business decision-making conduct and the ethical relationships between the enterprise, its stakeholders and the economy of South Africa.[19]

FH (Fred) Dormehl became the first managing director of Santam. He was an experienced insurance specialist, having worked for the London and Lancashire Insurance Company Ltd and thereafter for Alliance Insurance Company in Cape Town. To establish expertise in the Santam operational sphere, the board appointed several additional experienced and proven insurance professionals.

The English-speaking Scotsman, Alfred MacDowall, who had prior advanced banking and insurance experience became the first Santam general manager, and also filled the role of the company secretary. Initially an employee of Standard Bank, Boksburg, he had joined the General Accident Fire and Life Assurance Corporation in Cape Town in 1911 and his expert knowledge was instrumental in registering Santam. Following twelve meetings preceding the registration, he compiled the prospectus inviting members of the public from all four provinces of the Union to acquire shares in Santam.[20] MacDowall also played a key role in instituting the sound, interrelated departmentally structured administrative procedures essential to a successful insurance company. Differences of opinion with other members of the board led to his early departure in 1920.[21] With reference to these initial Santam

19 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 42.

20 Sanlam Archives *Santam Board of Directors Minute Book No 1*; Sanlam Archives *WJ Bezuidenhout* 6/1/1/5.

21 G Verhoef and A Drotskie 'Sustained in a competitive environment: Organizational capabilities and Sanlam, 1918-1945' (2015) *Management and Organizational History* 256; W Beukes, A Ehlers and G Verhoef 'Sanlam-amptenare uit die volk gebore om die volk te dien?' (2018) *Tydskrif vir Geesteswetenskappe* 11, 12.

appointments, King IV requires that members of a board will have acquired a sufficient working knowledge of the industry in which the enterprise operates, as well as the relevant administrative procedures of the business, as per the above example of MacDowall's drafting of the prospectus, which, at the very minimum, demanded a thorough knowledge of how to comply with the legal requirements for the allotment of shares to the public.[22]

Following the Santam/Sanlam company mission to alleviate poverty and economic development, two additional English-speaking people were appointed to the management team, both experts in their fields of specialisation. George Paterson, another Scot, who had served as an actuary to the African Homes Trust (AHT) after his arrival in South Africa, was appointed as the first actuary. Within a few months of its inception, Santam bought the AHT, an insurance company operating at the lower end of the market, to assist policyholders in accumulating security towards a mortgage on immovable properties (for example, to acquire a home). No sooner had Santam acquired a controlling stake in AHT than Paterson was appointed as actuary and accountant at both Santam and Sanlam.[23] Paterson established the crucial actuarial function in the two companies towards the end of 1918 but left at the end of 1919, having displayed a poor aptitude for establishing systematic operating routines and firm management conduct.[24] The founding members valued Paterson's professional capabilities but in the interests of

22 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 42; The legal requirements for a prospectus in Transvaal were regulated in s 79 of the Companies Act 31 of 1909.

23 Actuaries of South Africa, volume 1 (1920) 1; Sanlam Archives *Actuaries of South Africa* 6/5/1; Sanlam Archives *Sanlam Board of Directors minutes* 5/1/1919.

24 Sanlam Archives *Life of CR Louw,* Description of His Life 6/5/1; Western Cape Archives *Staff: G W Paterson Actuary* 144.

the company decided to appoint MS Louw, who in 1920 had qualified as the first Afrikaans-speaking Fellow of the Faculty of Actuaries (FFA) in Edinburgh.[25] By employing key qualified people from its inauguration, the Santam board manifested compliance with the principle of King IV that a board of directors is obliged to act in the best interests of the company in every decision.[26]

The search for expertise outweighed the option to employ only Afrikaans-speakers in the newly established companies. A London-born Jewess, Sarah Goldblatt, was appointed marketing officer for the Life Division of Santam, which within a month would form the core of Sanlam. Her role was to identify prospective clients and despatch Sanlam agents to visit them to conclude insurance contracts.[27] Having displayed on her arrival in South Africa an immediate aptitude for the Afrikaans language, she was able to perform all the necessary language editing and translating of official publications and letters to be circulated to policyholders.[28] In the same vein the Sanlam Board appointed Dr HD Max Ackermann as chief medical officer to provide the best professional medical advice available for underwriting purposes.

King IV requires that a board of directors must ensure that their aggregated knowledge covers the industry in which the business operates. The majority of the new employees of Santam/Sanlam were indeed Afrikaans-speaking South Africans, but the business imperative mandated the appointment of people with appropriate qualifications, proven skills and the drive to succeed

25 G Verhoef and A Drotskie 'Sustained in a competitive environment: Organizational capabilities and Sanlam, 1918-1945' (2015) *Management and Organizational History* 256-257.

26 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 43.

27 Sanlam Archives *Santam Board Directors Minute Book* 6/9/1918.

28 Sanlam Archives *Die Fakkel* 13/06/1975.

as a matter of priority. Dutch-born Harry van Dam first immigrated to Australia before joining Sanlam in 1918. Though more proficient in English, he rose to the post of assistant agency manager of the Cape Province and became the editor of the Sanlam staff magazine, *Die Fakkel* (The Torch). At Sanlam national meetings he often addressed Sanlam agents in English because he simply felt more comfortable doing so.[29] Numerous English-speaking South Africans applied successfully for employment as Sanlam agents. Cedric Baker declared on his application form that he did not speak Afrikaans well, as it was not one of his school subjects. Nonetheless, Baker was appointed, rose to hold several senior positions and retired as secretary (in the Claims Department) in May 1965.[30] In Pretoria, Alexander Duncan Struthers showed outstanding productivity and an exemplary attitude as an English-speaking agent, accepting the constraints of inferior public transport as part of his profession.[31]

Santam appointed Irish-born IC Scott-Hayward, previously an employee of the London & Lancashire Insurance Company, as accident manager. Scott-Hayward was outspoken about the prejudices encountered by South African-born employees in competing for positions in the upper echelons of business in their native country: 'At this time there was no senior place for any Colonial, irrespective of language group, in any bank or insurance company, for these avenues of employment were the close preserves of overseas-born

29 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 43; Sanlam Archives *Die Fakkel* 01/12/1933; Sanlam Archives *Sanlam Board Directors Minute Book* 29/07/1918.

30 Sanlam Archives *C Baker* 6/5/1; Sanlam Archives *Die Fakkel* 01/10/1949; Sanlam Archives *Die Fakkel* 01/013/1965.

31 Sanlam Archives *Die Fakkel* 01/09/1948.

men.'[32] This simply meant that people born in South Africa could not then occupy managerial positions in either the insurance or banking sectors, while 'colonial' referred to both English- and Afrikaans-speakers born in South Africa. Scott-Hayward continued that this state of affairs, for example, that managerial positions could not be occupied by persons born in South Africa, offended his sense of justice. These injustices motivated him to teach South-African born men from both language groups 'all I could'. At that time, SJP West brought along experience from the London & Lancashire when he joined as Santam fire manager – a position from which he was promoted to General Manager: Accidents in Santam. West's association with Santam was particularly significant since he had enjoyed a respected position in the fire insurance industry in the Cape Province and had served on the executive committee of the Fire Insurance Association of Cape Town, as well as being a member of the Council of the Insurance Institute of the Cape of Good Hope.[33] By supporting the company's purpose from its inception, the Santam/Sanlam public image reflected a broad South Africanism that transcended the objective of uplifting the impoverished sectors of the Afrikaans-speaking community.

1.4 Capital risk – shareholders

Raising capital for Santam/Sanlam was part of an explicit strategy to position the company as a South African enterprise among the predominantly English and foreign-owned insurance companies in the Cape Province. The Union of South Africa consisted of four provinces, each regulated to a certain extent

32 Sanlam Archives *Santam Board Directors Minute Book* 6/5/1919; Sanlam Archives *Die Fakkel* 07/05/1936; Sanlam Archives *Die Fakkel* 01/09/1948; *Die Burger* 03/09/1932.

33 Author Unknown *Insurance, Banking and Finance* (Unknown Publisher 1925) 17.

by a separate Companies Act. For example, Section 69(1) of the Transvaal Companies Act 31 of 1909 regulated the keeping of minutes of general meetings and contained no requirements to keep minutes for annual general meetings (AGMs). Nevertheless, it was Santam/Sanlam policy to keep AGM minutes on a level which meets the requirements of King IV from a contemporary perspective. Hofmeyr was adamant that Santam/Sanlam would not be 'another transmission agency for an overseas head office'.[34] By this he was referring to a foreign branch of the insurer conducting the business of insurance in South Africa, currently regulated by the Insurance Act 2017. Essentially, it was the ownership of shares by members of the public that defined Santam/Sanlam as a truly South African 'owned' insurer.

The sale of shares was directed by Santam's first 'agency manager', JH Harris, a member of the South African Jewish community. Harris and other Santam/Sanlam agents marketed Santam shares and insurance policies through a network of 'legal practitioners, trusts, notaries and boards of executors' before the physical establishment of different Santam agency offices in the Union of South Africa. The latter is in line with King IV, which states: '[boards of directors] should exercise courage in taking risks and capturing opportunities but do so in a responsible manner and in the best interests of

34 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 43. It is in the best interests of any enterprise to keep all minutes of all relevant meetings; Companies Act 31 of 1909 s 69(1) states: 'Every company shall cause minutes of all proceedings of general meetings and (where there are directors or managers) of its directors or managers to be entered in books kept for that purpose'; S 99 is relevant to annual general meetings when appointing auditors for the company, and perhaps minutes were also made even though not required by the Act 1909. The Cape Province was subject to company legislation other than Act 1909. King IV relates to ethical business practices, which implies the keeping of minutes of any meeting; Sanlam Archives *Minutes of Santam Annual General Meeting* 21/12/1919.

the company.' By making use of attorneys, for example, the selling of those shares was done responsibly. This network was primarily situated in the platteland or rural areas of the Orange Free State, Transvaal and the Cape Province. The highest concentration of shareholders occurred in the towns of the Western Cape and Boland, as well as in the larger urban centres such as Bloemfontein, Kimberley and Pretoria. Santam shares were marketed by a registered prospectus as 'an investment' in the insurer, not intended for 'share speculation', which was often the case with mining company shares. Harris vacated his position in June 1918, by which time he had sold 40 000 shares. A total of 52 000 Santam shares had been sold by 13 April 1918.[35] Shareholders received two voting rights for every 25 shares owned, but this ratio was later adjusted to ten voting rights for 5 100 shares owned.[36] In June 1919, the board decided not to issue any further shares, but to rather hold 20 000 shares for three months at nominal or par value for distribution in the provinces of Transvaal and Orange Free State.[37] The successful mobilisation of public interest in the new insurance company gave Santam access to £104 809 paid-up issued share capital in exchange for 173 050 issued shares out of a total authorised share capital of 200 000 shares. The share capital of Santam remained stable at £42 027.10 from 1918 to 1948.[38]

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35 Sanlam Archives *Santampos* (1959) 2.

36 Santam Articles of Association (1918) 20-22.

37 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 43; Sanlam Archives *Sanlam Board of Directors Minute Book* 06/05/1919.

38 Act 31 of 1909, s 79(5) interestingly states the following for a prospectus in Transvaal: 'Where any such prospectus as is mentioned in this section is published as a newspaper advertisement, it shall not be necessary to specify

Local investor confidence in Santam was high when one considers the volatility of the early decades of the 1900s. To reduce the risk associated with issued shares, Santam's board used the share capital to invest in low-risk investment products such as subsidiaries Sanlam and AHT and issued low-risk mortgages to policyholders. Following the success of the first allotment of shares, Santam issued additional shares in 1920 in the northern provinces of the Union. The registered prospectus of May 1920 offered an additional share capital of £111 915 (shares at £1 each), bringing the combined issued share capital to £300 000. This further successful share issue allowed Santam to acquire a controlling stake in the Eastern Free State Board of Executors and Trust Company, with eight branches in the nominal geographic region in 1921.[39]

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the contents of the memorandum or the signatories thereto, and the number of shares subscribed for by them.' We can assume that the requirements of a prospectus were adhered to in each province of the Union of South Africa since the penalty for non-compliance was very high, for example 500 pounds in the Transvaal. See in this regard s 79(6). S 80(1) states: 'A company which does not issue a prospectus on or with reference to its formation shall not allot any of its shares or debentures unless before the first allotment of either shares or debentures there has been lodged with the Registrar a statement in lieu of prospectus, signed by every person who is named therein as a director or a proposed director of the company or by his agent authorized in writing, in the form and containing the particulars set forth in the Fifth Schedule to this Act'; Sanlam Archives *Santam Board of Directors Minute Book* 28/09/1919; Western Cape Archives *A2213-50000025 Statement of Share Capital* 13 June 1919.

39 Sanlam Archives *Santam Board of Directors Minute Book No 1* 28/09/1919; Y Hagedorn-Hansen 'The transformation of the South African short-term insurance industry: The case of Santam, 1919-2011' Unpublished PhD thesis, University of Johannesburg, 2016 144.

King IV encourages the taking of business risks, provided these are approached responsibly. Here, Santam increased its liquidity through an additional allotment of shares to acquire control of another company. The Santam board supervised the allocation and sale of shares in a shareholder register, further evidencing best corporate governance practices. Santam thus established itself as a part of the South African economy and society with the overriding business objective of creating shareholder value (shareholders as internal stakeholders) and providing its policyholders (as external stakeholders) with value-added insurance products. This confirms that the Santam board conducted its business supported by the underlying premise of putting 'South Africa first'.

1.5 Management for sustainability

The distinctive nature of Santam/Sanlam was its local South African shareholders and policyholders, which positioned the company as a truly South African-owned insurer controlled by South African shareholders '[an insurer] very specific to itself, which includes its internal and external stakeholders with a material stake in its activities.' King IV supports the preceding statement.[40] Santam management's conscious South Africanism articulated, through a policy of shareholder empowerment, the vision and responsibility that motivated the Santam/Sanlam leadership to safeguard stakeholder interests on all levels (policyholders and shareholders). The company had emerged as a true South African corporate citizen enhancing its own value, the wealth of its shareholders and the economic upliftment of the greater South African society as a result of honesty, transparency and financially disciplined business transactions based on the exemplary guidance and conduct of the board of directors.

40 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 24 and 43. The board must always act in the best interests of the company.

The Santam board of directors received well-deserved public and commercial recognition. The general manager of the Standard Bank of South Africa Ltd commented in his report to the bank's London head office as follows: 'The directorate of the Company consist[s] of … highly influential persons.'[41] The board used the financial sector as a platform to encourage South African citizens to save and to empower their financial growth by investing in ways that were greatly beneficial to South African society.[42]

The proof of Santam's competency in business management and growth was reflected in their actual financial results. Santam's financial performance indicates consistent, gradual, long-term growth. By 1945 Santam was one of only 68 short-term insurance companies registered in South Africa, while there were 294 foreign-registered short-term insurers in operation. The company's gross insurance premium income comprised only 2.3% of the total national insurance premium income.[43] By the end of the Second World War Sanlam's total insurance premiums exceeded £1 888 766, indicating a compound growth in life insurance premium income of 16.45% between 1918 and 1945. Compared with Santam, Sanlam grew consistently and more rapidly, producing performances that exceeded the overall long-term insurance national sector growth by 6.4% per annum.[44]

The success of the Santam/Sanlam group in both the short-term and the long-term insurance sectors was founded on the development of dynamic, flexible management and organisational structures and skills, which in

41 Standard Bank Archives *General Manager's Office (GMO) Report to London* 13/12/1918.

42 J Mackey and R Sisodia *Conscious capitalism* (Boston Harvard Business Review Press 2013) 50.

43 Registrar of Insurance *Annual Report* (1945).

44 G Verhoef *The power of your life: The Sanlam century of insurance empowerment 1918-2018* (Oxford University Press Oxford 2018) 86.

turn were based on good corporate governance practices. The composition of the Santam board of directors (DB) remained similar to that of Sanlam after the latter's formation on 8 June 1918. The day-to-day management of both companies was placed in the hands of the *Dagelijks Bestuur* (day-to-day management).[45] The Santam DB comprised three members of the board; namely, the chairman WH Hofmeyr, Antoon Benning and Fred Dormehl, and it was assisted by the general manager, Alfred MacDowall. The same DB oversight structures existed in Sanlam after June 1918. The Sanlam DB consisted of CR Louw as deputy chairman of the board, WH Hofmeyr as chairman, Antoon Benning and Fred Dormehl. No clear distinction existed between the board and general management of the companies, a phenomenon that would probably be frowned upon by the King Report.[46]

During the formative years, Sanlam/Santam was highly centralised with an identical DB management structure overseeing the daily operations of both companies, described by Alfred Chandler as 'U-style management'. The weekly DB meetings reflected tight administrative oversight and accountability on all levels of business operations. The agendas of meetings were, therefore, similar in both companies: all matters financial, such as loans, insurance premium income (fire and accident in the case of Santam, and life assurance in the case of Sanlam), bank accounts, cheques drawn, guarantees granted, commission payments and matters pertaining to staff were presented on similar meeting agendas. A further example of the group's centralised management style was the DB's responsibility to appoint every agent/employee after an exhaustive scrutinising of the applicant's curriculum vitae, not only on the head office level in Cape Town but also for other regional branches outside Cape Town, with regional boards appointed and empowered to follow a similar procedure in the Orange Free State

45 Sanlam Archives *Sanlam Minute Dagelijks Bestuur* 12/1/1034.

46 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2009) 34.

and Transvaal. In this respect, MacDowall felt the DB was guilty of 'over-managing'.[47] Through adopting this meticulous approach the DB enforced the standardised administrative procedures and routines resulting from its decisions.

The Santam weekly DB meeting followed immediately after the Sanlam DB meeting. Attendance of all DB members was compulsory at every meeting in order to successfully implement a decision and non-attendance was acceptable only after prior notification. The experienced senior employees, such as MacDowall, Scott-Hayward, West and Dormehl, trained and educated junior employees in the business of insurance. To a certain extent, these strict administrative routines and procedures are aligned with King IV. For example, Principle 10 requires a governing body or board of directors to appoint persons or to delegate their authority to other employees by training them to perform the same function, as well as to ensure the transparency of administrative procedures, collective decisions and management of the business.[48]

A fundamental element of Santam/Sanlam's success lay in the mutual recognition of the individual professional accomplishments and shared ethical and social commitment of members of the board of directors. This is reflected in the identification of similar qualities in the selection of the individuals who engaged with the public in marketing the group's short-term or long-term insurance life assurance policies, although these individuals were not employees but independent agents earning a living through sales commission. In the founding years, the identification of sufficiently knowledgeable agents was no easy task. The DB scrutinised all agent applications, subject to the board's approval. When Harris resigned as

47 Sanlam Archives *MacDowall letter to Chairman* 25/05/1920.

48 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 58.

an agency manager, Jan Feenstra, chief clerk in the head office New Business Department, assumed responsibility for looking after the needs of agents. He was committed to establishing a much-needed agent and employee organisational structure and compiled an agent training manual, *General Instructions to Agents and Tariff Book*, which explained the rules, protocols and tariffs. Developing company-specific agent rules is an example of how Santam promoted the career development and upward mobility of agents by facilitating an understanding that the primary function of the agent is to serve the needs of policyholders through compliance with the company's business philosophy. The training manual contributed significantly to operational transparency, a core value of the practice of good corporate governance. A systematic discussion of all agent feedback reports was a permanent item on the weekly DB meeting agenda and might result in agent reprimands, dismissals or alternative disciplinary steps.

The expansion of the Santam agent network in the Transvaal and Orange Free State faced fierce competition from the Schlesinger Organisation. Schlesinger sought to expand its short-term insurance business through the acquisition of the Attorneys' Trust and Agency Business in the Orange Free State, after which it formed the South African Board of Executors and Trust Company to market policies to the public. This strategy had the potential to destroy the marketing efforts to sell Santam policies in the Orange Free State. Santam responded by acquiring a 60% stake in the Free State Board of Executors. The purchase was preceded by a rigorous due diligence investigation into whether such an acquisition would be in the best interests of Santam. This acquisition was important from a business perspective because the Free State Board of Executors had the support of an extended network of Free State attorneys, to whom it offered exclusive distribution rights of Santam and Sanlam insurance products. The Free State Law Society objected to this network, labelling it 'unprofessional' on the grounds that it

had the potential to promote a conflict of interest in the legal profession – selling policies and administering deceased estates.

The High Court ruled in favour of the Law Society and the Free State Board appealed the matter. The Appeal Court also ruled in favour of the Law Society.[49] This court case supports, for example, the King Report of 2002 (paragraphs 2.3 and 2.4 of the Report) that forbids business practices that lead to a conflict of interest. This abruptly terminated the network through which lawyers could act as the executors of deceased estates of policyholders.

Schumann described the first two decades of the twentieth century as incomparably difficult times in which to conduct the business of insurance. Two events contributing to this difficult period were the Great War and the 'unprecedented inflation and deflation of 1919–1922'.[50] Severe droughts aggravated the adverse economic conditions in the northern provinces (Orange Free State and Transvaal) and led to the eventual financial collapse of the Free State Board of Executors. Santam attempted to save the Free State Board and in the process nearly lost all its capital. In contrast, the life assurance and other long-term insurance business conducted by Sanlam suffered no financial losses during the period. At an annual general meeting of shareholders, one shareholder suggested that Santam should be liquidated.[51]

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49 *De Villiers and van Niekerk Applicants v Incorporated Law Society Respondents* 1921 AD 600; Sanlam Archives *Santampos* (1959) 7; Y Hagedorn-Hansen 'The transformation of the South African short-term insurance industry: The case of Santam 1919-2011' Unpublished PhD thesis, University of Johannesburg, 2016 110; G Verhoef *The power of your life: The Sanlam century of insurance empowerment 1918-2018* (Oxford University Press, Oxford, 2018) 57.

50 CGW Schumann *Structural change and business cycles in South Africa* (Staple Press London 1938) 131; J Nattrass *The South African economy: Its growth and change* (Oxford University Press 1982) 25.

51 Sanlam Archives *Santam Board of Directors minutes No 1* 22/08/1922; Sanlam Archives *Bezuidenhout Minutes of Special Annual General Meeting (AGM)* 1/5/1923.

Santam's disclosure to its shareholders of the financial predicament of the company as a result of the losses suffered due to the financial collapse of the trust and executors network in the Orange Free State illustrates the continuity of the board's integrity. The board disclosed the full £62 000 loss, almost its entire share capital, to the shareholders at the annual general meeting in May 1923 and took an unprecedented decision to invite the shareholders to reclaim the money paid for those shares from the company. Standard Bank committed to honouring every Santam cheque paid to those shareholders who had opted for a buy-back. On hearing of the losses in the Orange Free State, the general manager of Standard Bank, JP Gibson, expressed his admiration for the Santam Board and their sound practices and honest/ethical business principles. Gibson acknowledged that the company's financial predicament was not the result of poor business decisions but of the 'sheer force of circumstances' caused by the drought, placing his trust in the integrity and accountability of the board and pledging Standard Bank's financial assistance in reconstructing Santam's financial operations. Santam wrote off a financial loss of £135 705 and started a new capital reserve fund of £15 000.[52]

Santam displayed ethical business practices during the Orange Free State Executors dilemma. The board did not hesitate to disclose the financial risk to its shareholders as a result of the financial collapse of the Board of Executors. This transparency reflects King IV.[53] The Standard Bank's general manager had observed Santam's ethical business operations in its first five years of operation[54]and based on this record pledged the bank's financial support

52 Sanlam Archives *Minutes of Special Annual General Meeting* 1/5/1923; Author Unknown *Africa Insurance Record* (Unknown Publisher) 1924.

53 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2009) 43.

54 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2009) 47.

to reconstruct Santam. The reconstruction included the appointment of experienced executives, as well as other employees and agents to implement a successful reconstruction of business operations. The reconstruction illustrates how Santam adapted its role as a corporate citizen by following the ethical business principles of corporate governance.[55]

The development in the Orange Free State had severe financial implications for Santam, which emphasises the importance of the centralised control of business operations. The DB meetings played a central role in building a sustainable company. Innovation and flexibility are core principles in achieving financial sustainability and Santam incorporated new strategies and business operations to suit the high risk and volatile business environment in which the company operated.[56] The achievement of success in a competitive, volatile business environment can be explained by examining the three developmental stages of business growth, all of which demand flexibility. The initial stage is based on the ability to identify, develop, co-develop and assess business opportunities relevant to the needs of the policyholders; the second involves the acquisition of capital to invent new business operations to address those needs and to make profits from those new operations; and the final stage is the ability to sustain the profitability of the business operations created.[57] Teece refers to the combination of the three stages as 'entrepreneurial management'. Such management ensures compliance with

55 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2009) 49.

56 DJ Teece, G Pisano and A Shuen 'Dynamic capabilities and strategic management' (1997) *Strategic Management Journal* 537-553.

57 M Augier and DJ Teece 'Dynamic capabilities and multinational enterprise: Penrosean insights and omissions' (2007) *Management International Review* 175-192; DJ Teece 'Explicating dynamic capabilities: The nature and micro foundations of (sustainable) enterprise performance' (2007) *Strategic Management Journal* 1319-1350; DJ Teece 'The foundations of enterprise

the new administrative routines and maintains an entrepreneurial role in sustaining long-term profitability by selecting and prioritising new business projects to support the company financially. Management thus operates at a higher level than the ordinary employees of a company in exercising the necessary selectivity to find a financial partner to fund the successful reconstruction of a financially distressed company.[58]

Owing to the reconstruction, Santam developed administrative and managerial processes that are associated with contemporary insurers. This is exemplified in the establishment of an ethics or audit committee in contemporary practice. Santam's short-term insurance business, primarily fire and accident insurance, and from the 1930s onwards motor vehicle insurance, failed to capture a significant portion of the domestic market. It was only during the 1980s that Santam emerged as the leading domestic short-term insurer. On the other hand, by the end of the 1940s, Sanlam excelled as the third-largest domestic life insurer.

The economic relationship between Santam and Sanlam reflected their actual market share of policyholders. Santam was the holding company of Sanlam and Sanlam never paid any dividends to Santam. Sanlam paid Santam only for administrative services; for example, claims settlement department activities.[59] In 1955, the Sanlam Private Act 3 of 1954 required the life assurance company to act as an independent insurer. Sanlam had emerged as the leading insurer in the relationship between the holding company

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performance: Dynamic and ordinary capabilities in an (economic) theory of firms' (2014) *The Academy of Management* 328-352.

58 M Augier and DJ Teece 'Dynamic capabilities and multinational enterprise: Penrosean insights and omissions' (2007) *Management International Review* 175-192; DJ Teece 'Dynamic capabilities: Routines versus entrepreneurial action' (2012) *Journal of Management Studies* 1395-1401.

59 Western Cape Archives *Memorandum to Sanlam Board A2213* 18/8/1958.

and its subsidiary. Following its formation in June 1918, and operating in a diversified financial services sector, the company provided offered the public a variety of traditional life assurance products. In March 1964, Santam was listed on the Johannesburg Stock Exchange (JSE Ltd as it is known today) after diversifying its financial services to include banking. After the listing, at the end of 1974, thirty subsidiaries/shareholders controlled the company. Santam Insurance, the vehicle for short-term insurance, now formed a subsidiary of Santam Bank Ltd. In 1978 the banking section of Santam was separated from the insurance operations and finally, the original Santam stood without any holding control. Consequently, and largely due to the listing of Santam on the exchange, Sanlam acquired the controlling shares in Santam.[60]

The participation of board members in the respective DBs of Santam and Sanlam had the potential to undermine board independence and contravene good corporate governance principles. However, the conscious strategic purpose to empower policyholders and to create a sustainable insurance sector for South Africa acted as the principal motive for building a national asset. To achieve this purpose, Sanlam developed a powerful mechanism to acknowledge 'good corporate citizenship' by incorporating the 'six capitals' into its strategic vision for the future of South Africa. This occurred long before the recognition or importance of the International Integrated Reporting Framework of Corporate Governance in 2013.[61] While the independence of the respective boards was indeed compromised, the corporate structure of the boards tried to apply relevant governance principles and responsibilities that

60 Y Hagedorn-Hansen 'The transformation of the South African short-term insurance industry: The case of Santam 1919-2011' Unpublished PhD thesis, University of Johannesburg, 2016 181.

61 G Verhoef 'Savings for life to build the economy for the people: The emergence of Afrikaner corporate conglomerates in South Africa 1918-2000' (2009) *The South African Journal of Economic History* 118-163.

are evident in the present King IV; for example, the board is responsible for formulating and implementing a business strategy; approving new products suggested by employees, by departments or by the board itself; overseeing and monitoring the implementation of new products and administrative procedures; and is to be accountable by complying with relevant legislative provisions. The question for Sanlam was whether middle management could identify with the values established by the original DBs for promoting long-term growth and future prosperity.

1.6 Delivering five capitals: Human, social, relationship, financial and political capital

By the mid-1940s, Sanlam had consolidated its financial position in the domestic life insurance industry. The assumption since 1954 of independent insurers gave rise to an acceleration of the delivery on each of the six capitals. Between 1954 and 2000, by means of the Sanlam board of directors and its middle management structure, corporate governance displayed a high degree of recognition of the importance of regular meetings to promote corporate stability. This stability of leadership is fundamental to the general principles of good corporate governance.

In addition, the longevity of board members and employees dedicated to the company contributed effectively to the continuation of the original Santam business culture. WA Hofmeyr had been the chairman of the Sanlam board for 36 years, between 1918 and 1953. Over that period, he had also been the chairman of the Santam board and managing director of Sanlam. Upon Hofmeyr's sudden, unexpected death, CR Louw, also a founding director, succeeded him as chairman until 1966, when he retired at the age of 91. PA Malan and PGW Grobler, also founding directors, served Sanlam until the late 1960s. Section 41(k) of the Private Sanlam Act 3 of 1954 regulated director disqualifications and was later amended to set an age limit on the service of board members to age 75. In 1966, PA Malan retired from the Sanlam board

at the age of 86, CR Louw at 91, and MS Louw, the first Afrikaans-speaking actuary, at 78. The former minister of foreign Affairs, Eric Louw, also retired at the age of 76.[62] In the early 1940s, Santam issued a circular requesting their directors and/or managers to refrain from political activities, for example from participating as candidates in the national elections or being active members of political parties.[63]

Since the disqualification of directors included an age limit, the institutional memory of the board was maintained by appointing managers as board directors rather than introducing people from outside Santam/Sanlam. This practice had been evident in the early formative years. After the unexpected death of Fred Dormehl, the Sanlam managing director in 1918, CR Louw, acted in that capacity until 1922, while Hofmeyr acted as general manager until the same year in the wake of MacDowall's resignation. GF de Villiers moved into the position of general manager in 1922, after which MS Louw, the actuary, assumed that position between 1935 and 1946. Both GF de Villiers and CR. Louw retired in 1946 and were succeeded by AD Wassenaar. Senior management maintained a tradition of comprising only experienced Sanlam/Santam trained officials up to May 1978, when the first non-Sanlam trained official – Dr FJ du Plessis – was appointed to the position of managing director. He subsequently became executive chairman in 1982. Members of the executive management consistently replaced outgoing members of the board of directors, a case in point being AD Wassenaar.[64] Wassenaar retired as director and Du Plessis died in 1989. While second- and third-

62 G Verhoef *The power of your life: The Sanlam century of insurance empowerment 1918-2018* (Oxford University Press 2018) 94-95; Sanlam Archives *Interview with PA Malan* March 1965 6/1/5.

63 See above.

64 Sanlam Archives *Sanlam Board Director Minutes* 26/01/1983; Sanlam *Archives Life of CR Louw,* description of his life 6/5/1.

generation Sanlam managers succeeded Du Plessis – Pepler (PJF) Scholtz, Pierre Steyn and Marinus Daling – later board members inherited a stable company created by an institutional memory that supported good corporate governance principles.

Another fundamental aspect to promote corporate stability was 'contextual realism'. South Africa experienced radical socio-political changes during the 1980s and 1990s. Management and the board leadership were required to respond to a changing South African landscape, which saw Sanlam's appointment of a first woman and a first person of colour as members of the board. The high-powered intellectual and experienced industry leaders on the board had given the company a firm grounding on which to accommodate a diversified South African economy and society. King IV requires a board to include diverse skills, experience and professional knowledge during periods of business transitions as a result of the political environment.[65] Directors appointed from outside Sanlam have included Dr AJ van den Berg, a chemist who worked for the South African Torbanite Mining and Refining Company (SATMAR) and the Industrial Development Corporation of South Africa (IDC); Dr PJ Riekert, chairman of the Prime Minister's Economic Advisory Council and chairman of the commission proposing the relaxation of trade union restrictions for trade unions; Dr JG Loubser, a mechanical engineer and former general manager of the South African Railways and Harbours and a recipient of the Commonwealth Alexander Agnew Prize for professional leadership and Harvard Business Statesman of the Year in 1981; Dr PE Rousseau, former managing director of SASOL; and Dr CHJ van Aswegen, long-standing chairman of Santam. New directors at the turn of the millennium included Kate Jowell, professor and dean of the University of Cape Town Graduate School of Business; AC Bawa, deputy-vice chancellor of the University of KwaZulu-Natal; Murray Grindrod, chairman of the

65 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2009) 50-51.

Grindrod Unicorn Group; Dawn Mokhobo, a social worker and manager of the Change Management Consultancy Group; and Peter Schwartz, an educator and deputy vice-chancellor of the Cape Technikon.[66]

On the critical level of governance, by 2000, the Sanlam board of directors had thus responded to the need for diversity in several realistic capacities.[67] An analysis of Sanlam's financial performance since 1918 shows consistent growth outperforming general growth in the long-term insurance industry. For the first 27 years of its operation, between 1918 and 1945, Sanlam's premium income increased by an annual compound growth of 16.45%, compared to an industry index of 6.4%. By 1945, Sanlam had accumulated assets to the value of £9.4 million, representing an annual compound growth of 14% for the period 1922–1945, compared with the industry index of 10.33%. Sanlam sustained around a 4% return on assets up to the Second World War, after which the return showed a relative decrease. The first Sanlam funds as part of an investment portfolio, for example, unit trusts, exemplified a conservative but realistic business model. Sanlam invested in fixed interest-bearing deposits (now termed 'asset deposits'); immovable property from which rental income was earned and the growth portion allocated to the contributors of investment policies and/or pension funds; as well as in government bonds.

Santam sold its subsidiary, African Homes Trust (AHT), to Sanlam in 1934. AHT marketed industrial and funeral policies to other market segments.[68] The inclusion of the 'industrial insurance market' enlarged the demographics of

66 G Verhoef *The power of your life: The Sanlam century of insurance empowerment 1918-2018* (Oxford University Press 2018) 93-97, 156-158, 241-242.

67 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2009) 71.

68 Sanlam Archives *Sanlam Annual Report* (1935); Sanlam Archives *MS Louw Biographical Papers* 6/1/7; *Memorandum to Sanlam Board* 13/04/1959.

the policyholder base to increase its existing policyholder base. For example, the 'industrial insurance market' consisted primarily of income earners (or low income earners) of colour, European descent (for example, English, Afrikaans, German), and the people of the Zulu, Sotho and Xhosa-speaking communities who entered the insurance market as policyholders for the first time in 1920 and today comprises Metropolitan Life. The Santam Board was not in agreement regarding the purchase of AHT. This purchase was the largest single investment Sanlam had made to date and CR Louw perceived the transaction as one of extremely high risk.[69]

The Union of South Africa initiated a government policy that required the private sector to invest in government bonds. The Insurance Act 27 of 1943 required all insurers to invest in government bonds or other state-owned securities, resulting in a swift increase in Sanlam's investment risk exposure in terms of government bonds. The initial yield on government bonds was extremely high, but during the 1960s, the returns of other investment instruments surpassed their returns and insurers began to resist their mandatory inclusion in investment portfolios. Between 1945 and 1985, the yield on Sanlam investment products increased from 3.35% to 11.2%. During this period Sanlam's compounded insurance premium income increased annually by 9.55% compared to the industry index of 3.81%. By 1965, Sanlam's insurance premium growth had surpassed those of all other long-term insurers.[70] By 1985, total insurance premiums exceeded R1.605 billion and total assets R7.785 billion in 1985 and Sanlam, as the second-largest insurer in South Africa, controlled 25% of insurance industry premiums. These financial successes should be attributed to the company's excellent administrative procedures and strategies. The company's administrative efficiency exceeded that of all other insurers. For example, Sanlam's administrative costs were

69 Sanlam Archives *Sanlam Minutes Dagelijks Bestuur* 12/01/1934.

70 Sanlam Archives *Sanlam Annual Report* (1965).

7.1% in 1970 and 4.1% in 1985.[71] To a certain extent, the current binder fees passed from an insurer to a binder holder replicate Sanlam's administrative costs of 1985; namely, the binder holder is entitled to a 3% binder fee to settle claims in the short-term insurance industry, and so forth.

Intellectual capital is required to create new insurance products, as well as the support of appropriately trained and skilled insurance professionals, a dedicated agent network and head office administration. Sanlam started its business in 1918 by offering simple life insurance products. What distinguished Sanlam in the 1918 market was the administrative efficiency of service delivery. Policies were issued in either Afrikaans or English, a first for South Africa at the time. The products offered were the same as those of other life insurers in the market: standard whole-life policies, with variable premium payments according to the length of term and certain agreed conditions; child inheritance policies taken out on the lives of parents, or with an option to continue after the passing of a parent; and endowment or lump sum policies, maturing after an agreed term.[72] This product range brought two innovations to the life industry in South Africa. From September 1919, Sanlam paid annual bonuses to policyholders based on the company's annual policy premium valuations. The Stone & Cox Life Insurance Tables of 1920 noted that Sanlam was the only insurance company in South Africa to calculate annual policy valuations.[73] The second innovation was the inclusion of a disability benefit that allowed for cession; namely, the cession

71 Sanlam Archives *Sanlam Annual Report, Chairman's Address* (1985); G Verhoef *The power of your life: The Sanlam century of insurance empowerment 1918-2018* (Oxford University Press 2018) 130, 147-153. Besides the latter, this is one of the main reasons why an insurer concludes a binder contract with an underwriting manager; the underwriter's administration costs are lower on average than those of insurers in general.

72 Sanlam Archives *Rate Book* 1931-1936.

73 Sanlam Archives *Stone and Cox Life Insurance Tables* 1920.

of the premium or lump sum payments to another person in the event of the permanent disability of the policyholder. According to Stone & Cox, Sanlam followed a liberal interpretation of disability as a method of promoting lump sum payments. Circumstances, such as the loss of two limbs, or blindness, for example, were considered as total disability.[74] While disability benefits were not new in the industry, Sanlam was the first South African insurer to pay a lump sum disability benefit to a policyholder as opposed to an industry that paid benefits in instalments (annually or monthly). While instalment payments could be increased, it was argued that disabled people need immediate financial relief, generally due to the devastating change in their immediate personal expenses.[75]

In 1984, Sanlam launched a ground-breaking life insurance product; the One Policy, an industry-first flexible structured life policy that included investment products and targeted the middle- and higher-income brackets in South Africa. The product gave Sanlam a competitive advantage in the insurance market. Policyholders could convert any existing policies into the new One Policy.[76] By April 1987, Sanlam had sold 184 000 of these policies.[77] As the general demand for traditional life and risk products declined due to improved regulatory supervision in the insurance market, the demand for investment-linked insurance products increased. Sanlam developed several of these products, for example, the 100-Plus, 200-Plus Investment, and Index Plan series, which were maintained by monthly investment premiums. In 1995, Sanlam was the first South African insurer to offer a 'global investment'

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74 Sanlam Archives *Stone and Cox Life Insurance Tables* 1927.

75 Sanlam Archives *Stone and Cox Life Insurance Tables* 1921; Sanlam Archives *Sanlammer* 05/03/1993.

76 Sanlam Archives *Product Development: One Policy* 30/09/1984; Sanlam Archives *Sanlammer* 53(46) 05/09/1985.

77 Sanlam Archives *Product Development CJvR Memorandum* 12/06/1987.

opportunity through the company's 'asset swaps'.[78] The 200-Plus investment series delivered a consistent 27% growth between 1991 and 1997, and the return on the 100-Plus series exceeded 29% growth. In 1997 the 500-Plus series investment products entered the market, also delivering inflation-beating returns. The 1998 Asian Crisis contributed to the launch of further innovative products that offered a guaranteed return on investments, notably Sanlam's Guaranteed Equity Fund and Guaranteed Plan.[79]

The global life assurance industry was bound to be restructured. This phenomenon saw the expansion of insurer corporate structures, such as the creation of different classes of shareholders. Sanlam management anticipated this market trend. Sanlam, however, remained a mutual life insurer – policyholders own the insurer, not shareholders, and policyholders are not shareholders of the insurer. Sanlam now ventured into international markets as a means of expanding the corporate structure.[80] Global insurers adapted to the lucrative investment market through a change in organisational form – from mutually owned policyholders to shareholders. Mutual corporations worldwide demutualised and listed on exchanges to gain access to larger pools of investors.[81]

From 1987, Sanlam's insurance-based investments declined. Declining insurance-based investments posed a financial risk to Sanlam's working capital. George Rudman, the company actuary, analysed and explained the

78 Sanlam Archives *Board Director minutes* 13/12/1995.

79 Sanlam Archives *Annual Report (1995)*; Sanlam Archives *Annual Report* (1996); Sanlam Archives *Annual Report* (1997).

80 G Verhoef 'Not to bet the farm: Sanlam and internationalisation 1995-2010' (2016) *Business History* 947-973.

81 G Verhoef and M Keneley 'Pressures for change in the Australian and South African insurance markets: A comparison of two companies' (2011) *Competition and Change* 136-154.

complexity of the impact of demutualisation on the nature of the business of a mutual insurer. He systematically investigated and designed a transition strategy for Sanlam – from mutual-owned to shareholder-owned. Rudman outlined to the board and management that a mutual life office by definition has no true capital. Sanlam's capital in effect amounted to the surplus of its assets over its liabilities. The company had sustained a higher than required capital adequacy ratio of between 2% and 3.5% between 1985 and 1994 but that was insufficient. Rudman remained concerned about the poor return on assets that effectively reduced the 'capital' position of Sanlam, considering inflation, which was higher than 3.5%.[82]

Sanlam's accumulated surplus (profit) as a proportion of policy liabilities excluding market-related policies declined from 34.4% in 1986 to 7.7% in 1994. Sanlam's yield on assets had been lower than the inflation price index since the mid-1970s, only to recover marginally from 1997. The most disappointing asset investment performance was Sanlam's Legacy Investment. This investment held around R204 million in Bankorp, which was subsequently transferred to ABSA bank, and posted a yield of only 12.2% between 1979 and 1994. The average index in the banking sector presented a growth rate of 21.5%.[83] In addition, the profile of Sanlam policyholders by the mid-1990s was very different from that of the 1950s. The former predominantly Afrikaans policyholder profile now constituted about 33% of all policyholders, while

82 Sanlam Archives *Confidential Memorandum Rudman to Board* 19/04/1995; Financial Services Board, Solvency and Management Steering Committee, Position Paper 74 (Minimum Capital Requirements). This report focussed on the solvency requirements in the European Union and Australia with an explanation of the recommended ratios for insurer solvencies. Today the Financial Services Board has been replaced by the Financial Sector Conduct Authority and the regulator may interfere in the insurer's solvency in the event of non-compliance with the minimum required amount or ratio

83 Sanlam Archives *Confidential Memorandum Rudman to Board* 19/04/1995.

66% represented the so-called coloured or black population of South Africa, many of whom were also Afrikaans-speaking.[84] The demographics of head office employees also changed significantly from the early 1980s to reflect the national demography – long before the first democratic elections were held in 1994.[85] These changes had a profound impact on the nature of future insurance and the risk profiles of future policyholders.

Drastic financial re-engineering could assist Sanlam in regaining a competitive advantage in the domestic market. This had profound implications for the company in striving to maintain all aspects of its historical legacy – the empowerment of policyholders, loyalty to the company through an agent network, and shared collectivism through mutuality. Sanlam had to bring about a fundamental change to its business model of nearly a century ago. Demutualisation had closed a chapter in Sanlam's mutual history and signalled its entrance into global finance. It was obligatory for Sanlam to systematically engage stakeholders and explain the far-reaching consequences of the demutualisation process. The company sent regular written communication to existing policyholders and/or other stakeholders of the company and presented roadshows across South Africa and internationally to inform policyholders of the Sanlam demutualisation process and the expected impact it might have on the South African economy.[86] Policyholders were adequately informed about the technical nature of this process and how to

84 S Halleen 'From life insurance to financial services: A historical analysis of Sanlam's client base 1918-2004' Unpublished PhD Thesis, University of Stellenbosch, 2013 113, 149.

85 W Beukes, A Ehlers and G Verhoef 'Sanlam-amptenare uit die volk gebore om die volk te dien?' (2018) *Tydskrif vir Geesteswetenskappe* 1-20.

86 Sanlam Archives *The Demutualisation Proposal Information Memorandum to Policyholders* 09/1998.

receive free listed shares on completion of the demutualisation process.[87] Sanlam management acted, therefore, in the utmost good faith. Existing policyholders knew exactly how many equivalent-value shares according to their current policy value they would receive as free shares and further were invited to subscribe for additional shares on the listing date. Every stage of the lengthy process was thus in accordance with the principles of good corporate governance regarding honest, ethical and effective leadership, as defined in King IV.[88]

Organisational restructuring in the form of demutualisation offered a logical exit strategy from a weakening domestic insurance market. In December 1998, Sanlam followed the international trend of demutualisation and listed on the JSE. The demutualisation prospectus relied on the Sanlam legacy of 'trust' and called for stakeholder support to affirm the restructured company.[89]

Sanlam beat other South African mutual insurers in the race to demutualise, as Old Mutual listed in the middle of 1999. Sanlam investors favoured the market sentiment of demutualisation. On the listing date, Sanlam traded 62 million shares and a total of 200 million during the next ten days on the JSE Ltd. The bulk of those shares were free shares allotted to Sanlam policyholders. In January 1999, Sanlam increased the initial allotment by a further 16% in free shares.[90] Sanlam raised a total of R3.9 billion as a result of the demutualisation process. A new dispensation had dawned for Sanlam Ltd and its stakeholder (shareholders and policyholders) profile was

87 Sanlam Archives *Sanlam Share Offer Prospectus* 28/10/1998.

88 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016). (Johannesburg: Institute of Directors in Southern Africa 2009) 20.

89 Sanlam Archives *Sanlam Share Offer Prospectus* 28/10/1998.

90 Sanlam Archives *Board of Director minutes* 03/02/1999; Sanlam Archives *Sanlam Listing Update No 2* 12/01/1999.

fundamentally changed. By the end of May 1999, only 44% of the shareholders were private individuals. Retirement or pension funds accounted for 13% of the shareholder population and other companies for 43%.[91] A small portion of existing policyholders failed to claim the allotment before 28 October 1998 and Sanlam went the extra mile, expediting its Demutualisation Trust (DT) to find those 'missing'. The DT, which was composed of eminent persons, spent ten years hunting down those policyholders/shareholders to validate their outstanding allotment of shares. By 28 October 2008, only 1.01% of the free shares allocated to the DT had not been allotted to any shareholder/ policyholder (it is unclear whether those policyholders were still paying monthly insurance premiums).[92] The exhaustive tracking of all missing eligible shareholders (unknown policyholders) confirmed Sanlam's total commitment to establishing and protecting the all-inclusive stakeholder interests. The DT's operations were a testimony to Sanlam's successes in bringing empowerment not only to the economy of South Africa but also to its citizens as policyholders/shareholders. They searched for more than 50 000 eligible policyholders in KwaZulu-Natal, among them LN Ndimande, KK Dikhaar, MM Tolom, V Hemraj, I Essop, F Moosa, KV Tshinavhe, MJ Moseki, Phumla N Nyoka, N Siyolo, PP Nyoka and J Mzikayise.

1.7 New stakeholders

The newly listed Sanlam assumed the corporate structure of a diversified financial services company. Sanlam Ltd was the listed entity and Sanlam Life Insurance Ltd was a wholly owned subsidiary, with Sanlam Ltd owning the full complement (all the allotted shares) of the issued Sanlam Life shares. Sanlam's assets before the listing were divided between a policyholders'

91 Sanlam Archives *Flemming Martin Research South Africa* 26/07/1999.

92 Sanlam Archives *Demutualisation Trust* (1998); Sanlam Archives *Chairman's Report* 03/06/2009.

fund and a stakeholders' fund. The assets in the policyholders' fund were the assets of Sanlam Life Insurance Ltd and the stakeholders' fund consisted of the new shareholders' fund in Sanlam Ltd. From 1999, Sanlam Ltd served an enlarged stakeholder base consisting of insurance policyholders and shareholders. The newly listed share price of Sanlam Ltd failed to exceed 600 cents per share after the date of listing. The financial statements of Sanlam Ltd indicated a poor bottom line (net profit), which contributed *inter alia* to the demutualisation decision, leaving policyholders and shareholders waiting for an improved listed share price. The 1998 financial results released shortly before listing did not attract any enthusiasm among financial analysts or fund managers. One analyst, T Gamedze from HSBC Simpson McKie, described the results as 'Sanlam is running hard to stand still'. Sanlam's decrease in net profitability was the direct result of a 21% decrease in new business and a 43% reduction in individual single life policy premiums. Nevertheless, Sanlam expressed confidence about its investment performance – locally and internationally. Unit trust investments managed by Sanlam performed well, with the new Sanlam Select Trust outperforming all other unit trusts in the market. Non-life retail investments in unit trusts and the SP² special investment product accounted for 49.8% of its new business.[93] This growth in unit trust investments exceeded the expectations of stakeholders. Sanlam Ltd had, therefore, entered a new investment market at a time when the growth rate in the long-term insurance market was diminishing. This redefined the stakeholder profile of Sanlam Ltd – unit trust investments and fund management.

Marinus Daling retired as Sanlam Ltd CEO in 1999. Daling had been awarded a Sanlam bursary during his university years to study actuarial science, before being employed by the company as an actuary in the early 1970s. He considered himself as the transformation agent of Sanlam – from mutual life office to

93 Sanlam Archives *Director Board Minutes* 10/03/1999, 06/05/1999; T Gamedze *HSBC financial analyst report, Insurance sector* (Unknown Publisher 1999).

an international/national shareholder company. He was given less than three years to deliver on the demutualisation process. Senior management devised a demutualisation strategy and conducted administrative operations overseen by Sanlam Ltd and administered core business operations through the separate business subsidiaries of Sanlam Ltd. These business subsidiaries were Sanlam Life Ltd, which was responsible for Sanlam Personal Finance (SPF), Sanlam Employee Benefits, Sanlam Health, Gensec, and Sanlam New Business Development, all divisions or units of Sanlam Life Ltd. Short-term insurance was still the core business of Santam, in which Sanlam Ltd and Sanlam Life Ltd owned 56.9% of the issued shares. The new divisional and subsidiary structure of Sanlam Ltd appeared little different from the pre-demutualisation structure, nor were there any significant changes in the composition of the board and management of Sanlam.

The market proved to be unenthusiastic regarding Sanlam's decision to demutualise. Despite Daling's claim of transforming Sanlam into a world-class financial services group, a significant degree of functional overlap, as well as a lack of strategic focus and business specialisation, existed in the operations of Sanlam's subsidiaries and divisions.[94] One strategy was to address market scepticism and to build investor confidence through improved channels of communication and information disclosures. The UK Corporate Governance Code required that UK companies report on investment returns through a preferred method, the long-term rate of return (LTRR). Reporting on the LTRR on shareholder investment funds to headline earnings reduced the fluctuations in short-term returns on investments. This reporting technique offered Sanlam a tool for increasing investor confidence since it gave more stability to the projected outlook for investment returns. Table 1.1 clearly illustrates the effect of the reduced fluctuation as a result of the LTRR. The 98.3 cents per share of headline earnings calculated in terms of the LTRR projected a 23% stronger financial position than projected not using

94 Sanlam Archives *Director Board minutes* 06/05/1999.

LTRR, or when compared to the 1998 financial position of Sanlam. Sanlam outperformed the industry with its 1999 results.[95] (See Table 1.1).

Table 1.1: Sanlam headline earnings 1998 and 1999

	1999	1998	Difference %
Current headline earnings – Rm	1 955	1 186	65 %
Cents per share	73,4	58,4	26%
Headline earnings based on LTRR	2 618	1 507	74%
Cents per share	98,3	74,2	32%

The second innovative adjustment in financial reporting introduced after the demutualisation process was to disclose Sanlam Ltd's equity value. At that time, financial analysts severely criticised the lack of transparency regarding embedded or equity value. The first public disclosure of equity value was made in the Sanlam annual report of 1999. The main increase in headline earnings came from SPF (61%). When calculating equity value and profit, it is imperative to compare earnings per share to the listed price of the share. By 2001, SPF had increased its operating profit by 34% when compared to the 1999 financial results. Innovative investment-linked policies and single premium policies gradually restored domestic market confidence.[96] As illustrated in Table 1.2, Gensec underperformed financially and lost market share.[97] Asset management, an example being the management of pension fund investments, was a strategic part of the primary function of the new corporate structure of Sanlam, though Gensec was not the correct business vehicle for such investments. Financially, Sanlam's health business was also

95 Sanlam Archives *Director Board minutes* 09/03/1999; Sanlam Archives *Annual Report* (1999) 19.

96 Sanlam Archives *Board Director minutes* 13/09/2000.

97 Sanlam Archives *Board Director minutes* 03/09/2000.

performing poorly. In 2000, the Santam Competition Commission granted Santam permission to acquire Guardian National Insurance (GNI). This acquisition gave new life to the company's short-term insurance business and Santam emerged as the largest South African short-term insurer. Under new executive leadership (board members), Sanlam Ltd vastly improved the ratio of return on investment in Santam due to the value of the holding company controlling shares in Santam (See also Table 1.2).[98] The remaining poorly performing Sanlam investment was the ABSA Bank investment, which reduced the return on investment ratio.

98 Sanlam Archives *Board Director minutes* 09/02/2000; Sanlam Archives *Annual Report* (1999) 18 for Table 1.2.

Table 1.2: Contribution to earnings, Sanlam Group 1998–1999 (Rm)

	SPF		Gensec		Health care		Santam		Corporative		Total	
Year	**1999**	**1998**	**1999**	**1998**	**1999**	**1998**	**1999**	**1998**	**1999**	**1998**	**1999**	**1998**
1	4 619	4 279	1 247	1 029	854	970	2 603	3 261	239	215	10 988	11 016
2	783	608	747	710	11	(220)	59	20	(946)	4	1 722	1 237
3	974	722	788	648	34	(209)	214	236	113	18	2 522	1 703
4	1 301	1 237	48	(118)	112	(44)	98	(145)	(927)	(2 555)	1 482	(822)
5	50	61	19	25	2	-18	3	6	6	2	100	100
6	37	39	40	31	19	27	15	13			30	28
7	21	18	60	69	1	-23	3	1			18	13

Key:

1 = Income from financial services

2 = Operating profit after exceptional items

3 = Headline earnings after tax

4 = Headline earnings – investment surplus

5 = Attributable profit as a percentage contribution to headline earnings

6 = Administrative costs as a percentage of income

7 = Operating margin (%)

Daling passed away in February 2002. After a brief period of uncertain leadership, Sanlam Ltd appointed Johan van Zyl as CEO in 2003. Between 2000 and 2002, Sanlam Ltd's headline earnings had declined by 12%. Under Van Zyl's strategic leadership Sanlam sold its ABSA investment to Barclays in 2005 and, assisted by a strong network of capable managers, the company was able to focus more on the business of insurance and investment management, namely, the administration and management of unit trusts and life policies. Sanlam had undertaken demutualisation – as discussed earlier – with urgency and speed. The fundamental differences between a diversified financial services company, with reference to the ABSA investment and other business projects, and a long-term insurer had not been contemplated with the necessary consideration and industry knowledge by the Sanlam board. When Santam ventured into the business of insurance in 1918, the founding board members employed industry experts and experienced insurance professionals to guide their ambitious national project. When global insurance markets changed and financial deregulation assumed new dimensions for traditional mutual insurers, Sanlam followed industry trends – as explained earlier – and the board members fell short of repositioning Sanlam as a sustainable (profitable) organisation. Blindly following industry trends placed Sanlam's leaders with a lifetime of insurance experience in a territory with which they were not well-acquainted – the dynamic environment of stock exchange listings.

In the new millennium Sanlam has reaffirmed its roots in South Africa. From a centre-driven group strategy-focused on delivering on the commitment to the full range of stakeholders (policyholders, shareholders and other investors), Van Zyl capitalised on the group's human, intellectual, social and relationship capital. To restore the core of diversified financial services to the existing and constantly growing new shareholder/stakeholder base in South Africa, Sanlam Ltd engineered the development of a more streamlined, diversified financial services group. Life insurance and other wealth products

offered to the domestic market remained the core business of SPF, while it also developed new products for the entry- and low-income levels of the market. Innovative distribution and delivery channels supported the new rollout of insurance products, targeting even the full range of 'wealth preservation funds', to respond to the domestic demand. The SPF business emerged as a diversified, personal finance retail enterprise, offering a range of savings products, from endowments and individual life policies, wealth management using sophisticated investment platforms (acting as either the administrator or the fund manager) to business development products. Since 2013, SPF has consistently outperformed the Sanlam Group's return on embedded or equity value. This illustrates the ability to deliver sustainable strong performance in the volatile domestic market. Most significantly the Sanlam legacy, instituted almost a century ago to deliver insurance benefits to all South Africans, has survived virtually unchanged.

The development of new insurance products for the entry-level market led to the establishment in 2005 of Sanlam Developing Markets (SDM) as a separate business division in the Sanlam Group. Again, through the development of dedicated entry-level insurance products the Sanlam Group continues to expand and serve the financial needs of its policyholders, shareholders and other investors (stakeholders). In 1918, the number of new policyholders was very low. In the first decade of the new millennium, the numbers of new entrants into the insurance market have been exponentially higher. Following the creation of SDM, its tremendous business success saw its restructuring to create Sanlam Emerging Markets (SEM) as a business vehicle to attract international entry-level policyholders.

The modified corporate structure of Sanlam since 1999 was positively received by the investment community. The company enjoyed a greater inflow of policyholders and other stakeholders. An inflow rate of 28% immediately after the completion of the demutualisation process, and an inflow of international policyholders/stakeholders of between 20% and 40%

after the demutualisation process reduced the market volatility (inflow and outflow) by the late 2000s. At the end of 1999, the inflow was less than 0.6 million per day. The listed share price showed flexibility by rising above 995 cents per share in late 1999. By the early 2000s, individual shareholders accounted for 40% of the shareholder equity; 46% were nominee companies and 14% offshore investors – 9% from the USA and 4.8% from the UK.[99] The demutualisation process contributed to a growing geographical distribution of new shareholders. In 2007, 92% of the Sanlam Group's earnings from financial services originated from South Africa and 5.9% from the rest of Africa. In 2017, South Africa contributed 76.8% to Sanlam Group's earnings; 12.4% came from the rest of Africa, 6.7% from India, 0.7% from Malaysia and 3.1% from other global markets.[100] The long-term, consistent focus on the development of the South African economy as a result of the demutualisation process contributed to stakeholder (i.e., shareholder, policyholder, investor, fund manager) confidence. This occurred initially in the domestic South African market and, after 2006, in the international markets.

1.8 Firm foundations

Business sustainability as a function of ethical leadership rests on the formulation of a sustainable business strategy for the benefit of all stakeholders. The Santam/Sanlam corporate history is a case study of truly South African business leaders and leadership. The vision of the founding members was to mobilise public savings in a poor community that had no idea of how to overcome poverty. After careful consideration of the full scope of the business environment and community poverty following the Anglo-Boer and First World Wars, the founding members were able to devise a sustainable business

99 Sanlam Archives *Board of Director Minutes* 08/03/2000; Sanlam Archives *Memorandum P Rademeyer* 08/03/2000.

100 Sanlam Archives *Sanlam Group Annual Integrated Reports* (2007-2017).

strategy for the next century. Ethical management formed a core element of this sustainability. Management accepted the responsibility of achieving the expectations of its policyholders by establishing a centralised management process, subject to accountability and good corporate governance principles. Head office remained the intellectual executive of Santam/Sanlam, and later the Sanlam Group, throughout its history. Head office was supported by an accountable agent network and agent training, all focused on the integrated policyholder and stakeholder needs. These elements of managerial practice are also well documented after 1998.

The ending of poverty through self-empowerment required a financial business vehicle. While the short-term insurance industry in the Union of South Africa had been well established it had been controlled by foreign insurers, which meant that profits had flowed out of South Africa to foreign insurers. Entry into the insurance market in 1918 had been widespread and demanded fervour. Consequently, Santam faced a formidable challenge in entering the insurance market. Policyholder empowerment is more clearly observed in the life assurance business, which is designed to provide security for dependants, sustain livelihoods and cater for future needs in the case of life-changing events. When the business vehicle for providing comprehensive short-term insurance soon proved unsustainable and potentially less profitable, the solution was to enter the market of diversified financial services with a primary listing in South Africa. Subsequently, two companies emerged after 1918 – a long-term insurer Sanlam, and a short-term insurer Santam, with its multitude of banking and other financial businesses which spanned the last century.

From its beginnings, Santam/Sanlam remained firmly committed to the underlying principles of good corporate governance, accountability and managerial responsibility. This chapter has traced the points of business development that reflect these principles. The introduction of managerial expertise, both from outside and within the network of the founding

members, and the strict adherence to centralised executive oversight and managerial responsibility, kept the business operations focused on sustainability. Gradually the founding members achieved economic growth ratios. With socio-political change towards the end of the twentieth century, the original message of 'South Africa first' catapulted into the 21st century.

Today the Sanlam Group business vehicle remains the same, delivering diversified financial services – insurance, investments, fund managers, administration of pension funds in building future wealth products, verification of the need for black empowerment, and ultimately, always growing the economy of the Republic of South Africa. The global expansion of the Sanlam Group operations widened the stakeholder base but sustained financial well-being for all stakeholders – employees, policyholders and shareholders, both domestic and international. Today the Sanlam Group employs more than 110 000 people with more than 13 000 agents acting as financial advisers and is one of the top three insurers in Africa with more than R900 billion invested through Sanlam investments.[101] Internationally, Sanlam operates among the top 50 insurers and conducts business in 77 countries. The Sanlam Group consists of 65 subsidiaries. Not only has Sanlam complied with affirmative action legislation over the past 30 years, but it has given financial assistance to citizens in purchasing 111 million shares at an issue price of R70 per share to contribute to broad-based black empowerment in 2019, 111 million shares being issued to black woman, both individually and through urban and rural women's groups, and black youth business partners.[102] According to the group chief executive officer, Ian Kirk:

101 https://www.sanlam.com/about/Pages/snapshot.aspx (accessed 10 January 2020).

102 https://www.sanlam.co.za/mediacentre/media-category/media-release/B-BBEE%20Share% 20Issue%20Finalised (accessed 10 January 2020).

> [This] enabled management to forge ahead with the implementation of the [broad-based black empowerment] transactions. We believe this to be good for the company and for South Africa as a whole, enhancing our empowerment status and our long-term growth and sustainability while we continue to contribute to South Africa's shared prosperity.[103]

103 https://bit.ly/3eMIK1M (accessed 10 January 2020).

CHAPTER 2

The relevance of business human rights, administrative decisions, stakeholders, shareholders, directors and stock exchanges to investment treaties and cross-border investigations: Perspectives on international corporate governance principles

Neels Kilian

2.1 National law and international law

This section discusses business human rights and administrative decisions with reference to international corporate governance practices (Organisation for Economic Co-operation and Development (OECD) or instruments (United Nations Guiding Principles on Business and Human Rights–UNGPs). The section also discusses shareholders, stakeholders, directors and stock exchanges with reference to the Companies Act of 2008.

South African domestic law includes the Companies Act of 2008, the Protection of Investment Act of 2015, and applicable common law principles. The Companies Act requires the development of the common law. Accordingly, a court, tribunal or commission must develop the common law to improve the realisation and enjoyment of the rights enacted by this 2008 act. Therefore, the common law must be developed to promote the spirit,

purpose and objectives of this act.[1] The 'spirit of the law' may be defined to include the Bill of Rights as provided in the 1996 Constitution.[2] However, 'the spirit' is a broad term and includes the development of the South African economy to encourage enterprise (enterprise implies company) financial efficiency by focusing on good corporate governance principles and promoting investments (foreign investment treaties – treaty between South Africa and a foreign investment enterprise) in South Africa, as required by the Protection of Investment Act. This Protection of Investment Act is inherently also part of the purpose of the Companies Act; to maintain or bring about economic and social benefits for South Africa. On the other hand, the creation of wealth and the promotion of welfare in South Africa must be the main objectives of any investment treaty (foreign companies investing in South Africa). The latter objective will become a reality only if South African enterprises are participants in the international economy as if the parties to an investment treaty (investment contract) are, for example, the government/state of Germany and a South African enterprise or vice versa.[3]

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1 Companies Act 71 of 2008 s 158.

2 S 7.

3 S 7(a-l); See OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 6 to promote economic prosperity through the simplification of administrative processes; In this regard, see *JSE Ltd v The Registrar of Security Services* A25/2016 https://bit.ly/3fgXhCY (accessed 12 February 2019) whether 'small' decisions in a series of decisions to make a final decision is subject to review has been explained in this case para 11. Only the final decision is an administrative decision for all practical purposes; Concerning investment treaties, see *Gami v Mexico* http://www.oecd.org/daf/inv/investment-policy/WP-2014-3.pdf (accessed 25 March 2019) 42. If the host State were to injure that enterprise in a manner that does not directly injure the investors/shareholders, no remedy would ordinarily be available under customary international law.

As a requirement for entering into investment treaties the OECD encourages responsible management. To some extent, the domestic principles of corporate governance, for example, King IV, underlie investment treaties as well and are frequently referred to by domestic courts to establish or interpret the effective and responsible management of an enterprise.[4] In international law, South Africa is a member of the G20 (Group of Twenty) and must in principle also follow international principles of good corporate governance as required by the OECD.[5] South Africa is a key partner of the OECD. There are four other key partners: China, Brazil, India and Indonesia. As a key partner, South Africa has access to the OECD's expertise and good corporate governance practices. South Africa acts as an associate to six OECD bodies and projects and participates in 15 OECD projects. South Africa adheres to some OECD guidelines, for example, the Recommendation of the Council for Development Cooperation Actors on Managing Risk of Corruption of 2016. For this reason, it is only a matter of time before South Africa complies with/adheres to all OECD guidelines - when full OECD membership is granted to South Africa.

The purpose of the Companies Act 2008 is to promote the development of enterprises in all sectors of the economy. These sectors include financial services, mining, pharmaceuticals, tourism and other relevant sectors, as listed by the JSE Ltd.[6] However, in terms of the 2008 Act, not all enterprises are required to register as legal persons. Examples would be a pension fund or a friendly society. The development of enterprises is also subject to the Bill of Rights or business human rights, so international law principles relevant to business human rights (Corporate Duty of Vigilance of France

4 *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Ltd* [2015] ZAWCHC 113; 2015 (6) SA 338 (WCC).

5 OECD Principles of Good Corporate Governance (2015) 35.

6 Companies Act 2008 s 7.

2017) should not be ignored and should be implemented to avoid any form of legal conflict.[7] To fulfil its objectives as required by the 2008 Act, the CIPC may refer to international company law developments such as the Corporate Duty of Vigilance to achieve a clearer perspective on business human rights.[8] The CIPC may also consult any international organisation, such as the OECD, to achieve its statutory objectives.

In brief, the objectives of CIPC are as follows:

- The promotion of intellectual property laws and their enforcement.
- The promotion of compliance with the 2008 Act and/or any other relevant national/domestic legislation, such as the Protection of Investment Act 2015.[9]
- The clearest possible enforcement of the 2008 Act and any other legislation listed in Schedule 4 of the 2008 Act. As a result, in terms of the Pension Fund Act 1956, it is not a requirement to register a fund in terms of the 2008 Act as a legal person and it seems that the objectives of the 2008 Act are not relevant to pension funds.[10]

Nevertheless, a pension fund or enterprise should also apply, for example, the United Nations Guiding Principles on Business and Human Rights (UNGPs) to prevent any form of discrimination between contributors and the fund. South Africa is a member of the United Nations and a signatory to complete the sustainability goals identified by the United Nations.

7 S 57(3)(a)–(b).

8 S 186(2).

9 S 186(1).

10 S 186(1).

2.2 United Nations Guiding Principles on Business and Human Rights

The 2011 UNGPs requires enterprises to respect human rights as among the principles of international law. Irrespective of the size, location or ownership of enterprises or the financial sector in which the enterprises operate, they must uphold and/or protect the universal human rights that are fundamental to business practices. To partner with the international community, domestic enterprises should follow these principles/practices, especially when signing investment treaties.[11] In the event of a breach of the UNGPs, a remedy is provided in Chapter 3. In Chapter 2, the duties of an enterprise include the duty to respect human rights, namely:[12]

- to establish a human rights due diligence code of conduct to prevent or mitigate breaches of business human rights;
- to establish a process of remediation for any adverse breach of business human rights;
- to avoid breaches of business human rights resulting from the business activities of the enterprise; and that
- domestic enterprises should respect universally recognized business human rights.[13]

Clearly, a domestic enterprise can respect business human rights only if the state or government prevents any form of discrimination. Currently, discrimination is considered fair in South Africa owing to the relevance of

11 UN Guiding Principles on Business and Human Rights (2011) 1.

12 UN Guiding Principles on Business and Human Rights (2011) 13-16.

13 UN Guiding Principles on Business and Human Rights (2011) 22. Government or companies could make use of international human rights experts to consider the appropriateness of national legislation that limits human rights for certain designated groups.

section 36 of the Constitution. Discrimination on the other hand conflicts with the Corporate Duty of Vigilance of France 2017, and France could penalise French enterprises (who have signed investment treaties with South Africa) doing business in South Africa that contravenes the duty of vigilance in France.

Principle 25 of the 2011 UNGPs explains the remedies for a breach of international or business human rights. Monetary compensation is one such remedy.[14] It is expected that states or governments that are members of the United Nations should provide for a remedy to allow affected shareholders, employees or prospective employees of foreign investment enterprises to have access to an effective remedy in domestic law. If a state provides for no remedy in appropriate national or domestic legislation, the state's duty to protect human rights could be interpreted as being extremely weak or even meaningless. France has recently developed legislation to provide for suitable remedies in the Duty of Vigilance law in 2017.[15] South Africa currently has none of the remedies required by the UNGPs even though the 2008 Act stipulates the importance of promoting/developing the South African economy. It is, therefore, also possible to include remedies for enterprises in investment treaties as a method of upholding the UNGPs.

2.3 Breach of international human rights

If an enterprise breaches international human rights, an employee, shareholder or prospective employee should be able to approach the enterprise to redress the breach. In addition, the enterprise should approve or enter into any formal process to redress the harm as a result of the breach.

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14 UN Guiding Principles on Business and Human Rights (2011) 27.

15 The Netherlands has followed due vigilance principles to avoid child labour in the manufacturing chain of goods and to avoid products stemming from child labour manufacturing chains.

However, redressing the harm caused should not always be in the form of monetary compensation, unless an international treaty that provides for monetary compensation is relevant.[16]

Only an international tribunal which has jurisdiction over the treaty can hear a claim for damages. If the treaty between South Africa and a foreign investment enterprise makes provision for approaching domestic resolution bodies (courts) or tribunals, any interested person may approach a domestic court or tribunal to declare the breach as a breach of business human rights. However, South African domestic courts/tribunals do not grant monetary compensation for breaches of human rights.[17] As an example, should the right to dignity be violated, section 38 of the Constitution provides for 'appropriate relief'. This appropriate relief does not include monetary compensation but instead an interdict or mandamus to prevent the breach of or to enforce the right to dignity. In *Dendy v University of the Witwatersrand,* the High Court considered the preceding approach, but also held the importance of first resolving a dispute with a decision maker before approaching a court of law in terms of administrative law.[18]

In the event of a breach of a business human right, treaties or charters that are promulgated into national legislation may contain a provision/section that

16 As an example, see the United Nations Multilateral International Convention on the Elimination of All forms of Racial Discrimination (1969) art 6.

17 *Dendy v University of the Witwatersrand* [2005] ZAGPHC 39. A claim for damages based on breach of the right to dignity. The Constitution can be used to develop the common law, not vice versa. S 38 of the Constitution provides for appropriate relief when a human or fundamental right has been breached, and damages are not part of this relief.

18 Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 100. The emphasis is on internal controls in a state department or enterprise to follow all avenues to solve a dispute before approaching a court of law.

domestic courts/tribunals should first be approached before an international tribunal is approached. The dispute could also be between an enterprise and a foreign state. Should the enterprise be a South African business entity; the enterprise must generally first exhaust the foreign state domestic remedies before approaching an international tribunal. A technical argument to avoid a treaty (generally entered into between states), would be that a treaty must be recognised by Parliament before it becomes part of domestic law.[19] This argument was made more technical than it should be in the *President of South Africa v Quagliani* 2009 (4) BCLR 345 (CC) with reference to Article 46 of the Vienna Convention, which simply states that a state may reject a treaty clause if the clause is manifestly in violation of domestic or municipal law.[20] Whether non-monetary compensation manifestly violates domestic law remains an uncertainty between a state and a foreign investment enterprise. On the other hand, international tribunals other than domestic courts should also have jurisdiction to settle disputes between those parties; for example, the power to grant monetary compensation for violations of business human rights.[21] In legal relations between the government and a foreign investment enterprise, without a treaty being signed by either party the domestic law will

19 Protection of Investment Act 22 of 2015 ss 13(5) and 15. An investment treaty that exists between South Africa and foreign investment enterprises requires that any disputes should be resolved by domestic tribunals. The Protection of Investment Act prescribes its own procedure to settle disputes between South Africa and foreign investment enterprise(s) irrespective the treaty's contents. From an international perspective, a foreign investment enterprise may still approach an international tribunal if the treaty has no provision to settle disputes in domestic or municipal law.

20 S 13(5).

21 2009 (4) BCLR 345 (CC) 363 A-E.

generally regulate that relationship.[22] In addition, it is not a requirement that Parliament or the National Assembly should approve an investment treaty between South Africa and a foreign investment enterprise, unlike treaties entered into between states.

Treaties may contain definitions to explain the relevant legal relationship between a state and a foreign investment enterprise. An enterprise could be explained as either a natural or a legal person, depending on the circumstances. For example, in domestic law, a partnership is generally interpreted as a natural person. A legal person obtains a legal personality when incorporated or registered as such in terms of domestic law, as in the case of a company registered in terms of the Companies Act 2008.[23] Investment in enterprises is relevant to any lawful enterprise acquired (take-over) or expanded (business categories of an enterprise) by an investor within the borders of a state, and where the investors use the enterprise over a reasonable period of time to make future profits.[24] An investment treaty may also regulate/ include the investment in an enterprise to hold shares, debentures or other ownership instruments. Investment as a term may also refer to two or more enterprises that merge outside the borders of South Africa as a way to expand their business objectives within a state. Such a 'merger treaty' will be considered an investment only if it is lawful or if the holding of ownership instruments (such as shares) will still continue to be in that state.[25] In this regard assets could include the debt security of another enterprise, loans made to an enterprise, the mortgages of an enterprise, the liens/pledges of an enterprise, claims for breach of contract, the intellectual property of

22 S 15; See in general R Jennings *Oppenheimer's international law* (Oxford University Press 1992) 1290.

23 Protection of Investment Act 2015 s 1.

24 S 2.

25 S 2(2).

an enterprise, etc. Investments also include the proceeds of assets such as dividends due to shares, royalties due to intellectual property or return on an investment yielded by a fixed immovable asset. Further examples could be licences granted by a state to exploit natural resources or to participate in the financial services industry of a state as a pension fund. Whether a licence to conduct the business of insurance or pension fund is considered a true asset is unclear, but the licence does create an opportunity to make profits in future. Should the licence be subjected to the ability to conduct the business of insurance or pension fund, it could for all practical purposes be an asset instrument. Or the equity/goodwill associated with the ability of a foreign investment enterprise to do business in a state – such as South Africa– could also for all practical purposes be an asset.[26]

2.4 Relevance of investment treaties and domestic administrative law

An investment treaty between the state and a foreign investment enterprise in terms of the Protection of Investment Act should be interpreted in terms of and be consistent with the Constitution of South Africa.[27] In addition, any treaty between the state and a foreign investment company should be interpreted to uphold the principles of international law. The legislature should take note of the OECD Overcoming Barriers to Administrative Simplification Strategies regulatory report relevant to investments. In addition, the Constitution states that any domestic legislation must be interpreted in consistency with and with reference to the provisions/ principles of international law.[28] Generally, the interpretation of a treaty

26 S 2(2)(a-h).

27 Protection of Investment Act 2015 ss 3 and 4.

28 Constitution of South Africa 1996 ss 232 and 233; OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy

must be consistent with the Constitution.[29] The problem is that a treaty (between a foreign investment enterprise and the state) could provide that such disputes are generally not subject to domestic or municipal law on how to settle disputes between the parties. On this point, it would be difficult for South Africa to argue that an international tribunal has no jurisdiction to hear a dispute, irrespective of the contents of the Protection of Investment Act.

The 2011 UNGPs plays an important role in South Africa.[30] It is required that states and foreign investment enterprises should adopt the UN perspective on business human rights to protect good business practices – even if a business human right is limited by a domestic constitutional court order, such as the right to privacy. How a foreign investment enterprise should deal with the latter is unclear. In principle the enterprise has, on the one hand, a duty to follow the principles of the investment treaty, while, on the other hand, following the domestic judgments pertaining to business human rights. Article 46 of the Vienna Convention is relevant only to states, not to enterprises, so enterprises are not obliged to reject international law when it is manifestly contrary to domestic law. The latest example pertaining to balancing legislation and universal human rights has occurred in France. France has adopted the Corporate Duty of Vigilance Law, in terms of which parent or holding enterprises in that country have a duty to identify violations of human rights in other states and to prevent such violations in future by forcing their subsidiary enterprises doing business in those states

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Makers (2009) 6. Although this document relates to administrative law, it requires states to implement simple administrative processes to cut unnecessary 'red tape' resulting from excessive interference by bureaucratic states, as in an investment treaty where an enterprise must obtain a licence to participate in the financial services industry of a state.

29 S 233.

30 Protection of Investment Act 2015 s 3(b).

to stop violating business human rights.[31] If the subsidiary is unable to do so, the parent enterprise may be fined up to 30 million euro in France.

An investment treaty between a state and a foreign enterprise is regulated by the Protection of Investment Act and its regulations, such as alternative dispute resolution processes through mediation in South Africa only.[32] In relation to disputes, the state as a signatory to the treaty may also have the 'right to regulate investments' by domestic legislation as a method to 'promote international peace and security' that could be contrary to the treaty clauses. The Protection of Investment Act is an example.[33] To provide for international peace and security generally, an investment treaty provides for financial/economic stability for a particular state or enterprise doing business in other foreign states.

Whether the 2011 UNGPs cater for economic circumstances and whether those circumstances could be exceptions for violating relevant human rights are unclear from an international perspective.[34] It seems that economic circumstances could be an acceptable reason for violating human rights if the violation could contribute positively to tangible results over the long term – results relevant to a specific state's economy. Economic adjustments or circumstances could, therefore, violate a human right or business human right, but since human rights are part of various relevant treaties, identifying the true objective of changing the economic circumstances of a state is very important from an international perspective, for example, to adjusting the economic circumstances to benefit a state in the long term at the expense of

31 Corporate Duty of Vigilance 2017 Frequently asked Questions as Compiled by European Coalition for Corporate Justice https://bit.ly/3sKkAZa (accessed 25 February 2020).

32 Protection of Investment Act 2015 ss 12(1)(a)-13.

33 S 66(4).

34 UN Guiding Principles on Business and Human Rights (2011) 1-3.

universal human rights. In this matter, all circumstances should be considered to understand whether or not the violation is in conflict with international law and economic principles – if possible. In this regard, the emphasis of the OECD report, Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers cannot be overstated. Although section 33 of the Constitution requires fair and reasonable administrative action for everyone, a state is also subject to bureaucracy which effects everyone's right to section 33. To prevent the latter infringement of a right to fair administrative action, the OECD's report for policy makers requires that an economy should play a predominant role and should not be hindered by unfair administrative procedures that ultimately require the application of the Promotion of Administrative Justice Act 2002 for a suitable review or remedy. The OECD also requires states to use simple administrative processes to allow a foreign enterprise to operate within the state as required by investment treaties or otherwise. Such processes might include applying for mining licences or financial services licences and obtaining these licences within a very short period of time, thus contributing to the South African economy.[35]

Despite anything to the contrary, any state decision to infringe the rights and/or duties of an enterprise in an investment treaty could be subjected to the principles of domestic administrative law.[36] An administrative decision means any decision of an administrative nature made or proposed to be made as a result of either empowering domestic legislation or otherwise.[37] Administrative action includes any decision (or failure to take a decision) by

35 OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 6; See Y Burns and R Henrico *Administrative law* (LexisNexis 2020) 49.

36 Protection of Investment Act 2015 ss 6 and 15.

37 Promotion of Administrative Justice Act 3 of 2000 s 1.

the state that is contrary to the purpose of the investment treaty. Generally, the functions of the state to regulate an enterprise by granting it a licence to operate the foreign investment enterprise in a specific financial industry or to gain access to the premises of a foreign investment enterprise or to confiscate the assets of the foreign investment enterprise or to regulate those assets, for example, as part of a pension fund, or to prohibit access to private/public competitions, etc., could constitute a public function.[38] A minister may by notice in the Government Gazette classify certain decisions as administrative decisions, which, therefore, cannot be reviewed by a court or tribunal.[39] To promote administrative efficiency the minister may also permit the state or the enterprise to follow a fair administrative procedure when making decisions. The contrary is also possible – the minister may decide not to follow a fair administrative procedure when making decisions relevant to specific circumstances only. The latter is possible only if the action is reasonable and justifiable under the circumstances and/ or to uphold the purposes of investment treaties.[40] A practical example is decisions taken by the Reserve Bank of South Africa requesting a financial sector regulator to introduce directives to regulate pension funds and the like. The decision to request directives is an exemption in terms of the Financial Sector Regulation Act 2017, which regulates who the decision makers are relevant to administrative law. In this regard, the OECD suggests

38 *Johannesburg Stock Exchange v Witwatersrand Nigel Ltd* 1988 (3) SA 132 (A), where the court had to decide whether the decisions of the JSE were in fact a public function, and subsequently confirmed that they were; See *Herbert Porter & Co Ltd v Johannesburg Stock Exchange* 1974 (4) SA 781 (W) 791, where it was found that a circular sent to shareholders is not subject to administrative review; See *National Horse Racing Authority of Southern Africa v Naidoo* [2009] ZAKZHC 2010 (3) SA 182 (N) for a public function between private individuals.

39 Compare Protection of Investment Act 2015 s 6(2).

40 Promotion of Administrative Justice Act 2000 s 2.

the 'Kafka' test as leading to an understanding of how new directives create administrative burdens on foreign investment enterprises: Are the new directives to the benefit of the South African economy? Could they be part of the over regulation that prevents economic growth?[41] Although the OECD recommends indicators of how well a state is performing in terms of attracting foreign investments, a practical indicator for South Africa is simply Moody's investment rating agency.[42]

2.5 Procedurally fair administrative actions affecting any person

If a foreign investment enterprise or state issues a domestic administrative action/decision and the decision affects/infringes the rights or expectations of any person who is a party to an investment treaty, the enterprise or state must disclose the following to the affected person as part of procedural fairness:[43]

- adequate notice of when the proposed administrative action/decision will take effect;
- reasonable opportunity to make representations before the date of implementation of the administrative action/decision;
- a clear statement/explanation of the proposed administrative action/decision;

41 OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 47 and 50.

42 S Gokoluk and P Naidoo 'Moody's: Too early to assess SA's progress' (no date) https://bit.ly/3Fthq3k (accessed 26 February 2020).

43 Promotion of Administrative Justice Act 2000 s3; G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 21; Y Burns and R Henrico *Administrative law* (LexisNexis 2020) 66.

- any right/remedy to review the decision or possibility of an internal appeal of a decision; and
- adequate notice time period to allow for the right to request reasons.[44]

As part of the right to procedurally fair administrative action, as required by section 33 of the Constitution, any proposed infringement of the rights and/or duties created by an investment treaty could also be subjected to the following provisions: In complex infringement cases the affected party must be able to obtain legal representation, be able to obtain additional information and/or to dispute relevant information presented by the proposed decision maker and/or to appear in person to attest to why the proposed decision will infringe the rights or duties of either the state or the enterprise, depending on the circumstances, relevant to the treaty.[45] In addition, it is possible that the decision maker may follow a simplified administrative process as regulated in a treaty to avoid the implementation of domestic law relevant to administrative decisions. As an example, the OECD is proposing to evaluate the current administrative processes of a state by relevant 'stakeholders' (on an *ad hoc* basis) and whether the current processes are in the best interests

44 Protection of Investment Act 2015, s13(3) provides for the following mediation process, which is not compulsory: contact details of the foreign investor, including a physical address in the Republic or territory where the investor is predominantly resident, or where it is incorporated, its email address, facsimile number and telephone number, a summary of the claim, including the measures giving rise to the investment dispute, the specific organ, agency, province or other subdivision of the Republic allegedly responsible for the measures which the foreign investor alleges constitute a breach of any of the investment protection contained in this Act, the provisions of this Act that the foreign investor alleges to have been breached and the relief sought.

45 Promotion of Administrative Justice Act 2000 s 3(3); G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 149-156.

of foreign investment enterprises or not.[46] In this respect, international cooperation is required to increase the administrative efficiency of a particular state, for instance, to obtain licences in a short time in order to contribute to the South African economy.

Where a proposed domestic administrative action would adversely affect the rights embedded in a treaty, it is possible that either the state or the enterprise may call a public inquiry. The public inquiry will be chaired by a qualified person or panel of persons. Generally, the chair or the panel may determine the procedure that must be followed to hold the public inquiry and may hold the inquiry according to those procedures. At the end of the inquiry a written report must be compiled pertaining to the proposed administrative action and the possible implications thereof. The report must also be published in summary in the Government Gazette, as must relevant particulars in a place where the whole report can be inspected by any interested person.[47] Instead of a public inquiry, a notice and comment procedure may also be followed. Only those persons affected by a proposed administrative action may reply to the notice by submitting the necessary comments. It is also possible to do away with a public inquiry or the notice and comments procedure if it is just and equitable to do so.[48]

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46 OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 8-9.

47 Promotion of Administrative Justice Act 2000 s 4. See s 1 definition of an administrator.

48 When the international industry enterprises proposed 'fracking the Karoo' to obtain energy resources, a public enquiry was held by the state. Although the parties to such an investment treaty could be a foreign investment enterprise and the state, the Department of Environmental Affairs could nevertheless authorise the fracking. If it is authorised, then the signing of the treaty can continue. Even if the treaty is signed and the enterprise is a French enterprise, the Corporate Duty of Vigilance Law 2017 is also relevant not

A party to an investment treaty whose rights have been materially affected by an administration action may, within 90 days after the date on which that person became aware of the domestic action or might have been expected to become aware of the action, request written reasons from the decision maker. The state or enterprise that made the administrative action must or may:

- within 90 days after receiving the request give that person reasons in writing; or
- if it fails to furnish adequate reasons, the administrative action is subject to judicial review; or
- may depart from the requirement of giving reasons in writing, if it is just and reasonable, when taking into account all relevant factors for the decision, such as:[49]
    - the objects of the provision relevant to the decision;
    - the nature and purpose of the administrative action; or
    - the nature and extent of the departure and its purpose, the importance of the departure and the need to promote good corporate governance.[50]

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only to business human rights but also to protecting the environment; See Corporate Duty of Vigilance 2017 Frequently asked Questions as Compiled by European Coalition for Corporate Justice https://bit.ly/3Wf59p8 (accessed 25 February 2020); G Quinot *Administrative justice in South Africa* (Oxford University Press 2015) 87.

49 Promotion of Administrative Justice Act 2000 s 5; *Transnet Ltd v Goodman Brothers (Pty)Ltd* 2001 (1) SA 853 (SCA); In *Sikutswa v MEC for Social Development Eastern Cape* 2009 (3) SA 47 (TkH) the question was posed whether the 90 days could be reduced.

50 *Jeffrey v President, South African Medical and Dental Council* 1987 (1) SA 387 (C) that in the event of a disciplinary hearing and although the Council's

2.6 Judicial review of an administrative decision

Any person who is a party to an investment treaty may approach a domestic court or tribunal for the review of an administrative action/decision if so required by the treaty. The court or tribunal has a duty to review the decision if the person who took the decision was not authorised to do so or was biased. A person can also approach a court or tribunal when the procedure followed in making the decision was unfair, an error of law occurred, ulterior motives were present for the decision, irrelevant considerations were considered by the decision maker, or bad faith or capriciousness are also evident. The administrative action contravenes the principles of international law if there is no clear reason(s) why the decision was made, or it is not related to any empowering provision in the Protection of Investment Act 2015, or poor reasons were provided or it breaches the principles of the investment treaty.[51] In addition to reviewing an administrative action on the basis of a failure to take any decision, a judicial review can be instituted when there is a significant delay in taking a decision, and the aggrieved person may therefore either approach a court or a tribunal to give directions as to when the decision must be made.[52]

- on the other hand, it is possible to avoid judicial review. The OECD has issued certain strategies to prevent the judicial review of administrative decisions. These strategies are summarised here as follows:
- planning for a simple administrative process in the treaty;

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decision was fair, and although no reasons were provided, a court can set aside the decision of the Council.

51 Promotion of Administrative Justice Act 2000 s 6(1-2); See in general, G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 111-112. The three grounds for reviewing a decision are based on lawfulness, reasonableness and procedural fairness.

52 S 6(3); Y Burns and R Henrico *Administrative law* (LexisNexis 2020) 521.

- consulting with foreign investment enterprises to understand their individual needs or requirements in a treaty;
- designing a new administrative process for a state in a treaty relevant to a foreign investment enterprise;
- implementing the new process successfully; and
- monitoring the new process to prevent any form of future domestic judicial review.[53]

2.6.1 Procedure for judicial review

Any review of an administrative decision must be instituted without any unreasonable delay and not later than 180 days after the date the decision was made. In addition:

- no domestic court or tribunal shall review an administrative decision unless any internal remedy provided for in any other law has first been exhausted, but may excempt the latter requirement if it is in the interest of justice;[54]
- the person became aware of the administrative decision after 180 days;[55] and

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53 OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 15-16.

54 Promotion of Administrative Justice Act 2000 ss 7(1) and 2(a-c); G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 227. All internal remedies should first be exhausted before a court will review a decision; See also *Dengetenge Holdings Pty(Ltd) v Southern Sphere Mining and Development Co Ltd* 2014 (5) SA 138 (CC) relevant to s 7(2).

55 S 7(1). It is possible to extend the 180 days; See in this regard G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 228; Y Burns and R Henrico *Administrative law* (LexisNexis 2020) 591.

- all proceedings for judicial review of the decision must be instituted in the High Court of South Africa.

It should be noted that if an investment treaty contains relevant rules on how to review domestic administrative decisions, those rules must be followed by domestic courts.[56] On this matter, the OECD is proposing alternatives to traditional administrative regulation by a state's legislation where the state's actions, for example, hampers economic activities. A practical example is the Protection of Investment Act that requires mediation irrespective of what the treaty says. It is also possible to re-engineer the whole process to prevent (or to limit) the review of administrative decisions, especially licence applications relevant to treaties only, for example, a treaty where the state requires the services of foreign reinsurers in the domestic insurance sector.[57]

2.6.2 Remedies

When considering judicial review relevant to an investment treaty, a court or tribunal:

- may grant any order that is just and equitable;[58] and
- include orders directing the state/government and/or foreign investment enterprise to give reasons for their decisions or to act in a manner the court or tribunal requires the decision maker to act, or prohibiting the

56 G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 233.

57 OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 21.

58 Promotion of Administrative Justice Act 2000 s 8(1); G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 257; Y Burns and R Henrico *Administrative law* (LexisNexis 2020) 532.

> state or enterprise from acting in a particular manner or the court of tribunal may set aside the administrative action.[59]

When a court or tribunal has set aside an administrative action, that court or tribunal can require the state or foreign investment enterprise to reconsider the decision with or without giving directions on how to make the decision. Under certain circumstances the court or tribunal may replace the state's or enterprise's decision with its own decision or require the state, enterprise or any other party to the pleadings to pay compensation. It is also possible to request the court or tribunal for a declaratory order or to ask the court or tribunal for an interdict or any other relief with or without costs, such as a declaration order setting out the law to the parties.[60] In the event that the state or enterprise fails to take a decision, the court or tribunal may grant a just and equitable order, for instance, direct the state or enterprise to take a decision and/or may direct the parties to undertake or to refrain from committing certain acts.[61] These remedies are technical in their design and execution. To this end, the OECD states that legal complexity might become an 'unsolvable challenge' if the state is resistant to changing its domestic

59 S 8(1); *Metropolitan Collective Investments Ltd v Registrar of Collective Investment Schemes* (no case number provided) https://bit.ly/3t1xu5f (accessed 21 June 2019). This decision was delivered during 2010 without any reference to the Promotion of Administrative Justice Act 2002.

60 Promotion of Administrative Justice Act 2000 s 8(1).

61 S 8(2); G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 258-262. Compensation is also possible but only in exceptional circumstances – *De Jong v Trustees Simcha Trust* 2014 (4) SA 73 (WCC) where the court granted public law compensation since the claim of compensation could not be based on the law of delict; Y Burns and R Henrico *Administrative Law* (LexisNexis 2020) 538.

administrative processes relevant to investment treaties and the like.[62] To prevent this, the OECD recommends administrative simplification, and a state that is party to an investment treaty should thus understand why the use of simplification processes is so important for an economy.

2.6.3 Variation in time

The state and/or enterprise must make an administrative decision within 90 days. However, the 90 days may be extended. If no agreement can be concluded, the parties may approach a court or tribunal to extend the time period. The court or tribunal will extend the time period only if the criteria relevant to the decision are in the interests of justice.[63] In this regard, the OECD follows the 'silence is consent' rule. If no administrative correspondence is received pertaining to an administrative procedure within the time frame or exceeding the time frame, it is simply assumed that the decision is in favour of, for example, the foreign investment enterprise.[64]

2.7 International corporate governance principles relevant to enterprises

The OECD principles of corporate governance help to promote investor confidence in a particular state. Should a state possess poor corporate governance structures or undocumented corporate governance principles, it is possible that a treaty with that state could incorporate the OECD principles

62 OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 29 and 44; H Booysen 'A survey of legal relationships from state agreements' (1984) *SAYIL* 56.

63 Promotion of Administrative Justice Act 2000 s 9; G Quinot et al. *Administrative justice in South Africa* (Oxford University Press 2015) 201.

64 OECD Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers (2009) 22.

of good corporate governance. On this point, the responsibilities of the investor/foreign investment enterprise and/or state are clearly defined by the OECD principles. In the event of a dispute with a state or enterprise an international tribunal could be of use, which could consider administrative principles when making an award.

The OECD principles of corporate governance are the end result of the deliberations of numerous international organisations.[65]

The sections that follow focus on these specific organisations and other relevant sources or instruments.

2.7.1 The Basel Committee on Banking Supervision

The Basel Committee consists of 45 members from 28 jurisdictions/states. These members are largely central banks. The duties and rights of the central banks are regulated by the Basel Committee Charter or treaty. The sole purpose of the treaty is to maintain financial stability in the world economy. The Basel Committee oversees the supervision and practices of its members in this regard.[66]

2.7.2 The Financial Stability Board

The Financial Stability Board, of which South Africa is a member, supervises the international (world) financial system. Currently, membership consists of 25 members based on jurisdiction. The 25 members have signed a treaty and decisions among members are taken by consensus/majority vote.[67]

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65 OECD Principles of Corporate Governance (2015) 40; See in general international investments (prospectuses of enterprises) https://bit.ly/3UbOqRM (accessed 2 February 2019).

66 https://www.bis.org/bcbs/charter.htm (accessed 2 February 2019).

67 https://bit.ly/3NiUJAM (accessed 1 March 2019).

2.7.3 The World Bank Group

The World Bank Group, which comprises 189 members, seeks to promote prosperity in a sustainable way for each state and gives advice to developed countries or developing countries based on an analysis of their respective economies. The World Bank Group also provides financial products and consultants to states to solve their individual economic problems. The Group, among other things, gives advice to members on trade agreement treaties and gives assistance on how to design trade treaties between member states. Examples of trade agreements are the United States-Mexico Canada Agreement (USMCA), the Central American Dominican Republic Free Trade Agreement (CAFTA-DR), the European Union (EU) Trade Agreements and Asia-Pacific Economic Cooperation (APEC).[68]

2.7.4 The G20

In addition to King IV, South Africa is a member of the G20 and should in principle also comply with OECD's corporate governance principles as a participant/key state. OECD members are expected to implement these principles in their domestic law with the purpose of improving a member's national corporate governance and creating a better understanding of corporate governance principles from an international perspective. The main reasons why these principles are important to states and investment enterprises is to promote economic growth, economic efficiency, and financial stability. The sole purpose of these principles is to avoid/prevent corruption or corrupt government practices. These principles should in principle also be relevant to the relationships:

68 https://bit.ly/3WiJgFu (accessed 1 June 2019).

- between states, foreign investment enterprises - shareholders and stakeholders of these enterprises/states; and
- between a domestic or foreign investment enterprise and a state.[69]

2.8 Other sources or instruments

The OECD corporate governance principles are further explained in other sources or instruments.[70]

2.8.1 The OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises are recommendations for promoting responsible business conduct in international and domestic transactions. They are agreed to by different states, and enterprises should actively promote/implement these guidelines when operating in a specific state or from a specific state. In addition to these guidelines, the OECD Due Diligence Guide provides supplementary guidelines for enterprises on how to apply the OECD Guidelines for Multinational Enterprises in practice. The OECD has a separate corporate governance code for the business of insurance, which could also be followed voluntarily by domestic insurance enterprises.[71]

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69 OECD Principles of Corporate Governance (2015) 3-10. South Africa is not a member of the OECD but is recognised as a key partner of the OECD. Other key partners are Brazil, China, India and Indonesia.

70 OECD Principles of Corporate Governance (2015) 10.

71 OECD Guidelines for Multinational Enterprises (2011) foreword; OECD Due Diligence Guidance for Responsible Business Conduct (2018) foreword.

2.8.2 The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions

The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions explains that states have a positive duty to combat bribery. Bribery is generally regulated in national legislation but the combating of bribery will play a greater international role in the future. The World Bank, the United Nations, the Council of Europe and the European Union are actively working with different enterprises to understand the inner mechanisms of bribery and/or corruption. The purpose of Article 1 of the Convention on Combating Bribery simply says it is a criminal offence to bribe a foreign public official, irrespective of what method of bribery is to be used by an investment enterprise. The same applies to the bribery of an investment enterprise by a public official. The G20 could provide legal assistance to member states to help them to prosecute bribery as regulated by Article 9 of the Convention of Combating Bribery.[72] We in South Africa are unaware of whether or not the state has requested G20 assistance in the prosecuting of state capture offenders.

2.8.3 The UN Guiding Principles on Business and Human Rights

The UN Guiding Principles on Business and Human Rights is aimed at preventing states/foreign investment enterprises from abusing human rights and to remedy/ratify human rights abuses committed during or in business operations. As an example, any redress of past human rights violations to achieve justice in the business or corporate environment could still be contrary to the UN principles. The member state has a positive duty to change domestic legislation or to reduce barriers to achieve justice and/or to grant remedies for human rights abuses/violations as an inexpensive method

72 https://bit.ly/2qAA3LA (accessed 1 June 2020).

of accessing justice. Prof. John Ruggie of Harvard University explains the necessity for a 'business human rights treaty' to establish a tribunal with extraterritorial jurisdiction to consider human rights violations in the domestic corporate environment. For example, economic growth alone is not sufficient justification for human rights violations or for ignoring human rights violations, and the same applies to poor economic growth.[73]

2.8.4 The ILO (International Labour Organisation) Declaration on Fundamental Principles and Rights at Work

The ILO (International Labour Organisation) Declaration on Fundamental Principles and Rights at Work is relevant to member states even if a member state has not ratified the treaty or incorporated the treaty in its domestic legislation. On an international level, the treaty is valid and enforceable between states and enterprises. The treaty deals predominantly with the elimination of forced labour, the abolition of child labour and the elimination of discrimination in respect of employment in enterprises.[74] The ILO consists of 187 member states, which may not, in this respect, sign a treaty with an investment enterprise for investment purposes if the enterprise uses child labour.

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73 Complaints Procedures of the International Human Rights Supervisory Bodies https://bit.ly/3U7Umvk (accessed 15 August 2020).

74 https://bit.ly/2xOyoF3 (accessed 1 June 2020). The International Labour Organisation (ILO) regulates agriculture, metal production, commerce, financial services, construction, education, hospitality, forestry, health services, mining, engineering, oil, telecommunications, shipping, textiles, clothing, footwear, transport, water/electricity, etc.

2.8.5 The OECD Principles of Corporate Governance

The OECD Principles of Corporate Governance consists of six statements relevant to investment treaties. The preamble to the Companies Act 2008 also refers to these six statements to a certain extent. In brief they are:

- an effective corporate governance framework and/or an effective domestic corporate governance framework;[75]
- rights and equitable treatment of shareholders;
- regulated and fair reflection of stock prices and/or markets;
- the role of stakeholders (or the community at large) and their expectations in the domestic economy and/or for investment purposes in the domestic economy;
- principles relevant to disclosures pertaining to bribery and corruption or the prevention thereof to ensure financial stability in the domestic economy;
- responsibilities of the board of directors of foreign investment enterprises to complete their individual fiduciary duties in a particular state for the benefit of the economy;[76] and
- the prevention of human rights or business human rights abuses.

OECD countries require member states to establish a corporate governance framework and to monitor corporate governance principles. How a state monitors compliance varies from one state to another. In the Companies

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75 *Ex Parte Grassridge Wind Power (RF) Pty(Ltd)* CT00183ADJ2019 argued that it is not unethical to request exemption from establishing social or ethics committee(s) owing to the business nature of the company. After considering all the facts, the Tribunal may grant exemption for five years only.

76 OECD Principles of Corporate Governance (2015) 5.

Act 2008, for example, compliance with the Act is regulated by section 6.[77] In the Companies Act 1973, no relevant sections/examples for compliance purposes or for monitoring enterprises for compliance purposes were provided.[78] In the event of conflict between the Promotion of Administrative Justice Act and the Protection of Investment Act, the latter legislation may prevail, which is contrary to the OECD guidelines to administrative law. The same may apply to the Promotion of Access to Information Act 2000, the Banks Act 2011, and the National Payment System Act 1998, relevant to administrative decisions. In the case of the Protection of Investment Act mediation is required, but should a foreign investment enterprise not follow this alternative dispute resolution process, the Act effectively gives the enterprise the option to make use of the Promotion of Administrative Justice Act or the domestic courts, thus ignoring the legal basis of an investment treaty.[79] The OECD promotes the principles of economic sustainability and, in section 7 of the Companies Act 2008, the purpose of the Act is explained as promoting the welfare of the South African economy. In this respect, business human rights are fundamental to the principles of company law since the purpose of the Act is to promote compliance with the Bill of Rights. Besides the latter, international conventions should also be part of the Companies Act 2008 in order to understand the scope and the implementation and protection of business human rights relevant to the economic development of South Africa.[80]

77 Companies Act 2008 s 5(4).

78 S 7.

79 Protection of Investment Act s 13.

80 OECD Principles of Corporate Governance (2015) 13 and 15.

2.9 Corporate governance framework: Domestic compliance notices and review

The Companies and Intellectual Property Commission (CIPC) and the Takeover Regulation Panel may issue a compliance notice to any person who contravenes the provisions of the Companies Act 2008. All that is required is a reasonable belief of contravention. The notice can also be sent to any person who directly or indirectly benefited from a contravention of the said Act.[81] The Act also gives an option for an aggrieved person to approach a domestic court of law directly instead of requesting the commission or panel to issue a compliance notice. A compliance notice will request the following of the person/enterprise to whom it is addressed:

- to cease, correct or reverse any act in contravention of the Act;
- to take any action required by this Act, for example, to disqualify a director;
- to restore assets or their value to an enterprise or any other person;
- to take any other steps designed to rectify the contravention; and
- a commission or panel must send a copy of the contravention to the professional body that regulates that enterprise informing the body of the contravention.

In addition, a compliance notice must contain the following information:

- the person or enterprise to whom the notice applies;
- the provision of the Act that was contravened;[82]

81 Companies Act 2008 s 171.

82 S 171(4); *Maudi Lentsoane v Busisiwe Maureen Brown* CT00241ADJ019. In this matter, an application was made to remove a director, Busiswe, from Theromba Group Pty (Ltd). He had asked for a loan from the company in his capacity as a director, and according to the other two directors, such

- details of the extent of non-compliance;
- steps to be taken to rectify the non-compliance and the time period within which to rectify the non-compliance; and
- a penalty, if any.

A compliance notice remains valid and enforceable until such time as it is set aside by the Companies Tribunal or the courts. A notice to comply with the provisions of Companies Act 2008 relevant to mergers remains valid unless set aside by the Takeover Panel or a court. If the enterprise complies with or rectifies the breach (non-compliance), the Commission or Takeover Panel will issue a compliance certificate. No time period is assigned to answering notices or to complying with notices and thus the time period is arbitrary. Should a person submit a complaint of non-compliance, the principles of administrative law are relevant and the Commission or Panel must issue a non-compliance notice in a reasonable time. Although the Promotion of Administrative Justice Act refers to either a domestic tribunal or court competent to hear such matters, it is unclear whether the Companies Tribunal is able to hear them.[83] The Tribunal is a cost-effective dispute resolution institution since no legal representation is required. In this regard, the OECD corporate governance principles promote integrity and a flexible corporate governance framework which includes a flexible alternative dispute resolution body/institution. For this reason, the jurisdiction of the

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a loan or action was not to the benefit of the company because the money would never be paid back. The Tribunal did not grant an order to remove the director.

83 Companies Act 2008 s 171(5); *Ex Parte Samsung Electronics South Africa* CT00277ADJ20202, where Samsung asked the Tribunal for non-compliance with s 43(4) of the 2008 Act; *Ex Parte Outlook Farms* CC CT00297ADJ20202 where an application was made to exempt it from establishing an ethics and social committee. The applicant is a CC and the Tribunal has no jurisdiction in regard to close corporations.

Companies Tribunal should be flexible to accommodate this principle.[84] The OECD corporate governance principles also require that shareholders or stakeholders of investment enterprises should know the processes for implementing principles and laws with a degree of certainty, and it is not always clear what the jurisdiction of the Companies Tribunal is. On this matter, the role of the Companies Tribunal is not clearly defined in the 2008 Act – Schedule 4 of the Act. On the other hand, should a person fail to comply with a compliance notice, only a court or national prosecuting authority may pursue the non-compliance as an offence and/or impose a fine.[85]

The OECD requires a regulatory authority (Companies Tribunal, CIPC or Takeover Panel) to resolve compliance issues in a timely fashion and to fully explain the reasons for a notice issued.[86] The foreign investment enterprise may object to a non-compliance notice. Such an objection must be lodged with the Companies Tribunal, for instance, which must review the notice within 15 business days after receiving it. The Tribunal may cancel the notice after hearing either the enterprise's, the CIPC's or the Panel's arguments. The Tribunal will then either amend or modify the notice in part or completely and the applicant/enterprise must comply with that notice. However, the decision of the Tribunal is subject to review by a court.[87] Whether a notice is also an administrative decision is unclear. It seems that a decision by the CIPC is also subject to review by the Companies Tribunal. The Takeover

84 S 180; OECD Principles of Corporate Governance (2015) 14.

85 Ss 171(7) and 214; *Ex Parte Samsung Electronics South Africa* CT00277ADJ20202, where Samsung applied for exemption to appoint a director who was not involved in the day-to-day running of the business to the social and ethics committee. The Tribunal held that the appointment of such a director would be contrary to s 43(4) of the 2008 Act.

86 OECD Principles of Corporate Governance (2015) 16.

87 Companies Act 2008 ss 172(3) and 172(4).

Panel and special committees' (for example ethics committees') decisions could in principle also be reviewed.[88] In the event that a foreign investment enterprise agrees to the content of a notice the CIPC may make the notice an order. Should the foreign investment enterprise consent to that order, the CIPC may apply to the High Court for an order of consent.[89]

2.10 Rectify a breach of domestic law, 'excuse a person' and investigations

The OECD requires effective enforcement to rectify any breach of domestic law or breach of voluntary national/domestic corporate governance codes. A suitable example would be King IV. Section 174 of the Companies Act 2008 refers to non-referral notices. What is a non-referral notice? Textbooks on this matter do not explain a non-referral notice and the meaning of the phrase is unclear. It could mean that either in the opinion of the CIPC or the Takeover Panel a complaint received does not constitute non-compliance and, as a result, the complainant may approach a court directly concerning the 'non-compliance'.[90] The application to the court must not contain a statement of a person blamed for the 'contravention' of the 2008 Act either by the Commission or the Takeover Panel. In this regard, this decision to 'excuse a person' is not subject to review. It is also not an administrative decision. The OECD, on the other hand, requires an effective corporate governance framework and one may argue that section 174 is contrary to the OECD principles of good corporate governance. If the Commission or Panel makes a mistake in 'excusing a person' from the consequences of non-compliance,

88 OECD Principles of Corporate Governance (2015) 16; *Christopher Panayioutou v CIPC* CT001JUN2015, where the applicant applied for certain names and the CIPC refused to register them.

89 Ss 173 and 168.

90 Companies Act 2008 s 174.

this simply means that the decision is not subject to referral by the courts. In all other cases, the Commission or Panel may refer non-compliance to a court or tribunal.[91] In this respect, the court must give directions to the Panel and/or CIPC to issue a notice of compliance and/or to make any other order that is 'just and reasonable' in the circumstances.[92]

The OECD corporate governance principles addresses the effectiveness of regulatory bodies' ability to enforce legislation. The Companies Tribunal is not able to issue administrative fines for non-compliance with the Companies Act. On this matter, the CIPC or Takeover Panel must approach a court to issue an administrative fine. Why is the Companies Tribunal unable to issue fines in this regard? Similar regulatory bodies in domestic law are able to award damages/fines in the event of non-compliance with Financial Advisory Intermediary Services Act 2002. A practical example is the Financial Advisory Intermediary Services (FAIS) Ombud.[93]

The minimum quantum for an administrative fine should not be less than R1 000 000 or not greater than 10% of the enterprise's turnover. A court or tribunal must consider the following factors before issuing a fine: the nature of the contravention, any loss suffered, the behaviour of the respondent, the market in which the non-compliance occurred, the profit made as a result of the non-compliance, and whether the enterprise cooperated with Regulatory bodies to rectify the non-compliance.[94] Since South Africa is a member of

91 Cassim et al. *Contemporary company law* (Juta 2012) 850; Delport *New entrepreneurial law* (Lexisnexus 2014) 266.

92 S 174(2); OECD Principles of Corporate Governance (2015) 14.

93 Financial Advisory and Intermediary Services Act 37 of 2002 ss 1 and 21; Companies Act 2008 s 175; OECD Principles of Corporate Governance (2015) 15.

94 Companies Act 2008 ss 175 and 187.

the G20, the regulatory authorities/bodies could follow the guidelines of the OECD relevant to corporate governance fines.[95]

In the event of an enterprise scandal, the CIPC or the Takeover Panel should investigate the scandal for possible non-compliance[96] and may issue summons to any person to produce any document or to appear before the CIPC or Takeover Panel or the investigator in person. The investigator (or independent investigator) will ask questions, which must be answered truthfully and to the best of that person's ability. However, the person is not expected to answer a self-incriminating question.[97] Any person who is summoned to appear before the Takeover Panel, CIPC or inspector must also answer those questions under oath. Based on the information supplied, the CIPC or Takeover Panel may approach a High Court or Magistrates' Court for a search warrant to search for additional documents or request any information to be searched for that has a bearing on the investigation.[98] Before questioning any person when searching the premises, the inspector or investigator must inform that person/foreign investment enterprise of his or her right to be assisted by an attorney and any document or item removed from the premises must be clearly documented by the inspector.[99] The OECD corporate governance principles requires public interest as a standard or test to evaluate the effectiveness of domestic legislation. In other words, the investigation of non-compliance or financial scandals should be in the interests of the public and must be investigated by the CIPC, for example. However, the investigation may be frustrated if a person refuses to hand

95 OECD Principles of Corporate Governance (2015) 16.

96 S 176.

97 S 176(1-4).

98 S 178.

99 Ss 179, 208 and 209 for the appointment of inspectors/investigators.

over a document, data or computer on the basis of 'privileged information'.[100] In this regard, a court should be approached by the CIPC or Takeover Panel and only a court can declare that the document, data or computer in question is in fact privileged or not.

2.11 Cross-border investigations and exchanges

OECD principles require states to sign bilateral or multilateral treaties for cross-border effectiveness to investigate financial scandals. Currently, section 186(2) of the Companies Act 2008 requires the Council for Financial Reporting to take note of international developments. Although this section uses the word 'may', in terms of the OECD it should be 'must'.[101] Section 186(2) has no legislative effect in the event of cross-border investigations unless a treaty to interrogate any investment enterprise pertaining to a financial scandal is relevant to both states. For example, where domestic law is poorly drafted, the investment treaty or treaty between states can be used for such investigations.

OECD principles also require that regulatory bodies should have the integrity and the resources to fulfil their duties. In the Companies Act 2008, the Council for Financial Reporting must promote the reliability of financial statements. Considering the financial scandals of enterprises in South Africa, could it still be said that the financial statements are reliable information? One way to ensure reliability is to rotate the external auditors, but this requirement did not prevent the current financial scandals plaguing South Africa, such as Steinhoff. On the other hand, auditors follow acceptable accounting principles to draft financial statements, which could be unilaterally interpreted. There is no independent audit body that may be approached by an audit enterprise for a proper interpretation of an audit

100 S 179(5).

101 OECD Principles of Corporate Governance (2015) 17.

rule, such as an Ombud. Considering that it requires a court or tribunal to give the correct interpretation of legislation via a declaratory application, no such requirement is relevant to the auditing profession. So how can it be said that all auditors will interpret an accounting principle in a similar style and fashion? For this reason, the Council for Financial Reporting should play a greater role in terms of being approached by auditors for the correct interpretation of accountancy principles, for instance. Or the Commission (CIPC) should require listed companies to submit their financial statements to the Commission for an independent review. On this point, the Commission could ask questions to see how an external auditor applied a specific accountancy principle. In section 187(3) the Commission is required to monitor financial reporting or accountancy principles to improve the reliability of financial statements.[102] The Commission should liaise with the different auditing profession councils on a more regular basis, as required by section 188(3), to improve financial reporting as a common interest. The Commission also has a duty to recommend possible changes to the minister to bring the 2008 Act up to date with international best practices. On the other hand, the minister should inform the Commission of its obligation to comply voluntarily with the OECD principles to enforce its legislative duty in terms of the 2008 Act – for instance, its duty to monitor financial reporting standards.[103] The minister may also appoint special committees to report on financial scandals.[104]

The minister must establish a Financial Reporting Standards Council. In terms of section 203, which deals with the composition of the members of the Council, no one who is responsible for compiling financial statements for state-owned enterprises is required to serve on the Council; only

102 Companies Act 2008 s 178(1-3).

103 S 190.

104 S 191.

persons who are responsible for preparing statements for public and private companies in South Africa. OECD principles require public interest and one would have thought that state-owned enterprise representation should also be a priority in terms of section 203, as it is in the interests of the public that state-owned enterprises are managed on sound financial principles or comply with sound financial principles. The primary function of the Council is to consider the reliability of financial statements and how to improve their reliability in future.[105] Section 205 regulates the disqualification of members from serving as such on the Council, the CIPC, the Takeover Panel or the Companies Tribunal. Members are disqualified if they:

- are members of any political party, movement or organisation;
- have a conflict of interest that will interfere with the proper performance of their duties;
- are disqualified in terms of section 69 of the Act from serving as directors; or
- are mentally unfit, the determination being supported by a court order.[106]

Disclosure of a financial interest to the minister is not a requirement to remain a member of the Council.[107] With or without disclosure, any conflict of interest is a requirement for disqualification. The OECD principles are very clear that no political agenda should interfere with the principles of corporate governance. This requirement is simply to promote the integrity and credibility of regulatory bodies or councils.[108] Section 206 also states that no member must engage in any activity that may undermine the integrity

105 Companies Act 2008 ss 204, 210 and 211.

106 S 205(2).

107 OECD Principles of Corporate Governance (2015) 13-17.

108 Companies Act 2008 s 206(3).

of the Commission, Panel or Tribunal. Also, members may not influence the proceedings of a Commission, Panel or Tribunal as a result of financial interests. A member should always be fair and unbiased and take decisions in a proper manner. Moreover, a member may not make use for personal gain of confidential information obtained as a result of performing his or her duties. A member may disclose confidential information only to the South African Reserve Bank, the Financial Intelligence Centre, or the Board of Auditors among others.[109] A member may resign by giving one month's notice or less with the approval of the minister. In all other circumstances, a member must resign when he or she is disqualified, for instance for failing to disclose an interest or performing his or her duties improperly.[110]

The OECD principles state that domestic corporate governance codes are simply voluntary codes and, although this might be true, a state should follow and implement at least domestic legislation to promote certainty, especially if legislation may result in producing good corporate governance.[111]

Stock market regulation also supports effective corporate governance or an effective corporate governance framework. Currently, the JSE Ltd is regulated by the Financial Sector Conduct Authority (FSCA) with the following legislation: the Financial Markets Act 2012, the Financial Intelligence Centre Act 2001, and the appropriate JSE rules which regulate equities, derivatives, interest rate markets and bond markets. The primary market and secondary market are not discussed for compliance purposes in this chapter. What is important for good corporate governance principles is cross-border cooperation between stock exchanges as required by the OECD. When foreign investment enterprises are listed on more than one (jurisdiction) exchange it is important that those exchanges communicate

109 S 206.

110 S 207.

111 OECD Principles of Corporate Governance (2015) 15.

effectively with one another in the event of non-compliance with domestic law by an investment enterprise. Currently, the JSE Ltd has no public document on how to implement this OECD corporate governance principle.[112] In addition, the OECD has no separate corporate governance code/handbook relevant to world stock exchanges to, inter alia, require cross-border reporting mechanisms[113] for listed enterprises in more than one jurisdiction,[114] for example, for South Africa (JSE) and Switzerland (SWX) to report on domestic violations of exchange rules by an enterprise that enjoys dual listing – on the JSE and SWX.[115]

It is possible that members of G20 exchanges could enter into treaties to regulate their domestic exchanges in terms of how to report to exchanges in other jurisdictions and when or under what specific circumstances. In this regard, the treaty will impose international corporate governance principles, especially where enterprises enjoy dual listings or where two exchanges have merged internationally. It is also possible that listed enterprises on such a dual exchange should obey the treaty principles instead of only complying with domestic corporate governance codes relevant to a particular exchange.[116]

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112 https://www.jse.co.za/services/market-regulation (accessed 1 December 2019); OECD Principles of Corporate Governance (2015) 16-17.

113 Christiansen and Koldertsova 'The role of Stock Exchange in corporate governance' (no date) https://bit.ly/3sJmgSt (accessed 1 December 2020).

114 See above.

115 See above.

116 Christiansen and Koldertsova 'The role of Stock Exchange in corporate governance' (no date) https://bit.ly/3Nj6Spo (accessed 1 December 2020); The proposed failed international merger between Australia's ASX and Singapore's SGX. In this regard, see https://on.ft.com/3SQ7gwE (accessed 1 December 2020).

The Swiss directive of corporate governance (DCG) requires listed enterprises that have a registered office address outside of Switzerland to comply with the SWX exchange directive if those shares are also listed on the Swiss exchange. The directive also provides for the 'comply or explain' principle in the event of non-compliance with the directive(s). The 'explain or complain' process to indicate why compliance is not possible is subject to SWX examination. The SWX may, for example, stipulate that the reasons provided are not sufficient and that they must be re-drafted by the dual-listed enterprise. A practical example of this directive is to disclose the names of directors who are also directors of a SWX dual-listed enterprise and to disclose the names of other exchanges and their individual director remuneration relevant to both exchanges in the aggregate.[117] This disclosure should be done in the financial statements of the Swiss-listed enterprise.[118] Also, the financial statements should include a website link to all the business activities of individual directors. In addition, the post-employment benefits of directors should be disclosed in the financial statements. Financial statements will be randomly analysed by the SWX with a letter commenting on non-compliance or suggested improvements for future financial statements.[119] Should the directive of the Swiss Exchange be breached by the enterprise, a fine/sanction of up to CHF 10 million may be imposed by the SWX enforcement committee.[120]

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117 https://bit.ly/3fhDuDB (accessed 2 December 2020); OECD Principles of Corporate Governance (2015) 16; https://bit.ly/3DnwHjw (accessed 15 December 2020) and https://bit.ly/3WsMaYD (accessed 1 December 2020) concerning director remuneration/compensation.

118 Swiss Code of Best Practise for Corporate Governance (2014) https://bit.ly/3Wfu8c4 (accessed 5 December 2020).

119 See above.

120 See above.

2.12 Rights and equitable treatment of shareholders

The second principle of the OECD principles of good corporate governance relate to the rights and equitable treatment of shareholders. Employee pension funds or private employee annuities frequently use unit trusts as an investment vehicle on the JSE Ltd. This investment vehicle is generally classified as either high or low risk depending on the acquired shares of foreign investment enterprises listed on the JSE that form a unit trust. With a low risk unit trust or conservative unit trust, the fund manager or trustee will purchase shares in listed enterprises that are not volatile to economic conditions. In almost all unit trust purchases the investor (as trust beneficiary) will not know the name of the listed enterprise' shares elected by the trustee of a unit trust or asset manager/administrator of a pension fund. The non-disclosure deals with the principle of 'know-how' in shares that could increase the return on capital investments significantly and, should the 'know-how' be made public, every trustee of any trust would be able to make similar returns on investments based on the listed shares for their beneficiaries.[121] Accordingly, the identity of listed enterprises shares is never disclosed to the investor/trust beneficiary and the trustee is at liberty to sell and to buy shares without the actual knowledge of the beneficiary. The OECD requires active beneficiary engagement relevant to the above matters. The following stipulations are relevant to this chapter:

- The unit trust acts as a shareholder of a listed enterprise.
- Trust beneficiaries are the shareholders of an enterprise and the shares are collectively held/administered by the trust only.

121 Today it is required that a unit trust must disclose a 'fact sheet' on the website of the fund manager. This allows one, to a certain extent, to analyse the 'know-how' of the manager. It also discloses the names of the enterprises, etc.

The second option above is preferred. The OECD requires active shareholder dialogue with foreign investment enterprises irrespective of the number of intermediaries (unit trust managers/administrators) between a shareholder and the enterprise. Although part of shareholder engagement is the ability to exercise voting rights, the right to vote for a dividend/distribution is clearly relevant to the beneficiaries of a trust. Whether the dividend received by a unit trust will be shared with the beneficiaries is uncertain; nor can it be estimated by the beneficiary since the fund manager never discloses the history of dividends for each listed enterprise. In this regard, the value/growth of the unit trust is driven by the individual listed share prices on the exchange.[122]

In the second option, where beneficiaries vote as shareholders, the dividend is part of the value of their individual share purchases and it can contribute to their individual investment value in the unit trust. In this case, the increases in value are based not only on the value of the listed shares but also on the dividend payments. The principles/rules of the trust deed should also be disclosed to beneficiaries so that they may understand the investment rules that must be followed by the trustees of the trust.[123] The OECD recommends this disclosure. Even if the trust is considered to be the shareholder in domestic law, communication received or sent between relevant listed enterprises and trusts could be made available to the beneficiaries, allowing them to follow comments on their investments, for example. These voluntary disclosures are known as 'stewardship codes'. The trustee and/or trust should sign these 'stewardship codes' to promote the disclosure of relevant enterprise/stock exchange relationships with the trust beneficiaries to allow the beneficiaries

122 A Hogg 'Allan Gray is dead wrong – Naspers CEO earns his salary, and then some' *Biznews* https://bit.ly/3zvpxZo (accessed 1 June 2020).

123 OECD Principles of Corporate Governance (2015) 29.

an opportunity to understand the negative or positive impacts of their investments in unit trusts.[124]

2.12.1 The stewardship code

An example of a 'stewardship code' is the United Kingdom Stewardship Code of 2012. This code is relevant to unit trusts and is commonly referred to as asset/fund management. The trustee or asset manager, which is generally part of the business of an enterprise (for example, pension fund), must disclose on its website how the fund manager or trustee implements the code. If a specific section of the code is not relevant then the manager must explain why it is not relevant to the specific fund under the control of the fund manager. Listed enterprises appreciate this code as a method of understanding the expectations of asset managers in explaining the economic conditions/ circumstances of a state relevant to beneficiaries more clearly; also in helping listed enterprises to make better business decisions relevant to the economic circumstances of a state or enterprise; or to make use of a specific risk-rating enterprise for the disclosure of a specific business decision/model of the unit trust more clearly to the benefit of the beneficiaries, for example Moody's Investor Services. If the asset manager cannot disclose non-compliance on its website, the Financial Reporting Council (FRC) can confirm that non-compliance exists and that any person, such as a beneficiary, may request a copy of the non-compliance report from the FRC. The FRC will also safekeep the non-compliance document free of charge.[125] The code requires asset managers to disclose the following to their beneficiaries:[126]

124 OECD Principles of Corporate Governance (2015) 30.

125 https://bit.ly/2xdX9Kx (accessed 1 May 2020).

126 https://bit.ly/3DKETvC (accessed 15 March 2019).

- how the asset manager will discharge his/her disclosure duties; or
- how conflict of interest is being managed by the trustees of the unit trust; or
- how the listed shares relevant to a fund/trust unit are being monitored.

Asset managers must also:

- provide clear guidelines on when disclosure/compliance is not possible; or
- be willing to act with other independent asset managers of other enterprises; or
- provide clear policy on voting relevant to investment decisions; or
- disclose voting policies – how voting is conducted by trustees of a unit trust when casting votes at the meetings of a listed enterprises.

Concerning conflict among members of management, if the trust is the actual shareholder of the listed enterprise and the relevant trust received a dividend, who is entitled to the dividend? The unit trust or the beneficiaries? This must be disclosed to the beneficiaries so that they can understand whether growth of capital is based on listed share price movements only.[127] To prevent the impact of future financial scandals on the value of a unit trust, the trustees or asset managers or fund managers must be 'up to date' on the performance of the listed enterprises. In addition, unit trusts as shareholders must attend annual general meetings of shareholders to cast votes. Since the beneficiaries do not know the specific shares invested in, the stewardship code requires trustees to disclose to their beneficiaries any changes in the shares invested in, for example, selling and acquiring different listed shares and revealing the identity of shares of the foreign investment enterprises.[128]

127 https://bit.ly/3fhO79r OECD Principles of Corporate Governance (2015) 30.

128 https://bit.ly/3TTBGjg.

The Financial Markets Act 2012 also requires the disclosure of possible conflicts of interest – not sharing dividends with the beneficiaries of the unit trust. This disclosure should be relevant from a South African perspective to promote a transparent market infrastructure. For example, the unit trust as a shareholder may not have shared any dividends received with the individual investment portfolio (unit trust) beneficiary. Voting rights are also regulated by the Financial Markets Act but are relevant only to trustees who control a unit trust (the trustees) as a shareholder. For example, a unit trust that holds 15% of the votes may appoint directors of listed foreign investment enterprises or other listed enterprises.[129] In addition, the Prudential Authority (previously known as the 'Registrar') of financial markets may also attend board meetings of listed enterprises or shareholder meetings of listed enterprises (for observation purposes) but may not cast any votes during those meetings.[130]

2.12.2 Statutory voting rights

The OECD requires active participation in enterprises' (listed enterprises) voting procedures by unit trusts, fund managers and asset managers. Obviously, shareholders cannot manage board decisions in their entirety or review the board decisions of listed foreign investment enterprises. In recent years, shareholder ethics are being explained as a method to prevent financial scandals through active participation in board decisions by shareholders. Although the OECD is clear that the board must be able to take management decisions rapidly, more technical management decisions could be assisted by shareholders during management decision processes.[131] The Financial Markets Act 2012, which regulates transparent market

129 Financial Markets Act 2012 s 67(2)(iii).

130 Financial Markets Act 2012 s 70.

131 OECD Principles of Corporate Governance (2015) 29.

infrastructure, does not regulate the relationship between unit trusts as a shareholder of an enterprise pertaining to disclosures of how voting rights or the procedures relevant to voting rights should be conducted. However, the Prudential Authority of the FSCA can regulate this in a separate code of conduct, and may also prescribe a code for unit trusts as shareholders and/or their trustees/fund managers, their employees and their clients as trust beneficiaries.[132] The code may also regulate the disclosure of relevant information to beneficiaries, for example to receive future dividends and how dividends could be used as an investment indicator for growth. The code of conduct for unit trusts as fund managers in terms of the Financial Markets Act was never promulgated in South Africa.[133] Instead, the Financial Advisory and Intermediary Services Act (FAIS Act) 2002, regulates unit trusts in a separate code of conduct.[134] It could be argued that the integrity required by the FAIS Act calls for full disclosure relevant to unit trusts and it is possible to comply with full participation in terms of the OECD recommendation for the participation of shareholders in a listed enterprise's management decisions by exercising votes.

2.13 United Nations principles for responsible investment and the OECD guidelines for multinational enterprises

The OECD guidelines for multinational enterprises overlap the objectives of the United Nations principles for responsible investments. These require that good corporate governance principles relevant to investments be

132 Financial Markets Act 2012 ss 74 and 75.

133 https://bit.ly/3Nmezex (accessed 1 April 2020).

134 See above, and for example, General Code of Conduct for Authorised Financial Services Providers, Code of Conduct for Administrative and Discretionary Financial Services Providers where fund managers of unit trusts are not allowed to vote as to control the listed company, etc.

upheld and an environment of self-review be created to promote confidence between beneficiaries and trustees. The compliance officer of an enterprise or listed enterprise or enterprises registered as 'financial services providers' in terms of the FAIS Act plays an important role in upholding compliance principles, such as full disclosure of non-compliance with the law, the exercise of voting rights and the like.[135] The UN principles require enterprises to engage with the academic community to conduct further research on how to implement the principles of good corporate governance in practical analyses of enterprises. For example, the enterprise must disclose in its financial statements compliance with relevant UN principles to promote responsible investment.[136] This will create an environment in which the principles of good corporate governance are part of the investment processes for unit trusts.[137]

The OECD principles of corporate governance require trustees of unit trusts, commonly referred to as collective investment schemes, pension funds or the activities of insurance enterprises to allow their shareholders to make use of their statutory or common law rights as a method of promoting compliance with the relevant principles of good corporate governance. The right to vote, for example, as relevant to the beneficiaries of a unit trust, could be regulated in separate rules of the trust, when beneficiaries should be required to vote. If no voting rights are regulated and the beneficiary suffers a financial loss, then the trustees should in principle disclose to the beneficiary the relevance of the voting rights pertaining to the loss – for example, how to avoid the loss in future by agreeing to or rejecting certain investment decisions of the trustees. The beneficiary could then form his or her own opinion on whether the trustees have the ability to steer/manage the unit trusts transparently

135 https://bit.ly/3DnxaCi (accessed 10 June 2020).

136 https://bit.ly/3NnRfxc (accessed 10 June 2020).

137 https://bit.ly/3sLTKQl (accessed 10 June 2020).

and/or successfully.[138] In this regard, if a trustee decides to move an asset from one fund to another, beneficiaries who were not allowed to exercise a vote, or who had no say in how to protect the value of their capital could make a choice to invest in other unit trusts, for example to promote the growth of their capital.[139] It seems that in terms of the OECD, beneficiaries should also have fiduciary duties. Employees/trustees/beneficiaries should be transparent in their communications with one another. This duty can also be explained by domestic law, for example the FAIS Act, that requires enterprises to act honestly, fairly, with skill and with due diligence in the interests of the beneficiaries/clients or shareholders.[140] To act fairly is generally relevant in preventing conflicts of interest; for example, to balance the individual interest of the beneficiary with that of the trustee of a unit trust and vice versa.[141] In this regard, the effect of the financial collapse of Steinhoff in South Africa on unit trusts is not known. Most trustees (pension funds or annuities) would have selected those shares as part of a pension fund scheme before the collapse of Steinhoff and, while the Government Employees Pension Fund disclosed its losses after its collapse, no other enterprise (for example, Allan Gray) that participated in unit trusts or pension funds made a similar disclosure to their beneficiaries.[142]

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138 OECD Principles of Corporate Governance (2015) 30; *Corwil Investments Ltd v JSE Ltd* A21/2014 is an example where a director tried to set aside a decision of the JSE Ltd. The different arguments presented by the director never received a notice of delisting because of a change of address.

139 Financial Markets Act 2012 s 75 (2).

140 Financial Markets Act 2012 s 75 (2).

141 OECD Principles of Corporate Governance (2015) 31.

142 N Gous 'Steinhoff collapse points to serious governance challenges' *The Sowetan* https://bit.ly/3gVhuPk (accessed 12 September 2020).

In insurance enterprises, the relationship between an underwriting manager and insurer should also be transparent. Generally, an underwriting manager who owns shares in an insurer is referred to as a cell captive insurer. In this regard, if the insurer is profitable, the underwriting manager may receive a dividend by voting for a dividend. An insurer is profitable only if the loss ratio relevant to the financial product meets a certain predetermined percentage, for example, 65%.[143] This loss ratio percentage should also be disclosed to prospective policyholders where they want to purchase policies of that underwriting manager, and where the underwriting manager will share in the profits of the insurer on the basis of profitable insurance business practices. Such a disclosure of 65% may indicate a great possibility to reject policyholder claims in future. On this point, it is in the interest of a prospective policyholder to know the contractual relationship (binder agreement) between an insurer and an underwriting manager relevant to loss ratios and whether the underwriting manager or policyholder would be penalised in the event of not achieving the loss ratio.[144] Foreign investment enterprises, for example, are re-insurers in South Africa, and the relationship between a re-insurer, insurer and underwriting manager in terms of profit sharing should be transparent to all parties. Obviously, a re-insurer can operate in South Africa only if it is licenced as a financial services provider.

2.14 Stock exchange markets

This section discusses beneficial shareholders, conflict of interest, insider trading, cross-border stock markets, and fair listed prices for securities/shares.

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143 See in general CG Kilian and E Vandeventer 'To replace the Friendly Society Act 25 of 1956 with the proposed insurance bill 2015: A new perspective on society member's benefits in exchange for a premium' (2017) *De Jure* 281.

144 Binder Contracts, see Short-Term Insurance in the *Government Gazette* no 34877 of 23 December 2011 for a definition for an underwriting manager.

2.14.1 Beneficial shareholders could be trust beneficiaries

The OECD requires that unit trusts that are registered as nominee shareholders on the register of shareholders of a listed foreign investment enterprise must cast a vote according to the instructions of the beneficial shareholder that is the owner of the shares. The beneficial shareholder is in fact the trust beneficiaries of the unit trust. If the unit trust is registered as a shareholder, section 1 of the Companies Act 2008, states that the shareholder that is registered as such in the register is for all practical purposes the shareholder of that enterprise, although not the owner of those shares.[145] The owner of the shares is referred to as the beneficial shareholder or in this case the trust beneficiaries who made a capital investment to be managed by the trustees/fund managers of the unit trust. This raises the question as to who is entitled to a dividend. The registered shareholder or beneficial shareholder? In the case of *Smyth v Investec Bank Ltd*, a beneficial shareholder has no *locus standi* in the law.[146] This implies that a beneficial shareholder cannot approach a court should a unit trust or trustee act contrary to the interests of the beneficial shareholder, for example by not distributing a dividend received. The Companies Act 2008, is also not very clear concerning the difference between a registered shareholder and a beneficial shareholder. In the event of an investment treaty, a treaty may refer to the OECD principles when applying the principles of good corporate governance relevant to beneficial shareholders, such as transparency on how growth in investments is calculated. In any other case, in international law a beneficial shareholder has *locus standi* if it is regulated by a treaty. Canada's Foreign Investment Promotion and Protection Agreement treaty (FIPA) states the following in article 23(1):

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145 OECD Principles of Corporate Governance (2015) 31.

146 *Smyth v Investec Bank Ltd* [2018] 1 All SA 1 (SCA) para 30.

> An investor of a Party, on behalf of an enterprise of the other Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under Section B, and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach.[147]

A beneficial shareholder owns shares and controls an enterprise indirectly because a fund manager/trustee has used the capital to buy shares in specific listed enterprises, keeping those shares in a trust that will be managed by the trustee or fund manager of that trust.[148] The OECD requires that beneficiary shareholders should be able to cast a vote instead of fund managers at annual general meetings of shareholders or otherwise.[149] It is also required that beneficiaries should have a choice of whether they will actively participate in unit trust investee enterprises or not or be able to remove the trustees who manage such a trust. For example, Coronation Fund managers who invested beneficiaries' capital in Shoprite are in the process of preventing the chairman (Mr C Wiese) of Shoprite from exercising votes as a registered shareholder of Shoprite. No communication or transparency was received by the beneficiaries of the trust as to why the chairman should be removed and no beneficiary was allowed to cast votes at the meeting. Instead, only Coronation Fund managers are acting as nominee shareholders to either keep or to remove the chairman.[150] A shareholder beneficiary would not even know whether he has shares in Shoprite because the identity of the

147 https://bit.ly/2M6hL0B (accessed 15 July 2019).

148 *Sammel v President Brand Gold Mining Co* 1969 (3) SA 629 (A) 266.

149 OECD Principles of Corporate Governance (2015) 31 and 32.

150 T Cohen 'Shoprite v Wiese and the small matter of R4b' *BizNews.com* https://bit.ly/3UbvZNm (accessed 4 November 2020); S Watkins 'Christo Wiese shares sale puts spotlight on corporate governance' *BusinessDay* https://bit.ly/3TRSh71 (accessed 4 November 2020).

shares invested in and managed by a fund manager is a business/trade secret. By contrast, the OECD requires transparency in all matters relating to the principles of corporate governance and it is clear that South African fund managers are trying to apply the principles of the OECD through the FSCA, which requires a fact sheet to be disclosed on the website of fund managers of unit trusts.[151]

2.14.2 Conflict of interest

Conflict of interest in the domestic law recognises a unit trust as a registered shareholder to receive the rights and duties associated with shareholders, for example, to vote for the removal of directors or chairmen of boards of directors, and to vote for dividends, and such like. In this respect, the trustee/fund manager is entitled to receive dividends irrespective of the agreed fees or regulatory fees for managing the fund between the trust and beneficiary.[152] To a trustee/fund manager, the dividend to be received could be enormous and could be excluded from the fund performance statistics. Most unit trusts have a disclaimer that the performance of a fund is linked to the performance of the listed shares only – effected by the up or down movements in the price of the listed shares. Should the beneficiaries of the fund receive a dividend, this could contribute to significant growth in their individual investments in listed shares. A decrease in growth resulting from a decrease in the listed share price could be increased by receiving dividends and allocating those dividends to the beneficiary. This could increase the fund's overall value irrespective of the decrease in the value of the listed shares.

151 http://www.fsca.co.za/Regulatory%20%Frameworks/Archived%20Documents/Industry%20Comments%20Matrix.pdf (accessed 15 December 2019).

152 OECD Principles of Corporate Governance (2015) 32.

2.14.3 Insider trading

The OECD classifies insider trading as a gross violation of the principles of good corporate governance. It also requires vigorous enforcement of any breaches. In South Africa, insider trading is considered a statutory offence and is part of the civil law. The test to be used to conclude an offence of 'insider trading' is based on a 'balance of probabilities' and not the 'beyond reasonable doubt' standard. It is also possible for the state to proceed with insider trading as an offence. The OECD requires the prohibition of insider trading not only for listed securities/shares but also for unlisted securities/shares. The OECD considers this to be part of the equitable treatment of nominee shareholders and/or beneficial shareholders.[153]

Equitable treatment of shareholders and insider trading

The OECD does not define insider trading.[154] 'Insider' has been defined to include either a director, employee or shareholder of the listed enterprise to which the information relates. The use of such information may produce a 'market corner'. A 'market corner' is simply defined as an arrangement, agreement, or commitment relevant to the purchasing, selling or issuing of listed shares by which a person or group of persons may influence the price of the securities/shares either upward or downward in value and the listed price is therefore dictated by their arrangement, agreement or commitment. The term 'person' includes not only a trust or partnership.[155]

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153 Financial Markets Act 19 of 2012 s 78(1); OECD Principles of Corporate Governance (2015) 32; See in general *Sage Holdings Ltd v The Unisec Group Ltd* 1982 (1) SA 337 (W).

154 Financial Markets Act 2012 s 77.

155 See above.

An insider is not guilty of any offence of insider trading if he or she is able to prove that:

- he or she became an insider only after giving the instruction to deal in the securities/shares; or
- no material changes were made to the instruction after becoming aware of inside information; or
- all the parties to the transaction had possession of the same financial information; and
- the transaction information was limited to all the parties referred to above; and
- the transaction was not aimed at securing a benefit from exposure to the upward or downward movement in the listed share price.

The financial information above could be classified as inside information but is not subject to an offence if all the parties to the transaction possessed the inside information listed above.[156] As long as the transaction is not affected by the information or inside information, no offence has been committed. The agent or share broker acting on behalf of an insider, for example, the fund manager of a unit trust, is not liable to committing an offence if:

156 Financial Markets Act 2012 s 78(b); See *Micromega Holdings Ltd v JSE Ltd* A14/2017 https://bit.ly/3sHadoL (accessed 12 October 2020) where the applicant repurchased shares during a closed period. The JSE requires no purchase of shares during a closed period because of the possibility of creating value. The JSE relied on s 10(2)(e) of the Financial Markets Act, which imposes a duty on the JSE to enforce its listing requirements, *inter alia* ss 5.36(h) and 5.72(h) that forbids the repurchase of shares during closed periods. A closed period is very similar to 'inside information' because during such a period the purchaser could benefit at the expense of the market.

- the agent did not know the instruction was given by an insider; or
- after acting on the information, he or she became an insider but there were no material changes to the instruction; or
- the agent was acting on an instruction received from all parties; and
- the instruction was limited to all the parties referred to above; and
- the instruction was not aimed at securing a benefit from exposure to the upward or downward movement in the listed share price.[157]

Irrespective of the above, if a share broker receives an instruction from an insider and knows the person is an insider, the agent has committed an offence unless the above defences are relevant.[158] Also, an insider who discloses the information to any other person without buying or selling securities will also have committed an offence unless, on a 'balance of probabilities', the sharing of that inside information is part of his or her employment or was carried out during the course of his or her employment.[159] Also, any encouragement or discouragement to buy, stop dealing in or sell listed shares because of inside information is an offence even if there was no upward or downward value in the listed securities/shares. All that is required for an offence of insider trading to be successful is that the price per share is 'likely to be affected' by the information.

157 S 78 (2).

158 S 78(3).

159 S 78(4).

Inside information is considered public information when the information has been published according to the exchange regulator, or the information is open for inspection by any member of the public, or the information can be readily obtained by any person dealing in listed securities/shares.[160]

Liability for insider trading

A person who is guilty of insider trading must receive an administrative sanction. The quantum calculated for the sanction is equal to the profits made by the insider as a result of the inside information or an amount up to R1 million plus interest.[161] An insider, a broker or agent or any other person related to the prohibited transaction is jointly and severally liable to the Financial Services Board (FSB), which recently changed its name to the Financial Sector Conduct Authority(FSCA).[162] The money the FSCA receives must be paid into a trust account and the FSCA is entitled to claim the costs of the investigation first. Other claimants who were affected by the insider dealings may also submit claims to receive compensation on a pro rata basis.[163]

2.14.4 Cross-border stock markets

Enterprises listed on one or more stock exchange must disclose in their financial statements which principles of corporate governance of which country were predominantly followed. Generally, the first listing is known as the primary listing and the second listing as the secondary listing. Therefore,

160 S 79; See in general *Gaffoor v Vangates Investments (Pty)* 2012 (4) SA 281 (SCA) relevant to the transfer of shares.

161 Financial Markets Act 2012 s 82(1).

162 S 82(3).

163 S 82 (5-8).

the primary listing or primary country's corporate governance principles would normally apply. Any exceptions as to why the principles or codes could not be followed should be clearly disclosed in the statements.[164]

2.14.5 Fair listed prices for securities/shares

The financial statements of an enterprise should contain reliable information in order to assess the value of listed shares or should disclose good corporate practices to understand the link between the value of listed shares and good corporate practices. If such a link is missing, the beneficial shareholder should re-evaluate its strategic business decision pertaining to the shares, for example, to limit investment in the unit trust.

2.15 Stakeholders

The OECD principles do not promote the preference of one race over another or recommend domestic legislation to achieve such a result. Nor do they force the board of directors to consist of percentages relevant to a state's demographics. In terms of the OECD, these do not form part of the stakeholder debate from an international perspective. On the other hand, the OECD does not prohibit the formation of partnerships between enterprises that are willing and able to work together to create wealth to benefit the state's economy.[165] Part of this debate is the ability to raise capital to fund the business activities of a foreign investment enterprise or partnership. The funding can either be from investment treaties, such as international investors/enterprises and states, or World Bank loans/subsidies made to states. Investors will apply their own principles of good corporate governance to establish whether it is viable to invest in a state or to act as a partner of a foreign investment enterprise. Banks and financial institutions

164 OECD Principles of Corporate Governance (2015) 33.

165 OECD Principles of Corporate Governance (2015) 34.

will also apply principles of good corporate governance regarding whether the enterprise or state has the ability to repay a loan. Where reckless loans are granted or loans are granted to enterprises/states that are unable to repay the loans, this is also not part of the stakeholder debate.[166] The main idea of a good stakeholder debate is to build competitive and profitable enterprises or foreign investment enterprises.

Parties to a stakeholder debate are employees, customers, suppliers, protectors of the environment, and such like. These were to a certain extent relevant to *Metropolitan Collective Investment Schemes Ltd v Registrar of Collective Investment Schemes* (2010, no case number is provided), where Metropolitan acted as a fund manager for its unit trusts. In this regard, Metropolitan applied for white label portfolios, portfolios that rented Metropolitan's licence to other individuals to operate a unit trust lawfully. There were 154 white label portfolios (belonging to certain uneducated or untrained individuals). It was also stated that the white label granted an opportunity for people to act as fund managers to obtain the necessary skills and expertise for managing unit trusts. Mistakes made (financial losses) were of no concern to Metropolitan, since its main focus was simply the renting of it licence for monetary value, instead of conducting appropriate supervision of their white label portfolios/unit trusts, as stated by the Registrar (today known as the Prudential Authority). In addition, Metropolitan did not participate in the selection of listed shares that made up a white label unit trust. For this reason, the Registrar decided not to allow any renting applications in future from Metropolitan. Metropolitan appealed this decision, arguing that there was appropriate oversight of the 154 white label unit trusts, and that the renting of its licence did not become more important than the investment interests of trust beneficiaries, and neither was there a conflict of interest.

166 OECD Principles of Corporate Governance (2015) 34; *Metropolitan Collective Investments Ltd v Registrar of Collective Investment Schemes* (no case number provided) https://bit.ly/3NnwYYE.

The Appeal Board (today it is known as the Tribunal for Financial Services) held that the Registrar (today it is known as the Prudential Authority) had no reliable evidence to draw such conclusions about Metropolitan's white label unit trusts.[167]

The rights and duties of stakeholders are regulated either in domestic legislation or in the common law. In areas where there is no domestic legislation relevant to a foreign investment enterprise, for example, a partnership, a partnership as an enterprise may consider the voluntary application of the OECD corporate governance principles.[168]

The application of King IV is voluntary. Generally, it seems that King IV is mandatory in its application when one considers, for example, section 30 of the Insurance Act 18 of 2017. Stakeholders in the Insurance Act could specifically be the policyholders or could be the beneficiaries of white label unit trusts as explained earlier.[169] The OECD requires long-term cooperation with stakeholders to build effective industries/financial sectors in the economy. Accordingly, an insurer or a unit trust, for instance, must have procedures in place to identify non-compliance with its corporate governance principles or with domestic law. In the event of non-compliance, the compliance officer must, for example, notify the insurer immediately.[170]

In domestic law, a stakeholder could also be either a nominee or a beneficial shareholder. It is trite law that the memorandum of incorporation (MOI) or fund rules or a unit trust deed (rules of the trust) is a contract between stakeholders and the enterprise. Should the MOI, for example, regulate

167 See above.

168 OECD Principles of Corporate Governance (2015) 34.

169 Insurance Act 18 of 2017 s 30; See in general OECD Principles of Corporate Governance (2015).

170 S 31.

dividend payments or state that a stakeholder is entitled to a dividend, then this constitutes a personal right and possible breach of contract could occur in the event of non-declared dividends.[171] The OECD is clear that any violations of rights of stakeholders must be rectified by the enterprise. A shareholder as a stakeholder can only approach a court for relief, since the breach of the MOI is not subject to the Promotion of Administrative Justice Act.

Stakeholders should take note of the limitations of the share/fund/unit trust capital. For example, permission must be obtained to authorise any additional shares, convert shares from one kind to another, repurchase shares, delist shares, reduce the authorised share capital, grant loans to stakeholders, disclose financial statements to stakeholders, and comply with the King principles.[172] This is an attempt to protect the rights of creditors or the stakeholders of a pension fund or trust or any other regulated enterprise.

In *Corwil Investments Ltd v JSE Ltd* A21/2014, the JSE decided to remove Corwil's listed shares from the exchange. The consequences could have been very serious since unit trusts could have selected Corwil shares as part of their trust beneficiaries' investments. The legal question to be answered was whether the JSE Ltd gave Corwil sufficient notice to remove the shares from the exchange and whether the JSE could delist Corwil unilaterally – keeping in mind the interests of Corwil's various stakeholders. As Corwil did not send financial statements to shareholders and did not comply with King's corporate governance principles,[173] the JSE argued that it was in the interests of the public, in other words in the interests of all stakeholders, to delist Corwil. Section 12(2) of the Financial Markets Act requires an opportunity for Corwil to argue why it should not be delisted. However, Corwil failed to respond to this opportunity to give reasons as to why it should not be

171 OECD Principles of Corporate Governance (2015) 34.

172 OECD Principles of Corporate Governance (2015) 35.

173 Paras 9, 49, 50, 61.

delisted. Although the reasons why it should not be delisted are also regulated in the Financial Markets Act, the Promotion of Administrative Justice Act also requires adequate information for appealing a decision.[174] The JSE Ltd argued that there was no compulsion to inform Corwil of its right to appeal/review its (JSE) internal procedures. However, the Appeal Board held that the JSE decision in terms of the Financial Markets Act was not a final decision since Corwil could use other internal methods of the JSE to reconsider the delisting, so the Promotion of Administrative Justice Act was not relevant at that time. The Appeal Board (today known as the Tribunal for Financial Services) consequently held that the delisting was in the interests of the public. In this respect, the potential loss of capital investments by stakeholders could be enormous. Therefore, would delisting be an efficient method to mitigate the financial losses for those stakeholders?

Generally, any decision taken by an enterprise relevant to a stakeholder is subject to review or appeal.[175] Such decisions are the short-term ombud's decisions relevant to an insurer and a policyholder. The Pension Fund Adjudicator's decision is relevant to a fund and a contributor, the FSCA's decision relevant to a financial services provider, and so forth. The Companies Tribunal is also an alternative dispute resolution body and can review, for example, decisions to remove directors of enterprises,[176] reconsider decisions not to appoint a social and ethics committees,[177] complaints concerning fundamental transactions regarding parts B and C of Chapter 5 of the Companies Act, mergers, etc.[178] In this regard, the authority of the

174 Paras 62, 67.

175 Companies Act 2008 s 62(3).

176 Companies Act 2008 ss 6(2) and 12(3).

177 *Ex Parte Grassridge Wind Power (RF) Pty(Ltd)* CT00183ADJ2019.

178 Companies Act s 169(1).

Companies Tribunal should be extended to hear matters concerning delisting instead of making use of notices to be sent to a foreign investment enterprise in terms of the Financial Markets Act and to inform the enterprise of a possible delisting. This process of delisting to be initiated via the Companies Tribunal would be a more formal process than the current process of making use of informal letters/notices of delisting, as was seen in the *Corwil* case. In this case, greater attention from the enterprise would be required in terms of why the enterprise should not be delisted, since the reply would be sent directly to the Companies Tribunal after the Tribunal has received a notice to delist an enterprise. This method of communication is more formal and could protect the capital investments of stakeholders better than the current JSE informal process of sending notices.

2.16 Disclosures

King IV allows an enterprise to draft voluntary corporate governance codes. It is possible to regulate both directors and employees with fiduciary duties owing to the enterprise. Currently, national/domestic company law regulates the fiduciary duties of directors only. The OECD makes provision for enterprise employees to attend board of directors meetings and/or to participate in key board decisions. Although this form of corporate governance is unique from a domestic perspective, it is proposed that shareholders should at least attend to key decisions. For example, the beneficiaries of unit trusts should at least attend/be informed of key decisions of the trustees/fund manager. In recent years more emphasis has been placed on shareholder (which includes beneficial shareholders) participation and that ethical behaviour should include shareholder representation in key management decisions.[179]

What amounts to ethical behaviour is the ability to disclose material information to all stakeholders of the enterprise. Weak disclosure or non-

179 OECD Principles of Corporate Governance (2015) 34.

transparent behaviour could be linked to unethical behaviour. The test to be used to identify whether the disclosure of information is material or not is the test of materiality. This test simply identifies any omissions in disclosures or misstatements that influence the decision of prospective or current stakeholders pertaining to investments, or information which a reasonable prospective or current shareholder would consider to be important in making his or her decision.[180] The same test is used to understand the voting rights of shareholders. A voting right is exercised correctly only if the information supplied by the enterprise is reasonably required to cast an informative vote.

2.16.1 Prospectus

Section 95 of the Companies Act 2008 defines an untrue statement as a statement that is misleading in the form and context in which it is made. A report attached to a prospectus which contains a summary of the prospectus could also fall within the definition of an untrue statement. An untrue statement also includes an omission, even if the Companies Act 2008, does not require such information in the prospectus *per se*.[181] A contract of sale of securities which includes a clause to waive compliance with the 2008 Act is void. But in the event of an investment treaty, it is also possible to require a state to purchase shares/securities in the investing enterprise from, for example, a foreign investment enterprise in Australia, to invest in South Africa. Should the state or state-owned company purchase shares on the basis of a prospectus, the investment treaty can also state that in the event of a dispute, recourse is possible only by making use of international tribunals. The tribunal could be situated in England, for example. In this regard, the principles of international law are relevant and not the regulations of the 2008 Act or section 13 of the Protection of Investment Act 2015, relevant to

180 OECD Principles of Corporate Governance (2015) 37.

181 Companies Act 2008 ss 95(3-4) and 101.

prospectuses, for resolving a dispute between South Africa and an investment enterprise.[182] The minister may make additional disclosure regulations pertaining to the form and content of rights offers, prospectuses, and any ancillary matters concerning disclosures in domestic law, and it is suggested that an investment treaty should follow a 'copy and paste' approach to the 2008 Act relevant to prospectuses. In this case, an international tribunal may refer to domestic case law to solve a dispute between the parties – a state and a foreign investment enterprise.[183] Every prospectus relevant to an investment treaty must contain all the information that an investor may reasonably require to assess the assets and liabilities, the financial position, the profits and losses, the cash flow, and the future prospects of the enterprise, the shares/securities being offered, the rights attached to them and any other prescribed specifications.[184] The 2008 Act makes the provision that not all enterprises are entitled to a prospectus in domestic law and it is uncertain whether international law recognises this principle. Whether selling shares/ securities without a prospectus or a prospectus that contains very little information could be interpreted as unethical behaviour from an OECD point of view is unclear. For example, a financial services provider acting as an underwriter for an insurer and that is in the process of acquiring shares as a cell captive is exempted from receiving a prospectus from the insurer in domestic law and his/her behaviour is thus ethical.[185] An underwriter in this case possesses the necessary financial skills to know the exact financial position of the insurer and therefore a prospectus is unnecessary to disclose the financial position of the insurer. The same might apply to states that have

182 S 95(5).

183 S 95(7).

184 Ss 100(2), 102, 111.

185 Davis et al. *Companies and other business structures in South Africa* (Oxford University Press 2013) 193.

economic advisers and the like to determine the appropriateness of buying shares/securities in foreign investment enterprises.

In our opinion, the OECD guidelines should be followed and implemented relevant to disclosures (that includes prospectuses). The OECD recommends full disclosure, and therefore no exemptions should exist.

In a securities or share offer where the securities or shares will be listed on an exchange, the prospectus must disclose this before the allotment of the securities or shares can occur.[186] If the prospectus contains such a condition, the securities or shares can still be allotted but must not be issued.[187] The securities or shares can be issued only if the enterprise submitted an application to be listed on the exchange before or on the date of registration of the prospectus and the prospectus discloses the name of the exchange where the application has been filed. In this situation, the principles of domestic law are relevant pertaining to listing requirements. Any person who is a party to any untrue statement in the preparation, publication and dissemination of a domestic prospectus is guilty of committing an offence.[188] If the exchange is in a foreign state, the foreign law, not international law, is relevant for determining the listing requirements.

2.16.2 Voting decision

Not all stakeholders have voting rights or have voting shares/securities due to the legal nature of the investment vehicle, which may be a pension fund, annuity or unit trust relevant to beneficiaries.[189] A unit trust is generally not required to inform the beneficiaries of changes to its shares relevant

186 Companies Act 2008 s 111; Davis et al. *Companies and other business structures in South Africa* (Oxford University Press 2013) 193-197.

187 S 111(2).

188 S 214.

189 Companies Act 2008 ss 1 and 37(3).

(for example, the trustee/fund manager sells non-performing shares) and the beneficiary may be unable to seek relief in terms of section 164 of the 2008 Act simply because the beneficiary will not know when and/or how the shares were being sold and/or why. Generally, section 37 of the 2008 Act states the following regarding changing rights lawfully in terms of the 2008 Act:

- the holder notified the enterprise in advance to oppose the resolution; and
- the holder was present at the meeting and voted against the resolution.[190]

The proposal or notice must disclose the content of section 164. In brief, the notice must disclose the unit trust (as shareholder) and the right to object to the proposed resolution; and within 10 business days after the listed enterprise has adopted the resolution the enterprise must send an additional notice to each dissenting shareholder (for example, other unit trusts) that the resolution was adopted. The shareholder may in domestic law demand that the enterprise purchase his or her shares (as held by a unit trust) because the resolution materially affects the rights of the shareholder.[191] It seems that the shareholder is not always required to send a notice of objection when the enterprise failed to inform the shareholder of the proposed vote and/or the enterprise failed to inform the shareholder of his or her rights in terms of s164 by a notice.[192] Irrespective of whether the enterprise sent a notice of adoption, the shareholder/unit trust may deliver a written notice within 20 days after the adoption or within 20 days after learning of the adopted resolution to demand a buy-back of the shares held by the shareholder at fair value.[193] A notice of demand submitted by the shareholder must:

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190 S 37(8).

191 Companies Act 2008 s 164(4-5).

192 S 164(6).

193 S 164(7).

- disclose his or her name and surname;
- disclose the address of the shareholder;
- disclose the number and class of shares for which the shareholder demands payment;[194] and
- request payment at a fair price.

2.16.3 Value of shares

A unit trust as shareholder could approach a court to calculate the fair value for the buy-back of shares or securities and may also approach the court for an order to compel the enterprise to pay the fair value. Whether the latter principle is relevant to international law pertaining to treaties is unclear unless the treaty refers to an international tribunal to consider the value of shares. This is possible only if the enterprise failed to make an offer to buy back and/or the enterprise made an inadequate offer to the other party (perhaps a state) in terms of the value of the shares or securities.[195] It is suggested that the enterprise must inform all shareholders of the tribunal process initiated by the state to be able to join all dissenting shareholders to the application process. The tribunal may appoint an assessor or appraiser to calculate the value of the shares.[196] However, the enterprise may also approach the tribunal to set aside the order due to financial circumstances– for instance, it being unable to pay its debts.[197] To calculate the value of the shares or the future financial obligations of the enterprise the OECD requires the following disclosures, which should also be relevant to investment treaties where a

194 S 164(8).

195 Companies Act 2008 s 164(14).

196 S 164(15).

197 S 164(17).

buy-back of shares application has been made in an international tribunal that is not relevant to domestic law *per se*:

- the financial and operating results of the enterprise;
- the objectives of the enterprise and non-financial information relevant to the enterprise;
- disclosure of major share ownership in the enterprise;
- the remuneration of the directors of the board;
- objective and independent actions of directors when considering a buy-back;
- related transactions that affect a buy-back;
- foreseeable risk factors, if any, relevant to buy-backs;
- future issues regarding stakeholders, for example a recalculation of voting rights; and
- the corporate governance framework, for example OECD principles.[198]

Any assessor or valuer working for an enterprise should also recognise the abovementioned OECD disclosures when calculating the value of shares. In their simplest form, the valuer should recognise the financial or operating results of the enterprise.[199] Most valuers use the weighted average cost of capital and the internal rate of return to calculate the value of an enterprise, which in fact constitutes the value of the shares. The relationship between the weighted average cost of capital and the internal rate of return indicates the ability to create future shareholder value. If the relationship does not indicate future value, then for all practical purposes that is the value of the

198 OECD Principles of Corporate Governance (2015) 38-44.

199 https://bit.ly/2M104Pq (accessed 12 August 2019). This website indicates how many claims are brought by shareholders in the international law arena to be settled by international tribunals.

shares. In this regard, there will be no need to approach the international tribunal if the enterprise is unable to pay its debts.

The relationship between the weighted average cost of capital and the internal rate of return cannot be overstated and financial statements should also indicate what the weighted average cost of capital and the internal rate of return for a particular enterprise is. For example, even if the enterprise was unable to produce cash in the last financial year (in the cash flow financial statement), indicating a possibility of not being able to pay its debts, the relationship between the weighted average cost of capital and the internal rate of return will indicate an increase in cash flow for the following financial year. In such a situation, foreseeable risk factors should also be considered, such as the economic life of an enterprise, etc. The above provisions should also form part of an investment treaty to give guidelines on how the valuer should calculate the value of shares, etc.

2.16.4 Non-financial information

Non-financial information should also be disclosed in the financial statements of the foreign investment enterprise, see, as an example, Chapter 6 with reference to environmental, social relations and good corporate governance practices (ESG). Sometimes it is difficult to understand how an enterprise is making a profit although the enterprise has been targeted by employee strikes. Some enterprises may have a unique approach to employee strikes and this should be disclosed as a non-financial indicator in the financial statements before signing an investment treaty. In this regard, a prospective treaty party (in general) will be able to make an informed decision whether to sign the treaty or not.[200] Non-financial information also contributes to the value of shares. How to deal with strikes is, for example, an objective enquiry and every enterprise should consider their objectives carefully to

200 https://bit.ly/2M104Pq (accessed 12 August 2019).

be able to make profits in future. This is also one of the issues relevant to stakeholders. An investment treaty should also consider the domestic law and incorporate the principles of domestic law into a treaty to give jurisdiction to an international tribunal that has to decide on the appropriateness of the non-financial information relevant to the value of shares.[201]

Since shares or securities can be divided into different classes, the following serves as a technical argument for why the fair value of shares cannot always be calculated:

- A person who founded an enterprise, and who was able to make the enterprise profitable over the years, could decide on issuing different classes of shares, such as deferred or founder shares or preferential shares. Although deferred shares could constitute the majority of the shares, generally they cannot be sold by the founder of that enterprise in domestic law even though they are used to control the enterprise.[202] In this regard, the majority shareholder should be disclosed in prospectuses as part of the material information in order for a potential investor to be able to make an informed decision as to whether purchasing shares in that enterprise is a viable option or not. Or the majority shareholders could be disclosed on a continuous basis in relevant financial statements/ documents. From the perspective of an investment treaty, it is not clear whether a tribunal would consider the rights allocated to deferred shares in a way similar to that in domestic law unless the treaty regulates those shares clearly.
- How to calculate the value of deferred shares? Since the weighted average cost of capital and the internal rate of return are not relevant to deferred

201 https://bit.ly/2M104Pq (accessed 12 August 2019).

202 OECD Options for Obtaining Beneficial Ownership and Control Information (2002) 3; OECD Financial Action Task Force's Guidance on Transparency and Beneficial Ownership (2014) 7.

shares, such shares may still have value because they could influence the outcomes of shareholder meetings, including the appointment of directors. These deferred shares will simply have value based on the willing buyer/seller principle or based on a forced sale. A forced sale is simply how much cash can be paid for those shares in circumstances similar to liquidation in terms of domestic insolvency law.[203] A forced sale should also be incorporated in an investment treaty. If the investment treaty is silent on such a provision, it is unclear whether a forced sale would form part of customary international law to recognise such an approach to value deferred shares.[204]

2.16.5 Director remuneration

Whether director remuneration should be deducted as an expense when calculating the value of an enterprise is unclear. Remuneration could be a concern for dissenting shareholders and could negatively affect the value of an enterprise. Full disclosure of director remuneration is also required, or director remuneration should at least be disclosed in prospectuses to aid understanding from an international perspective of whether or not shares in the enterprise should be purchased. In this regard, an enterprise could be expected to continuously disclose relevant information to other parties to an investment treaty pertaining to whether a director is objective (for example, how the director was selected by a board to act as such, any personal relationships with other directors or on how many boards a particular director serves, the different forms of remuneration received, whether a director knows the basics of domestic or international law (the importance of an investment treaty), and any personal relationships with

203 See above.

204 For example, the 2008 China–Mexico bilateral investment treaty (BIT) prohibits certain domestic law principles. In this regard, see https://bit.ly/3NhBlUY (accessed 23 March 2019).

the major shareholders.[205] The same applies to a state.[206] If the enterprise/ board of directors is unable to report on such information as required by an investment treaty, the enterprise must explain why non-compliance is necessary. The OECD does not regulate this issue in particular.

The ability to estimate the fair value of shares depends on receiving reliable financial statements. Such financial statements will fairly represent the financial position of the enterprise in all material aspects. Information is reliable only when the auditing principles used during an external audit process are internationally acceptable. An investment treaty should in principle make reference to financial statements drafted according to recognised international auditing principles; if not, then it is unclear on what basis the tribunal would accept the financial statements of a particular enterprise that is a party to an investment treaty. The presiding officer in the tribunal cannot give directions on how to draft statements, unless the rules of the tribunal or investment treaty regulate this in detail. For example, there must be:

- an independent external verification of internal audited financial statements;
- an audit or external audit that is pursuant to internationally acceptable standards;
- an independent auditor or external auditor; and
- an auditor checklists for enforcing compliance with accounting and auditing standards.

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205 *Gihwala v Grancy Property* Ltd [2016] ZASCA 35*;* OECD Principles of Corporate Governance (2015) 41.

206 Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence (International Organization of Securities Commissions 2002) 3.

The audit committee of an enterprise should be the only point of contact between the enterprise's internal auditors and external auditors. To ensure successful interaction with the external auditors, the audit committee should be free from any influence, self-interest, intimidation, etc., this is supported by the International Organisation of Securities Commissions (IOSCO). An auditor serving on the audit committee should be independent and his or her reappointment should be in accordance with applicable standards. For disclosure purposes, an audit committee should be free to discuss any form of management intimidation with an external auditor (and free to consult experts in a certain field) and the enterprise must pay all the expenses reasonably incurred by the audit committee in completing its functions. The audit committee is regulated in section 94 of the Companies Act 2008, which also underlines the independence of the audit committee as prescribed by the Independent Regulatory Board for Auditors.[207] A private, personal liability, non-profit, public enterprise may require the services of an audit committee in terms of section 34(2) and as required only to the extent that its duties are regulated by the MOI. In these circumstances, an investment treaty should also refer to audit committees and their independence when considering the value of shares based on financial statements, for example.

2.17 Responsibilities of the board

This section addresses three relevant issues pertaining to the responsibilities of the board. These are that directors should act on a fully informed basis, the duty of care and duty of loyalty vested in directors, their responsibility to act in an even-handed manner, and the high ethical standards expected of them.

207 Companies Act 2008 s 94(8)(c); Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence (International Organization of Securities Commissions 2002) 3-11.

2.17.1 Directors should act on a fully informed basis

It is unclear whether international customary law recognises the fiduciary duties of a director in the event that an investment treaty neglects to regulate the duties of directors specifically. This section focuses on the responsibilities of the board from a domestic law perspective. A director, an alternate director, a prescribed officer or a person who is a member of the audit committee may not approve or enter into any agreement in which he or she has a personal financial interest. A director may approve or enter into such an agreement only after he or she has disclosed the nature and extent of the conflict of interest to the shareholders of the enterprise (if he or she is the only director and does not hold all shares/securities in that enterprise) or the board of directors.[208] The director must disclose the conflict of interest to the board in the form of a written notice. This duty also extends to a director who knows another director (on the same board) with a possible conflict of interest.[209] The director 'who knows of another director' must also disclose this to the board and, if requested by the board, also disclose any relevant observations or insights into contracts concluded by this particular director. The director being accused of conflict of interest may not participate in the investigation into the possible existence of conflict. No legal representation is required

208 Companies Act 2008 s 75(3-4,6); Concerning international law see *Gami v Mexico* http://www.oecd.org/daf/inv/investment-policy/WP-2014-3.pdf 42 (accessed 25 March 2019). 'If the host State were to injure that enterprise in a manner that does not directly injure the investor/shareholders, no remedy would ordinarily be available under customary international law. In such a case, the loss or damage is suffered by the corporation as the investor has not suffered a direct loss or damage, it does not have standing to bring a claim.' Although this case focused on derivative actions – which are not part of international customary law – it is quite possible to argue that international customary law recognises directors' duties as a method of preventing derivative actions in the first place.

209 S 75(5)(e).

during the statement of the director's version of how the contracts that constitute conflict of interest were concluded. Generally, the non-disclosure of conflict does not automatically invalidate any agreement entered into by the director;[210] the board can always ratify the agreement or the agreement can be ratified by the shareholders of an enterprise.[211] Directors who did not disclose any conflict should also be recorded in the appropriate register of the enterprise as an aspect of good corporate governance.[212]

The OECD requires a foreign investment enterprise to design mechanisms or systems to ensure that the board obeys all relevant laws – including tax laws, competition laws, environmental laws, business human rights, and health and safety laws. The system or systems could be part of an internal corporate governance check list.[213]

2.17.2 Duty of care and duty of loyalty

A director, alternate director, prescribed officer, or person who is a member of the audit committee must not use his or her position to obtain relevant information to gain an advantage for him/herself or for another person other than the enterprise. The OECD corporate governance principles are very clear that a director owes a duty of loyalty not only to the holding or controlling enterprise but also to the subsidiary of the holding enterprise. This is relevant only if the director serves on both boards – the boards of

210 S 75(7). A director does not own all the shares/securities (beneficial interests) of the company.

211 S 75(8).

212 OECD Principles of Corporate Governance (2015) 45.

213 OECD Principles of Corporate Governance (2015) 45-46.

both the holding and the subsidiary enterprises.[214] Irrespective of whether the director serves on the board of the subsidiary, the director may not cause harm to either the holding or the subsidiary enterprise.[215] A director should also disclose any relevant information to the board unless the information is immaterial.[216]

A director must exercise the functions of a director:

- in good faith and for a proper purpose; and
- in the best interests of the enterprise; and
- with the care, skill and diligence that may reasonably be expected of a person carrying out the same functions of a director and having the general knowledge, skill and experience of that director.[217]

If a director took reasonable steps to become informed about the best interests of the enterprise or to act with care, skill and diligence towards the enterprise, or if the reasonable steps are part of a 'business judgement' decision, then for all practical purposes there is no breach of these duties.[218]

When is a decision a function of business judgement?[219] A business decision is relevant in this respect only if the director had access to all the relevant

214 Companies Act 2008 s 76(2); OECD Principles of Corporate Governance (2015) 46.

215 S 76(2)(a)(i-ii).

216 S 76(3).

217 Companies Act 2008 s 76(3).

218 S 76(4).

219 S 76(4)(a)(i-iii); OECD Guidelines on Insurer Governance (2017) 17. The OECD suggests, among other things, a method of reviewing the decisions of the board to increase the effectiveness of those decisions or to identify opportunities to increase the effectiveness of decisions.

information pertaining to the proposed decision. A business decision could also be based on information supplied to the director by other relevant competent employees, accountants, legal advisers and the like. Or business decisions could be made as a result of the delegation of a director's functions to other employees who also made use of competent persons, for instance accountants and/or legal advisers, when making decisions. In other words, if an erroneous decision is taken as a result of the receipt of incorrect reports from competent employees, this will excuse the director from liability.

2.17.3 Even-handed manner

The OECD states that majority shareholders must appoint directors but the directors appointed should act 'even-handedly' to all classes of shareholders without favouring the majority shareholders at the expense of the minority shareholders.[220] However, domestic law states in the 2008 Act that any person mentioned in the MOI may appoint or remove directors. In addition, the memorandum for a profit company must also state that the election of directors must be provided for by at least 50% of the directors and at least 50% of alternate directors by shareholders of the enterprise.[221]

The OECD requires high ethical standards of directors, for this reason, the 2008 Act is clear that enterprises may not appoint any ineligible or disqualified director. Nor should any disqualified director accept such an appointment.[222] This follows the principles associated with trust, the performance of fiduciary duties, the duty of care and the exercise of skill, and the proper purpose doctrine as a method of establishing a credible/trustworthy enterprise in the economy and promoting a sustainable economy.

220 Companies Act 2008 s 15(6)(c); OECD Principles of Corporate Governance (2015) 46.

221 Companies Act 2008 s 66(4).

222 Companies Act 2008 s 69(2); OECD Principles of Corporate Governance (2015) 47.

2.17.4 Statutory ethical standards

Since the OECD is rather vague on the high ethical standards expected of directors, the 2008 Act regulates director disqualifications to improve future ethical behaviour. An ineligible director, who is disqualified from acting as a director of enterprise (company), includes an unemancipated minor.[223] For this reason, an investment treaty should incorporate the principles of the 2008 Act relevant to ineligible or disqualified directors, especially when disputes are resolved by international tribunals only. International tribunals have no duty to rely on domestic law when formulating determinations unless the treaty refers to or incorporates the principles of domestic law.

To declare a director a delinquent requires an application to the domestic court. An enterprise, shareholder, trade union or representative of the employees may apply for such a court order of delinquency or to declare the director to be placed 'under probation'. This application is also relevant to previous directors of the enterprise if such an application is made within 24 months after the removal of the director. A court must also make a delinquency order if the director grossly abused the position of director, took personal advantage of information, inflicted harm upon the enterprise, displayed wilful misconduct during the management of the enterprise, defrauded a creditor, repeatedly received a compliance notice, was convicted of an offence or previous offences in terms of any legislation, was part of an enterprise that was convicted of an offence and the like.[224] In cases where the director was guilty of gross abuse of office, took personal information, inflicted harm or engaged in wilful misconduct, etc., those delinquency orders are valid for seven years and the court may attach any conditions thereto – for example, that the person may not act as a director for certain types of enterprise for life.[225]

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223 S 69(11).

224 Companies Act 2008 s 162(1-5).

225 S 162 (6) and (9).

The director may apply to a court to set aside the order or replace the order of delinquency with one of probation, but this is possible only if the application is made within three years after a delinquency order was issued. Or the director may apply to set aside a probation order two years after that order was made by making a relevant application to the court. The court will set aside the order only if the applicant can show that he or she complied with all relevant court order conditions pertaining either to a delinquency or to a probation order. Instead of delinquency, a court may also place a director under probation where the director attended a meeting and failed to vote against a resolution when the enterprise was clearly not solvent/ sufficiently liquid to carry on with its business purposes, etc. A court may also place a director under probation if the director was a director of an enterprise that applied for business rescue in the past.[226] The conditions a court may make (delinquency and probation) may include that the person attend educational programmes that teach directorial duties, participate in community service projects, or pay compensation to any person affected by his or her incompetency. In addition to probation, the court could also make the order that the director must be supervised by a mentor in future when acting as a director.[227]

2.18 Final observations: Additional functions to promote ethics, and recommendations

The OECD requires the board to fulfil key functions (to be followed voluntarily by domestic enterprises) and an investment treaty should also incorporate these key functions, namely:

- reviewing the corporate strategies on a regular basis;

226 S 162(7)(b).

227 S 162(10)(d).

- formulating major plans of action, risk management policies, annual budgets, business plans, setting performance objectives, and monitoring corporate performance on a regular basis;
- overseeing major capital expenditure timeously; and
- acquisitions, divestitures, monitoring corporate governance principles, knowing when to replace key directors/managers, aligning board remuneration with the long-term goals of the enterprise, ensuring transparency in nominating proposed directors, eliminating the misuse of corporate assets, monitoring conflict of interest, preventing the abuse of related business transactions, ensuring robust accountancy reporting systems, ensuring independent audits, ensuring financial and operational control, reviewing mechanisms to comply with the law, forming independent board judgements, overseeing effective communication with stakeholders/shareholders, etc.[228]

The OECD also recommends the following additional functions (to be performed voluntarily by domestic enterprises) and an investment treaty should also incorporate these functions:

- Identify clear lines of accountability for management.
- Identify self-assessment tests by the board to monitor the individual performance of directors.
- Establish a remuneration committee relevant to directors' remuneration. It is suggested that no director should serve on such a committee. The committee should also indicate whether it is appropriate to remunerate a director and to remunerate a director for additional consultancy purposes.
- Consider (this is a task of the remuneration committee) the salary conditions relevant to a director's contract of employment and other forms of remuneration a director is or should be entitled to:

228 OECD Principles of Corporate Governance (2015) 47-50.

- establish a nomination committee with the sole purpose of recommending possible director candidates to serve as directors on the board. To promote the objectivity of the appointment/ recommendation of a director candidate, this committee should not include a director; and
- establish an anti-bribery committee to analyse all business transactions of the enterprise, for example contracts and the role of agents of other entities and whether they induced payments to conclude transactions between the enterprise and the other entity. The OECD recommends harsh penalties for bribery.

In addition, the chief executive officer should not be the chairman of board meetings. A separate chairman is required to act as such with clear 'separation of powers' between the chief executive officer and the chairman. In this regard, the company secretary should report matters relevant to board meetings directly to the chairman, etc.[229]

In addition to an audit committee, the Companies Act 2008 requires the establishment of ethics and social committees. Section 66(2) requires directors to serve on those committees. The minister may make additional regulations relevant to social and ethics committees although an enterprise may apply to the Companies Tribunal to be exempted from the establishment of these committees. Such an exemption is generally valid for five years. Section 72(8) requires those committees to ask any director for any information or explanation necessary to complete the performance of his or her functions. The ethics and social committees may also attend shareholder meetings. The same may be relevant to an investment treaty.

The Companies Act 2008 regulates the duties of a company secretary, but in section 88, does not limit these duties. The duties of the company secretary are as follows, but are not limited to these:

229 OECD Principles of Corporate Governance (2015) 47-54.

- Give collective and/or individual guidance on the rights and duties of directors.
- Make the directors aware of any law.
- Report to the board on any failure to comply with the law.
- Ensure that the minutes of any board/shareholder meeting or committee meeting are up to date.
- Certify the financial statements of the enterprise and send a copy to every person entitled to them.
- Ensure self-assessment by the board of individual directors' performance.
- Establish a remuneration committee relevant to directors' remuneration.[230]
- File the annual financial statements together with the prescribed fee to the Companies Intellectual Property Commission (CIPC).[231]

The Companies Act 2008 requires the publication of the resignation of a company secretary in the financial statements of the enterprise. Section 89(3) requires the publication of reasons and whether the secretary wishes to include the resignation letter or summary of the reasons for his or her removal in the financial statements. Wherever the OECD is silent on appropriate regulations, an investment treaty may contain all the above provisions.

230 Companies Act 2008 ss 86-88; OECD Principles of Corporate Governance (2015) 15, 47-54.

231 S 33.

CHAPTER 3

What are cell captives, trust security and the corporate duty of vigilance? Guidelines from international corporate governance principles

Neels Kilian

3.1 Underwriting managers

The Organisation for Economic Co-operation and Development (OECD) guidelines on Insurance Governance are relevant to South Africa. This chapter discusses the influences of the OECD on domestic insurance law to indicate possible future insurance law developments. The OECD requires that various regulatory bodies be established for the different financial sectors in the economy, for instance, the Prudential Authority for the insurance sector, which regulates (and considers) unique complex relationships, although generally the relationship between an insurer and policyholders is neither unique nor complex.[1] While the OECD does not define the parties to the regulated relationships, it does require the regulation of these relationships. For example, the Prudential Authority regulates the relationship between a non-mandated intermediary and an underwriting manager in the insurance

1 OECD Guidelines on Insurer Governance (2017) 40. In this chapter, only short-term insurance principles are relevant to our discussion. Not all countries are similar in terms of complex relationships and the overall application of OECD is still relevant to those relationships.

sector. Before focusing on this, it is important to point out that insurance companies may pay incentives (binder fees) to financial intermediaries such as underwriting managers. This allows them to share in the profits of the insurer and is not contrary to the principles of the OECD. The relationship between an underwriting manager and an insurer is regulated by a binder contract and the way in which the underwriting manager will be sharing in the profits in future. A binder contract does not, however, regulate the relationship between a financial adviser (broker) and an insurer.[2]

An underwriting manager is an enterprise (registered as either a private or public company or a close corporation) that exercises one or more of the following binder functions on behalf of the insurer:

- enters into, varies or renews a short-term insurance policy;[3]
- determines the wording of a short-term policy;[4]
- determines the premiums under a short-term policy;[5]

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2 Binder Contracts, see Short-Term Insurance in the *Government Gazette* no 34877 of 23 December 2011; OECD Guidelines on Insurer Governance (2017) 82-83. Here the OECD states general principles for a policyholder to participate in the profits of the insurer. An underwriting manager is not a policyholder of the insurer or a shareholder, although a cell structure, more specifically a cell captive, is in fact a shareholder of the company. The OECD requires the discretionary power of the board when deciding how profits should be shared/allocated to a cell captive insurer; Financial Conduct Sector Authority Position Paper (FSCA) Final Policy Proposals for Conduct Related Requirements Applicable to Third Party Cell Captive Insurance Business (2019) https://bit.ly/3UcRJbI (accessed 23 March 2020).

3 Short-Term Insurance Act 53 of 1998 s 48A(1)(a).

4 S 48A(1)(b).

5 S 48A(1)(c).

- determines the value of short-term policy benefits; [6] and/or
- settles claims under a short-term policy.[7]

Generally, an insurer concludes a binder contract with an underwriting manager because of the exceptional underwriting skills of such a manager, which the insurer does not have, and for this reason the underwriting manager (or underwriter) could make financial profits for the insurer. Besides the binder functions, the underwriter could also render services as an intermediary. If the underwriter performs 'intermediary services', no other person may 'enter into a policy', 'vary a policy' or 'renew a policy' on behalf of the insurer.[8] 'Enter' into is simply defined as any act that results in the underwriter becoming liable to provide policy benefits, and the underwriter may enter into such a policy without obtaining the permission of the insurer.[9] The underwriter will generally use its own policy wording to limit its exposure to unnecessary policyholder risks, deciding on relevant policyholder benefits and making use of sophisticated computer systems or actuaries for calculating or collecting premiums for policyholders.[10] To settle a claim generally implies the partial or full acceptance of a liability in exchange for policy benefits. The underwriter may rely on its policy wording to determine the extent of the underwriter's liability/risk and/or the rejection of a claim submitted to the underwriter by a policyholder. In such a case, the underwriter may either settle or reject a claim without

6 S 48A(1)(d).

7 S 48A(1)(e).

8 Binder Contracts, see Short-Term Insurance in the *Government Gazette* no 34877 of 23 December 2011 s 6.1.

9 See s 6.1 the same applies to renewing and varying the short-term policy without the permission of the insurer.

10 S 6.1.

the insurer becoming aware of either the refusal to pay a claim or to settle a claim. A non-mandated intermediary does not include an underwriting manager. Such an intermediary may conclude a binder agreement with an insurer without performing any of the binder functions listed above.[11] A non-mandated intermediary and an underwriting manager are binder holders in terms of relevant binder agreements.[12] A mandated intermediary is not a binder holder but does have a mandate from all the policyholders to transfer them to another insurer if, for example, the current insurer increases the monthly premium.[13] A mandated intermediary is not a binder holder.

A non-mandated intermediary may not conduct any business with a mandated intermediary.[14] The same applies to an underwriting manager, where the mandated or non-mandated intermediary is an associate of the underwriting manager.[15] Generally, an underwriting manager cannot be an underwriter for two insurers on one and the same class of commercial or personal policies unless the insurers have agreed to this in writing.[16] The OECD does not prohibit this complex relationship either. The preceding example of two insurers for the same class of policy is not relevant in the event that the underwriter gives notice of the termination of the binder contract and signs

11 S 6.1; D Joffe 'New PPR and binder legislation … What now?' (2018) *Financial Intermediary Association of South Africa* https://bit.ly/3DpgDhg (accessed 16 April 2020).

12 S 6.2.

13 S 6.1; OECD Guidelines on Insurer Governance (2017) 40 requires that should a policyholder be transferred to another insurer, the long-term benefit of such an act should have priority over short-term benefits.

14 S 6.2(2).

15 S 6.3(3).

16 S 6.3(3).

another binder contract with another insurer after termination. However, the underwriter is not allowed to conduct any binder functions on behalf of the terminated insurer during the termination period.[17] This may be part of the OECD governance principles to promote fair treatment for policyholders and to allow insurers an opportunity to manage and/or to control their risks during the termination period.[18]

The OECD requires insurer management practices to be sound. In this regard, a binder agreement must contain the following terms, commonly referred to as *essentialia*, between the insurer and the binder holder. These terms should specify whether the binder holder is either a non-mandated intermediary or an underwriting manager, the duration of the contract, the level of standard and service that must be rendered to policyholders, that the binder holder complies with specific risk or governance controls, the value of the remuneration (binder fee) or how profit should be calculated, the information to be disclosed to the policyholder, how the insurer will monitor the services of a binder holder, that the insurer must have continued access to policyholder information and that the binder holder must update policyholder information at intervals of 60 days. It should also regulate a dispute resolution process and provide for a business contingency process when the binder holder is liquidated or placed under business rescue, or the like.[19] During the period of termination, a binder agreement may limit the binder functions of the binder holder to reduce the risk to the insurer during

17 S 6.4(a-b).

18 OECD Guidelines on Insurer Governance (2017) 40 and 69. In the event of the termination of a binder agreement, the policyholder may be confused as to who the actual insurer is. In this case, the underwriter should communicate to the policyholder the effect of the termination and/or give the policyholder the option to continue with a proposed new insurer.

19 S 6.3(1)(a-t).

the termination period.[20] In addition, an insurer may always communicate directly with policyholders and, thus, a binder agreement may not contain a clause contrary to this.[21] A binder agreement may also specify the following, which is relevant to non-mandated intermediaries:

- the maximum value of the policy benefits to be managed by the non-mandated intermediary or the maximum claim value to be settled by a non-mandated intermediary; and
- the risk factors to be considered by a non-mandated intermediary when entering into, varying or determining the policy benefit values.[22]

If the above *essentialia* are not clearly expressed, confusion may arise with regard to the functions of the different binder holders. An 'underwriting manager' is defined as a person who enters into and/or varies, among other things, a policy without the assistance of an insurer. In this regard, a non-mandated intermediary is also allowed to perform these binder functions. Although a non-mandated intermediary is not defined as exercising any binder functions, it seems that such an intermediary may perform only very limited binder functions.[23] Accordingly, an underwriting manager shares in the profits of the insurer while a non-mandated intermediary is not allowed to share in any insurer profits.[24]

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20 S 6.3(2)(a-b).

21 S 6.3(3)(a-b).

22 S 6.3(4)(a-b).

23 S 6.1 and 6.3(5)(a-d); See the definition of an underwriting manager and a non-mandated intermediary. A non-mandated intermediary is not allowed to determine premiums payable by policyholders, reject a claim, terminate a policy or declare a policy void, and in addition may not share in the profits of the insurer.

24 S 6.4(4).

A non-mandated intermediary may not declare a policy void and has no discretion as to whether to renew a policy or not.[25]

3.2 Sharing in profits

The OECD states the following guidelines for establishing a well-functioning insurance industry:

- an expected prudent approach that would not be in conflict with the economy pertaining to the business and the financial strategies of the insurer;
- a well-developed risk culture and risk management systems with additional independent control functions; and
- policies and procedures that ensure proper treatment of customers and policyholders and/or any relevant business beneficiaries.[26]

The above guidelines sound simple in practice but are rather difficult to comply with. In this regard, an underwriting manager may share in the profits of the insurer. To share in these profits, a loss ratio calculation is relevant. A loss ratio calculation should be regulated in the binder agreement but the end result could be such that a profitable underwriter may seem unprofitable as a method to avoid profit sharing. Another example could be the explicit transformation of enterprises regulated by the Insurance Act 2017 with regard to the requirement that the board of directors of those enterprises complies with employment equity principles.[27]

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25 S 6.3(5).

26 OECD Guidelines on Insurer Governance (2017) 41, 69.

27 S 6.4(4); D Joffe 'New PPR and binder legislation…what now?' (2018) *Financial Intermediary Association of South Africa* https://bit.ly/3SNIY6v (accessed 16 April 2020). Only binder fees are regulated and not a loss ratio calculation.

3.3 Examples of loss ratios

What exactly is a 'prudent approach' that will not be in conflict with the financial strategy in sharing the profits of the insurer? And does it relate to risk management systems or what the procedures should be to ensure the proper treatment of customers/policyholders? In this regard, an underwriting manager could be considered a customer of the insurer. The insurer and underwriting manager could use one of the following loss ratio calculations with different end results:

Table 3.1: Example 1 of a loss ratio

Earned premium	1 000 000
Plus reinsurance commission	100 000
Less broker commission (12.5%)	(125 000)
Less binder fee (5%)	(50 000)
Less insurer fee (3%)	(30 000)
Less UPR (unearned premium reserve)	(20 000)
Less IBNR (claims incurred but not reported)	(100 000)
Less claims	(450 000)
Total profits/(or loss) for insurer	325 000
Loss ratio (675 000/1 000 000)	67.5%

Table 3.2: Example 2 of a loss ratio

Earned premium	1 000 000
Less broker commission (12.5%)	(125 000)
Less binder fee (5%)	(50 000)
Less insurer fee (3%)	(30 000)
Less IBNR	(100 000)
Less claims	(450 000)
Total profits/(loss) for insurer	245 000
Loss ratio (755 000/1 000 000)	75.5%

The above earned premium (annual premiums received from the policyholders) is the same for Tables 3.1 and 3.2. However, the first table has a better loss ratio. Concerning this, Table 3.1 shows more profit to be shared with the underwriting manager. The above tables illustrate a conflict in loss ratio calculations. Which table illustrates a proper treatment of the customer/underwriter? The OECD states the following: 'Any guidelines on insurer governance should be of practical use and benefit to the industry itself, serving as a useful benchmark for good insurer governance and thus a starting point for more specific approaches and practises within insurers.'[28] In this regard, it is important that an appropriate loss ratio calculation should also be regulated by the Government Gazette 34877 of 23 December 2011 to ensure compliance with relevant statutory guidelines on how to calculate loss ratios appropriately for underwriting managers as a method of adopting the required 'prudent approach'. Tables 3.1 and 3.2 show how an underwriting manager could be excluded from profit sharing simply by leaving out the reinsurance commission, thus making the binder functions of the underwriter unprofitable, as indicated in the second table.[29]

A non-mandated intermediary is entitled to receive only a binder fee and may not participate in the profits (directly or indirectly) of the insurer.[30] The fee is payable to the non-mandated intermediary for conducting certain binder functions only; that is, to settle claims on behalf of the insurer. The fee payable to the non-mandated intermediary must be disclosed to the policyholder. This is generally done in the policy documents.[31] The binder

28 OECD Guidelines on Insurer Governance (2017) 41.

29 OECD Guidelines on Insurer Governance (2017) 42.

30 S 6.4(3); D Joffe 'New PPR and binder legislation…What now?' (2018) *Financial Intermediary Association of South Africa* https://fia.org.za/blog/new-ppr-and-binder-legislationwhat-now/ (accessed 16 April 2020).

31 S 6.4(5).

fee is 3.5% for entering into, varying or renewing policies, but is 4% if it includes both the preceding binder functions and the settlement of claims. If the non-mandated intermediary also calculates monthly premiums for policyholders, the fee is 5% inclusive of the preceding binder functions.[32] An underwriting manager is also entitled to a binder fee and the fee is not capped as in the case of non-mandated intermediaries. The binder fee should be reasonable in relation to the actual cost of rendering binder functions. Accordingly, it would appear that the differences between a non-mandated intermediary and an underwriting manager (in terms of binder functions) are purely academic. The true difference seems, therefore, to be based on remuneration sliding scales only, although the binder fee is paid on a monthly basis and amounts to a percentage of the monthly earned premium. If non-mandated intermediaries do not give advice to prospective policyholders, they are in fact entitled to the same binder fee structure as an underwriting manager, as an underwriting manager is not entitled to give advice. These principles are confusing and guidance from the OECD could be relevant to this problem. The OECD states that 'the governance framework for insurers should be well-defined and be comparable to the framework for other financial institutions, there should be sufficient recognition of the specificities of the insurance sector.'[33] Why a non-mandated intermediary is required not to give advice to policyholders is unclear when compared to an underwriting manager, since an underwriting manager has a choice to either share in the profits of the insurer or not. If the underwriting manager is not sharing in the profits, owing to a different loss ratio calculation,

32 Author Unknown 'New binder fees bring consistency' https://bit.ly/3zp7tQP (accessed 29 October 2019); The Financial Services Conduct Authority (FSCA), previously known as the Financial Services Board (FSB) takes a firm stance on binder agreements and outsourcing https://bit.ly/3ztSS6t (accessed 20 April 2020).

33 OECD Guidelines on Insurer Governance (2017) 42; D Joffe 'New PPR and binder legislation…What now?' (2018) *Financial Intermediary Association of South Africa* https://bit.ly/3DNN6PX (accessed 16 April 2020).

there are no clear factual differences between the underwriting manager and a non-mandated intermediary.

A hold-covered binder agreement is also relevant to either a mandated and/or a non-mandated intermediary. It would appear that a hold-covered binder agreement is relevant even if a mandated intermediary conducts business with a non-mandated intermediary.[34] Hold cover is relevant for entering policies on a limited time basis only; that is, the legal liability of the insurer lapses after 96 hours for personal lines and 30 days for commercial lines.[35] For hold-cover policies no binder fee is payable by the insurer to either the mandated or the non-mandated intermediary for specific binder function(s), for example, to 'enter into' a policy.[36] An underwriting manager may not conduct business with a mandated or non-mandated intermediary.[37] In this regard, the regulation of the different binder holders and the mandated intermediaries is clear and coherent with the OECD's guidelines for 'recognition of the specificities of the insurance sector.'[38]

An underwriting manager – as an example – who has a spouse on the underwriter's board is also considered to be 'associated' with the insurer's board of directors and a binder agreement between the underwriter and insurer is in principle prohibited. Nevertheless, even if associates exist on different boards, it is possible for an insurer to apply for an exemption and

34 S 6.2(1-3); S 6.5(1).

35 S 6.5(1)(ii).

36 S 6.5(1)(iii).

37 Ss 6.5(b)(i-ii) and 6.5(4)(a). An 'associate' is defined in terms of the Financial Advisory and Intermediary Services Act 37 of 2002 in s 1 of the General Code of Conduct for Financial Services Providers and Representatives as, for example, a spouse, a civil union partner, holding subsidiary company and/or a director of a company who is also a member of a close corporation.

38 OECD Guidelines on Insurer Governance (2017) 42.

the Prudential Authority may approve the binder agreement.[39] However, the Prudential Authority will approve such an agreement only when there is absolute certainty that no conflict of interests exists between the insurer and the underwriting manager.[40] In addition, in the event of the termination of a binder agreement the insurer must be informed 60 days prior to the date of termination so as to inform the Prudential Authority – in writing – of the following: the underwriter's date of termination, the reasons why the binder agreement is being terminated, how the policies of the policyholder will be dealt with in future, and compliance with relevant legislation.[41]

3.4 The Corporate Duty of Vigilance Law 2017 of France

The Corporate Duty of Vigilance law 2017 of France (a pioneering piece of law) is relevant to all French enterprises doing business in South Africa. Should a foreign-owned South African insurer implement transformation indefinitely, and although the Insurance Act 2017, requires transformation, the Insurance Act could nevertheless be contrary to the principles of the Corporate Duty of Vigilance law 2017 of France, which promotes the protection of business human rights and prohibits any form of human rights violation.[42] Should a violation occur and not be addressed by the parent

39 S 6.5(2); D Joffe 'New PPR and binder legislation…What now?' 2018 *Financial Intermediary Association of South Africa* https://fia.org.za/blog/new-ppr-and-binder-legislationwhat-now/ (accessed 16 April 2020).

40 S 6.5(3).

41 S 6.6.

42 Corporate Duty of Vigilance law (2017) https://bit.ly/3sIPJfn (accessed 13 July 2019). This is, for example, a holding-subsidiary relationship in enterprises. A practical example is Total South Africa, which is a subsidiary of Total France; D Cossart 'What lessons does France's duty of vigilance law have

enterprise situated in France, the parent enterprise may be fined up to 30 million euros. Every French enterprise must have a 'vigilance plan' and must identify risks associated with business human rights violations in their South African enterprises. A mere 'tick box' approach to identifying non-compliance is not sufficient; enterprises must disclose their vigilance plans to the public to avoid future violations of business human rights.[43]

3.5 Cell captive insurance

The Insurance Act 2017 defines a captive insurer, a cell captive insurer and a cell structure. A 'captive insurer' is an insurer that insures only first-party risks. A 'cell captive insurer' means an insurer that conducts business only through cell structures. And a 'cell structure' means that:

- the owner of a cell (enterprise) has shares or equity in the insurer and those shares are administrated separately from other classes of shares of the insurer;
- the owner of a cell can either share in the profits or losses of the insurer; and
- the business of a cell structure is contractually ring-fenced from the other businesses of the insurer.[44]

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for other national initiatives?' (No date) https://bit.ly/2J2QV5W (accessed 13 July 2019).

43 C Kilian 'A practical explanation of ethics as a good corporate governance principle in South Africa and New Zealand: A case study' (2020) *Koers E-Journal*, which illustrates a 'tick box' exercise. This exercise, unfortunately, does not comply with the duty of vigilance, which requires more compliance than a mere 'tick box' approach.

44 Insurance Act 18 of 2017 s 1; Compare to binder holders in D Joffe 'New PPR and binder legislation … What now?' (2018) *Financial Intermediary Association*

Cell structure could include an underwriting manager where the underwriting manager has bought a certain number of shares in the insurer. The MOI of the insurer will make specific reference to the types of shares relevant to the cell structure. Whether the underwriting manage will share in the profits of the insurer depends on the declaration of dividends or distributions. In company law, a preferential shareholder is entitled to participate in the profits of the insurer before other classes of shares may participate in profit sharing. In the Insurance Act, cell shares are ring-fenced from other classes of shares and this could mean that the insurer will focus on the profitability of the cell to declare whether or not there are any dividends. This could infer that a cell structure could receive a distribution/dividend even if the insurer did not recommend a distribution of preferential shares in general owing to the overall poor financial position of the insurer. This may be due to the fact that although the insurer is less profitable, the cell structure was profitable during the same financial year. It could also mean that even if the insurer is profitable during the financial year, the cell owner should contribute capital to the insurer in the event the cell structure made a financial loss. How exactly losses should be regulated is unclear. Generally, in the event of losses the insurer could insist on buying more cell shares from the insurer.[45] The OECD guidelines state the following: 'as managers [directors] of the insurer may pursue their own interests contrary to the interests of shareholders'.[46]

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of South Africa https://bit.ly/3WiecWA (accessed 16 April 2020); M Dunn, J Gray and C Hougaard 'Cell captives' (2019) *Cenfri* https://cenfri.org/publications/cell-captives/ (accessed 1 December 2020).

45 OECD Guidelines on Insurer Governance (2017) 43-46 and 55; Companies Act 71 of 2008, s 4 explains the requirements for a profitable enterprise to declare dividends/distributions; Financial Conduct Sector Authority Position Paper – Final Policy Proposals for Conduct Related Requirements Applicable to Third Party Cell Captive Insurance Business (2019) https://bit.ly/3Wkw8js (accessed 1 December 2020).

46 OECD Guidelines on Insurer Governance (2017) 43. My inclusion.

This latter could imply that an insurer can say to a cell owner that claims recorded in a specific year have not been settled in full and for this reason the insurer will not declare any dividends. This may be the result of a claim submitted by a policyholder that is subject to legal action and legal action could take a few years to finalise before the insurer will consider the financial data of that year as closed.[47] In this regard, it is not very clear when dividends should be declared. On the other hand, should the cell structure suffer financial losses the insurer can demand immediate participation in those losses. The Insurance Act does not provide for a counterbalanced mechanism to achieve fairness between the cell owner and the insurer as to 'how and when' a financial year should be considered closed or to participate in those losses only when the financial year is closed. After all, the cell owner is in fact a shareholder of the company and the general principles of company law should also regulate the relationship between an insurer and the cell owner.

Section 4 of the Companies Act 2008 regulates the statutory requirements for dividends or distributions. In this regard, the insurer as an enterprise should be liquid and solvent when declaring a dividend. Thus, an insurer is liquid and solvent when the assets of the insurer exceed the insurer's liabilities and it is able to pay its debts as they become due in the ordinary course of business for a period of at least 12 months following the dividend payment.[48] In addition, the insurer must consider a fair valuation of its assets and liabilities, including any reasonable foreseeable contingent assets and liabilities, to consider the consequences of the proposed dividend payment.[49] Also, the insurer may consider any other valuation of its assets and liabilities.[50] On this matter, the Insurance Act defines eligible own funds and ancillary

47 OECD Guidelines on Insurer Governance (2017) 45. This is referred to as opportunistic behaviour.

48 Companies Act 2008 s 4(1).

49 S 4(2)(b)(i).

50 S 4(2)(b)(ii).

own funds.[51] 'Eligible own funds' include the sum of the basic own funds and the ancillary own funds. 'Ancillary funds' are items which are not basic funds to be called upon by the insurer to absorb any financial losses, and they exclude items that have been called up before.[52] What exactly constitutes an item is unclear since there is no definition of an item and the definition of ancillary funds is confusing. However, the insurer must comply with section 36 when dividend payments are anticipated.

3.6 Insurance Act solvency requirements for dividends

In compliance with the principles of good corporate governance, the complexity of the insurance business requires that an actuary should control and assess the solvency of the insurer and should comply with the technical calculations associated with solvency requirements. The OECD requires further that insurers should adhere to the OECD guidelines for actuaries.[53] Section 2 the Insurance Act states that a court, the Prudential Authority or any other person (Ombud or Tribunal) may, to the extent that it is practicable and with due consideration of South African insurance law, consider relevant international corporate governance guidelines relevant to the regulation of the insurance sector. The Prudential Authority may direct an insurer to appoint an actuary to recalculate the solvency capital requirement if the Prudential Authority believes that the calculation is incorrect or to improve on the calculation. Although section 36(3 and 5)[54] of the Insurance Act requires a qualified person for such a re-calculation, it should also have reference to an actuary or valuator. The owner of a cell is

51 Insurance Act 2017 s 1.

52 S 1.

53 OECD Guidelines on Insurer Governance (2017) 46 footnote 7.

54 Insurance Act 2017 s 36(3).

not required to make use of an actuary to calculate the financial soundness of the cell structure. In this regard, the insurer or cell captive insurer must at all times maintain its business in a financially sound condition.[55] The Prudential Authority may also give guidelines on how to recalculate the solvency of the insurer and such a calculation will be considered to be the true value of the solvency of the insurer and the relevant cell structure.[56]

The Prudential Authority may also investigate the correctness of any solvency assumption, solvency technique, solvency adjustment, solvency calibration, solvency parameter, solvency calculation, the valuation of assets or liquidity/ solvency model of any insurer.[57] The costs of such an investigation should be paid by the insurer. The Prudential Authority may also prescribe the intervals for calculating the frequency of the insurer's solvency, for example every three months.[58] The Act is unclear on whether a cell structure is liable to pay additional capital when the insurer's cell captive business is not financially or solvency sound. If the cell structure should pay for the financial soundness of the insurer, it may cause the cell structure to enter into a loan agreement with the insurer to fund the solvency shortcomings and the insurer may deduct payments from future dividends.[59] It seems that the Prudential Authority has the ability to direct an insurer on how to calculate loss ratios appropriately, which are also relevant to underwriting managers,

55 S 36(1); See also Financial Conduct Sector Authority Position Paper–Final Policy Proposals for Conduct Related Requirements Applicable to Third Party Cell Captive Insurance Business (2019) https://bit.ly/3DLt3BD (accessed 1 December 2020).

56 S 36(3)(b).

57 S 36(4).

58 S 36(6)(a-g).

59 S 36(6)(cc); See also s 38(1)(a), which states that the Prudential Authority must give permission to allot additional shares to a shareholder.

so as to achieve consistency in loss ratio calculations in the insurance sector. An underwriting manager is not required to share in the losses of the insurer unless they are part of a cell structure. In terms of a cell structure, a loss ratio calculation will most likely also be used to calculate the financial or solvency soundness of the cell for dividend purposes. What percentages of the loss ratio should be considered as 'profit' is unclear. A 75% or even a 90% loss ratio indicates a profit of 25% or 10% respectively

3.7 Failure to maintain solvency

An insurer must ensure that the eligible own funds are at least equal to the minimum capital requirements or solvency capital requirements, as prescribed.[60] The Prudential Authority may also prescribe relevant requirements when an insurer wants to invest money, or wants to make use of financial instruments, namely, derivatives, or wants to make use of an off-balance sheet transaction, or wants to conclude transactions that will either increase or reduce the assets or liabilities of the insurer, or wants to obtain other instruments to shield financial exposure to risk.[61] In such a case, it seems that an insurer should contact the Prudential Authority to obtain compliance permission before concluding relevant transactions as indicated earlier. It is also possible that the Prudential Authority may prescribe capital add-ons relevant to solvency requirements. This will be done only if the insurer is unable to rectify previous solvency deficiencies.[62] A capital add-on is also possible even if the minimum capital requirements exceed the solvency capital requirements of the insurer. Accordingly, it seems that an insurer should be

60 S 36(1); OECD Guidelines on Insurer Governance (2017) 47. The OECD emphasises the importance of prudential regulation and it is clear that the Insurance Act 2017 complies with the OECD standards, i.e., to promote sound risk management.

61 S 36(i).

62 S 37(3-4).

in regular contact with the Prudential Authority to obtain instructions on how to control/manage the solvency or capital requirements successfully. For example, in section 39(1)(a) of the Insurance Act an insurer is required to monitor its financial soundness, and any deteriorating condition relevant to either the capital or solvency requirement must be communicated to the Prudential Authority immediately to avoid non-compliance with section 36 of the Insurance Act. It seems that even if a specific ring-fenced cell structure is profitable, the insurer is not allowed to pay any dividends to that cell structure if the overall financial position of the insurer had deteriorated or will deteriorate in the following three months,[63] or if the insurer is unable to apply an off-balance sheet transaction successfully. The Prudential Authority may review those transactions and may change or abolish them to prevent further deterioration of the financial soundness of the insurer.[64]

If an insurer gives notice to the Prudential Authority for not complying with the solvency or other capital requirements within three months, the Prudential Authority may direct the insurer within one month to submit a recapitalisation scheme to the Prudential Authority for approval, the scheme containing the procedures the insurer must implement in the following three months to restore 'eligible own funds' at a level equal to its minimum capital or solvency requirements or to reduce off-balance sheet transactions to ensure compliance with the capital requirements for insurers, etc.[65] Reducing the risk profile of an insurer may include the termination of a binder agreement and/or to cancel high-risk cell structures, etc.[66] In addition, if the Prudential Authority reasonably believes that an insurer is failing to meet its capital or

63 Ss 39(1)(a-b), 39(2)(a-b) and 39(3).

64 S 39(2)(b).

65 Insurance Act 2017 s 39(5)(a)(i-ii); OECD Guidelines on Insurer Governance (2017) 47.

66 S 39(11); Financial Conduct Sector Authority Position Paper – Final Policy Proposals for Conduct Related Requirements Applicable to Third Party

solvency requirements, the insurer may agree with the Prudential Authority to submit a recapitalisation scheme within two months for approval and to re-establish its 'eligible own funds' within a specific time period.[67] If the Prudential Authority approves the recapitalisation scheme, the insurer must report monthly to the Prudential Authority.[68] The Prudential Authority may also restrict or prohibit certain transactions during this period, for example not to conclude any binder agreements, etc.[69]

In addition, the Prudential Authority may extend the three-month period by an additional three months; or in exceptional circumstances only, extend the three-month period by an appropriate period by considering all relevant factors or circumstances of the insurer.[70]

3.8 Transfer of insurance business

An insurer may not transfer all or any of its assets and/or liabilities to any other insurer unless the Prudential Authority has given its approval. The same applies to any other insurer, for example, a foreign insurer doing business in South Africa or a Lloyd's underwriter.[71] In addition, an insurer may not participate in any merger or takeover transaction or change into a

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Cell Captive Insurance Business (2019) https://bit.ly/3NlQEMm (accessed 1 December 2020).

67 S 39(6); OECD Guidelines on Insurer Governance (2017) 48.

68 S 39(8); OECD Guidelines on Insurer Governance (2017) 49 and 55.

69 S 39(9).

70 Ss 39(5)(b) and 39(7).

71 Insurance Act 2017 s 50(1); See also s 51 concerning a material acquisition or disposal.

different form or type of company, without the approval of the Prudential Authority.[72] The Prudential Authority must grant approval when:

- a transfer, merger, takeover or change will not affect the financial soundness of the insurer; or
- a transfer, merger, takeover or change will not affect the policyholders negatively and when the prescribed procedures have been complied with, i.e. takeover.

The Prudential Authority may:[73]

- set relevant requirements for a transfer, merger, takeover and change and communicate the requirements through appropriate media;
- appoint a person to assess the transfer, merger, takeover and change and to explain whether such a transaction is in the interests of the policyholders, and a transaction approved by the Prudential Authority is binding and enforceable against all persons;[74] and
- transfer any immovable property in the deeds register in accordance the approval of the Prudential Authority.[75]

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72 S 50(2-3).

73 S 50(3-4); Financial Conduct Sector Authority Position Paper – Final Policy Proposals for Conduct related Requirements applicable to Third Party Cell Captive Insurance Business (2019) https://bit.ly/3NnW4Xm (accessed 1 December 2020) and see s 10 of the Financial Sector Regulation Act 9 of 2017, that considers a division as a merger; See also C Kilian 'What is a legal interest as required by derivative actions? – A brief look at *Lewis Group Limited v Woollam and Others* [2017] 1 All SA 192 (WCC)' (2019) *SA Merc* 356 concerning divisions and the legal consequences of such a business entity.

74 S 50(5)(a-b).

75 S 50(6-7). If a transaction is done without the approval of the Prudential Authority, such a transaction will be void.

3.9 Good corporate governance

The OECD explains the relevant guidelines of good corporate insurance governance in detail.[76] Section 30 of the Insurance Act 2017 regulates good insurance governance. The main focus of good corporate governance is to act in the best interests of the policyholders. An insurer must adopt, implement and document a framework to establish compliance with the principles of good corporate governance, irrespective of whether the insurer is a controlling company or part of a group of companies.[77] It seems that a large insurance company will have a more complex framework and compliance should be ensured more robustly, for example, in reporting on the French Corporate Duty of Vigilance law 2017. A small insurer should not be compared with a larger insurer in terms of the robustness of their compliance practices.[78] However, the effectiveness of internal controls/ mechanisms should be proportionate to the scale and complexity of the insurer's business. The board of directors of an insurer is responsible for complying with section 30, irrespective of whether the governance framework has been outsourced or has been delegated to another person. The Prudential Authority may prescribe certain principles and requirements relating to good corporate governance.

The first principle states that an insurer must be committed to transformation – in other words, must participate actively in broad-based black economic empowerment. This principle could be criticised, however, since the OECD makes no provision for racial quotas relevant to (or as a characteristic of) good corporate governance.[79]

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76 OECD Guidelines on Insurer Governance (2017) 49.

77 Insurance Act 2017 s 30(1)(a-b).

78 S 30(2)(a-b).

79 S 22(1)(c)(iii); OECD Guidelines on Insurer Governance (2017) 49. The OECD requires quality decision making from the board of directors relevant to the business of insurance.

The composition of the board of directors (executive and non-executive directors), roles and responsibilities of the board of directors, duties of directors, committees to be established by the directors, risk management/ policy/strategy, solvency capital assessments, internal controls, control functions and heads of control functions (for example, the debit order collection department of an insurer), outsourcing of the business of insurance to other persons, functions or activities that may not be outsourced, matters or activities relating to sub-outsourcing and relevant notification of outsourcing, must be disclosed to the Prudential Authority.[80]

In addition, the OECD requires that the control or the managing of risk and the appropriate business strategies should be superior to those found in most ordinary domestic corporate governance principles to establish an effective Prudential Authority regulator.[81] It would appear that the Insurance Act complies with the OECD principles, but it is clear that the tenets pertaining to transformation – whether in small or larger South African enterprises – could run counter to the French Duty of Vigilance Law 2017.

The OECD requires a higher standard for director duties (and/or ethics) to prevent directors' conflict of interest. In *Anderson Insurance Underwriting Managers v Constantia* [2017] ZAGPJHC 195, the previous insurer was liquidated and Anderson negotiated a new binder agreement with Constantia Insurance. After the negotiations and after the policyholders were transferred to Constantia, Constantia appointed a new CEO and rejected the negotiated binder agreements. Constantia argued that the binder agreements were

80 S 22(4)(a-f).

81 OECD Guidelines on Insurer Governance (2017) 49-50,69; OECD Methodology for Assessing the Implementation of the G20/OECD Principles on Corporate Governance (2017); Corporate Duty of Vigilance Law (2017) https://bit.ly/3fnhdnR (accessed 13 July 2019); D Cossart 'What lessons does France's duty of vigilance law have for other national initiatives?' (No date) https://bit.ly/2J2QV5W (accessed 13 July 2019).

void because of Anderson's loss ratio. Anderson applied for an interdict to prevent the cancellation of the binder agreement in order to continue receiving a monthly binder fee. It was argued that Anderson was running at a loss. What is strange about this case, though, was that Constantia did not hand back the policyholders Anderson to allow Anderson to conclude a new binder agreement with another insurer, but instead kept the policyholders.[82] Therefore, it is easy to argue that the board of Constantia did not comply with the principles of good corporate governance relevant to domestic corporate governance principles, for example, King IV (King IV explains ethical leadership, fairness, accountability, etc).[83] The OECD requires the boards of enterprises to develop and to monitor a code of ethics.[84]

3.10 Failure to maintain good corporate governance

Section 30 of the Insurance Act requires the implementation of an effective corporate governance framework. Following this, the OECD requires that the board of directors draft a code of ethics as part of a corporate governance

82 Paras 25, 69, 71. Anderson had 116 brokers and an annual insurance premium turnover of R144m; S 10 of the Financial Sector Regulation Act 2017 refers to mergers/amalgamations, implying the relevance of the Takeover Regulation Panel for the business of insurance. In this regard the binder agreement made provision for a division business structure which tacitly implies a merger; S 10 is relevant to s 115 of the Companies Act 2008 in terms of receiving a compliance notice in the event of mergers and/or takeovers. Since a s 115 compliance notice was not issued, Anderson could have argued for a void merger.

83 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 20; OECD Guidelines on Insurer Governance (2017) 53.

84 OECD Guidelines on Insurer Governance (2017) 53.

framework.[85] The OECD requires further that the code of ethics should set out appropriate standards of board behaviour, as well as standards for the employees of an insurer. This code is relevant not only to regulating internal relationships but also external relationships. We were not able to find any reference to the establishment of an ethics committee in the Insurance Act, only an audit committee. The Companies Act 2008, requires the establishment of an ethics committee but only when the requirements of section 72(4) are met (in regard to annual turnover), the number of employees, the nature of the company's business, etc. However, in terms of section 94(7)(i) of the Companies Act, the board may assign the oversight and the implementation of ethics to the audit committee.

Although King IV defines ethics, it remains a complicated term in practice and it is difficult to formulate appropriate procedures for ensuring that an enterprise is always ethical. Should an insurer fail to make use of section 94(7)(i) to implement the oversight of ethics as required by the OECD, this insurer must without any delay:

- notify the Prudential Authority of the failure and the reasons for the failure;[86]
- within 30 days after notification set out a compliance scheme for implementing an ethics committee, etc. within four months to rectify non-compliance.[87]

85 OECD Guidelines on Insurer Governance (2017) 53-54.

86 Insurance Act 2017 s 31(2)(a)(i); OECD Guidelines on Insurer Governance (2017) 61. The OECD discusses audit committees in great detail.

87 S 31(2)(a)(ii).

The Prudential Authority may extend the four-month period by an additional two months and/or with any other time period, considering all relevant circumstances.[88]

In addition, if the Prudential Authority approved a scheme, the insurer must report on a monthly basis to the Prudential Authority;[89] or the Prudential Authority may restrict, for example, off-balance sheet transactions until a compliance scheme is implemented by the insurer,[90] or:

- impose limitations and/or conditions on the business of the insurer; the same applies to Lloyd's and Lloyd's underwriters and representatives;[91] or
- to indicate to the Prudential Authority that section 31 is being followed and implemented in practice, or the Prudential Authority can recommend an expert to help the insurer to implement an effective governance framework or give directions to a key person of the insurer to strengthen the governance framework and/or any other action the Prudential Authority may require.[92]

The ethical codes or policies should deal, amongst other matters, with the principle of conflict of interest facing directors. In *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Ltd* 2015 (6) SA 338 (WCC), the High Court of South Africa had to consider whether the chief financial officer should be allowed to attend future board meetings after her suspension due to a breach of her fiduciary duties, i.e., a conflict of interest. The High Court referred to King IV in order to exemplify what is meant

88 S 31(2)(b).

89 S 31(5).

90 S 31(4)(a).

91 S 31(4)(b).

92 S 31(5)(a)–(8).

by the principles of good corporate governance. The court held that the mere fact that the company had suffered R15 billion financial losses should indicate the degree of the breaches (of the principles of corporate governance) committed by the chief financial officer. However, the court also focused on section 75(5)(d) of the Companies Act 2008, which requires a director to immediately leave a board meeting after full disclosure of the conflict of interest. In addition, King IV does not require a suspended director to attend any future board meeting.[93]

Section 30(4)(b)(iv) of the Insurance Act 2017, requires the Prudential Authority to prescribe governance principles and requirements relating to committees that must be established by an insurer. The OECD states that a risk committee may be established to oversee the insurer's risk strategy, risk management and internal control and to review compliance. The OECD also states that insurers may establish a remuneration committee relevant to directors' remuneration, nomination committees to nominate future directors, ethics committees to oversee conflicts of interest and the like.[94] However, it is possible that the Prudential Authority may assign the functions of these different committees to the audit committee only.[95] The

93 See also *South African Broadcasting Corporation Limited v Mpofu and Another* 2009 (4) All SA 169 (GSJ), which argues that a dismissed or suspended director should attend all future board meetings to preserve the integrity of the board's decisions. This statement was rejected by Davis J in *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Ltd* [2015] ZAWCHC 113; 2015 (6) SA 338 (WCC); OECD Guidelines on Insurer Governance (2017) 54.

94 OECD Guidelines on Insurer Governance (2017) 63.

95 S 33(3)(b); See in general Financial Conduct Sector Authority Position Paper – Final Policy Proposals for Conduct Related Requirements applicable to Third Party Cell Captive Insurance Business (2019) https://bit.ly/3NiErIn (accessed 1 December 2020).

audit committee should not be overseen by the board of the insurer so as to ensure its independence as required by the OECD.[96]

3.11 Fiduciary duties of directors and key persons

The OECD requires the same standard of the performance of the fiduciary duties prescribed by either domestic common law or domestic legislation from key managers/employees or key executives of the insurer. On this point, the insurer must draft an additional code of ethics to impose fiduciary duties on key employees on the same level as those pertaining to directors.[97] Section 63 of the Insurance Act requires the Prudential Authority to prescribe prudential standards relevant to insurers' key persons/executives.[98] The Prudential Authority could set the following standards:

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96 OECD Guidelines on Insurer Governance (2017) 55.

97 OECD Guidelines on Insurer Governance (2017) 63; S 1 of the Insurance Act 2017 defines a key person as:
'(a) a director;
(b) a senior manager;
(c) a head of a control function;
(d) an auditor referred to in section 32;
(e) a trustee of a trust referred to in section 41; and
(f) a representative and a deputy representative of Lloyd's or a branch of a foreign reinsurer.'

98 OECD Guidelines on Insurer Governance (2017) 63-64 and 69; P Kruger 'Key individuals cannot delegate accountability' (No date) https://bit.ly/3zvJAa9 (accessed 1 January 2020); Financial Advisory and Intermediary Services Act 2002, s 17(3) requires a key person to comply with the provisions of this Act; A Arde 'FSB Appeal Board upholds debarment of Interneuron's Willem Jonker' (No date) https://bit.ly/3DKJu0U (accessed 1 January 2020). The Appeal Board of the Financial Services Board (FSB) is today known as the Tribunal for Financial Services. Therefore, any decision of the FSB (today

- standards relevant to board strategies;
- standards promoting and adhering to high standards of ethics;
- standards relevant to identifying key risk factors facing the insurer and controlling the risk;
- standards relevant to an effective risk management policy;
- standards relevant to internal control systems and establishing control functions;
- standards relevant to effective compensation systems, promoting effective human resource management and planning; and
- standards relevant in monitoring objectives, the achievement of objectives, policies and plans approved by the board.

The above standards could, for example, be used to explain the importance of receiving information timeously and correctly to be able to make relevant business decisions. The standards could also indicate the way the information should be supplied to the directors or key persons. In New Zealand, the High Court delivered a complicated judgment.[99] In this judgment, which was 172 pages long, the court considered the dealings between the New Zealand Exchange (NZX) and Ralec Commodities. In brief, Clear Ltd would supply an electronic trading platform to record transactions on the NZX. In this regard, Ralec made some projections of future transactions to be conducted by Clear, and those projections were misrepresentations. The court held that although future projections are uncertain and the actual end result could differ from a projected result, such projections could be honestly made if the projections were supported by objective evidence – for example, if the number of grain growers per ton and per grower per annum were known or part of the future

known as the Financial Sector Conduct Authority) may be reviewed by the Financial Services Tribunal.

99 *NZX Ltd v Ralec Commodities Pty Ltd* [2016] NZHC 2742.

projection. In this case, the projections were based on an uncertain number of growers, including growers who did not agree to participate in the trading platform of Clear. Therefore, the evidence presented in the projections was not objective but subjective. In this case, the projected results were not honestly made by Ralec when sharing future projected transactions to NZX. On the other hand, Clear had two directors who knew the inner workings of an electronic trading platform. The two directors were dismissed on the basis of infighting, and there were no other suitable key persons with similar knowledge in Clear. Ralec also did not disclose the dismissal of the two directors to the NZX as a method of promoting ethical behaviour for the trading platform or to promote transparency/integrity between NZX and Ralec relevant to future platform transactions. The court also did not make any reference to relevant corporate governance codes, for example, the FMA Handbook of Corporate Governance or the NZX Code of Corporate Governance dealing with ethics.

3.12 External auditor

An insurer must have an appointed auditor at all times. If an insurer is unable to appoint an auditor, the Prudential Authority may appoint an auditor to complete the auditing requirements for that specific insurer.[100] An auditor appointed by the Prudential Authority is assumed to have been appointed by the insurer.[101] In addition, an auditor must without delay submit a written

100 Insurance Act 2017 ss 32(1-3) and 47; OECD Guidelines on Insurer Governance (2017) 64-66. The OECD requires an external auditor to certify that the financial statements fairly represent the financial position of the insurer, according to accepted accounting practices. The problem is a loss ratio calculation; how should an auditor give an opinion relevant to an appropriate loss ratio calculation? The OECD contains no clear guidelines in this regard.

101 S 32(3)(b); South Africa's Audit Regulator and the UK Audit Regulator are planning to break up the following audit firms: KPMG, Deloitte, PWC

report to the board of directors and the Prudential Authority concerning the financial soundness of the insurer, irregularities in the functions and duties of the insurer, irregularities concerning security held in trust, inability to perform any other duties as required by the Financial Sector Regulation Act 2017, inadequate maintenance of internal controls, significant owner that contravenes any provision of the Insurance Act, or on any other matter that the auditor becomes aware off in the performance of his or her duties and functions.[102]

A person is disqualified from acting as an external auditor if the he or she is a director or prescribed officer of the insurer, an employee of the insurer, has been appointed a company secretary of the insurer, habitually performs the duties of an auditor, is related to any director or prescribed officer of the insurer, or was a director or prescribed officer of the insurer at any time during the last five years.[103] In addition, an external auditor is disqualified if he or she is not independent of the insurer according to the insurer's audit

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and EY. The main reason is simply conflict of interest. A young, articled clerk completes his articles, whereupon a listed enterprise will eventually employ him or her. The person will then become part of the management of the enterprise although, to a certain extent, loyalty will still exist to the audit firm where the articles were completed. In this regard see T Kinder 'Regulator outlines plans to break up big four accounting firms' (No date) *Financial Times* https://on.ft.com/3FtcLOY (accessed 10 October 2020); Author Unknown 'South Africa wants to dismantle the big four after scandals' *Bloomberg* https://bit.ly/3SYkNTi (accessed 10 October 2020).

102 S 32(4), (5) and (6); Financial Services Board 'Understanding the FSR Act' (No date) https://bit.ly/3TOzObx (accessed 10 October 2020).

103 Companies Act 2008 s 90(2)(i-vi); OECD Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors (2013) 9 the abuse of public or private office to promote personal gain.

committee requirements.[104] A first external auditor holds office until the end of the financial year and the retiring auditor may continue for the following financial year without requiring a resolution to be passed by the annual general meeting of shareholders unless the retiring auditor is no longer fit to qualify for an appointment or no longer willing to accept the appointment. The same auditor may not serve for more than five years as an auditor for the insurer.[105] Generally, the OECD supports the rights and functions of an auditor.[106] These include:

- the right to access at all times the accounting records and all books/ documents of the insurer;
- the right to pose any questions to the board of directors or ask for explanations relevant to any insurer information;
- the right to access all current and previous financial statements if the auditor is an external one for a holding company and explanations are relevant to those statements from the directors of the holding or subsidiary company;
- the right to attend and/or to receive notices of any general meeting of shareholders; and
- the right to ask questions at a general meeting of shareholders.

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104 S 90(2)(c).

105 Ss 90(6-7) and 92.

106 S 93(1-3); OECD Guidelines on Insurer Governance (2017) 66 requires access to all relevant persons, documents and/or financial statements. In the event that the external auditor disagrees with the insurer's record keeping, he or she should be able to discuss these with the audit committee of the insurer. The OECD recommends whistleblowing if an external auditor becomes aware of any irregularity or breach of the law; OECD Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors (2013) 51-55.

The insurer may not ask an auditor to complete functions if this would result in any form of conflict of interest.[107] If an insurer frustrates the rights and functions of an external auditor, the auditor may apply for a court order against any director or board that frustrates the auditor in completing his tasks.

3.13 Security to be held in trust

The OECD states that a sound legal and regulatory environment protects the interests of the policyholders of an insurer and/or prevents conflicts of interest between an insurer and its policyholders. For example, instead of being financially sound the insurer recommends exorbitant compensation for its individual directors.[108] The Insurance Act also regulates the security to be held by foreign insurers doing business in South Africa for the benefit of the policyholders.[109] For example, a branch of a foreign insurer in South

107 OECD Guidelines on Insurer Governance (2017) 65. Conflict of interest would occur if the external auditor were also performing consultancy-based work for the same insurer. In this regard, an external auditor should only complete audits and not any other form of consultancy work.

108 OECD Guidelines on Insurer Governance (2017) 47; OECD Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors (2013) 51.

109 Insurance Act 2017 ss 1 and 40(1-2). S 1 defines a foreign branch of an insurer, foreign insurer and insurer as meaning '… an operating entity of an insurer that is part of the insurer in terms of its organisation and is not a legal entity separate from the insurer, but is established outside of the Republic' and '… an institution authorised and supervised by a regulatory authority to perform business similar to reinsurance business as defined in this Act under the laws of a country other than the Republic' and '… a person licensed to conduct insurance business under this Act, and includes, unless specifically otherwise provided for in this Act, Lloyd's, a Lloyd's underwriter and a reinsurer.'

Africa or a Lloyd's underwriter must provide and maintain security in the form of assets valued in accordance with the prescribed requirements of this Act. Although the preceding sentence may be difficult to understand, it simply means that the assets should at least be equal to the solvency of the business. In other words, the solvency capital requirements are secured in addition to 'a value equal' to the solvency capital. A Lloyd's underwriter should have assets 'equal to the aggregate' of the solvency requirements for each underwriter in the Lloyd's group.[110] The assets must be held in trust and trustees appointed to maintain those assets.[111] The Prudential Authority may prescribe additional matters to calculate the value of the assets with reference to section 36(6) of the Insurance Act 2017, for example, assumptions, methods, and principles to be used when calculating the value of the assets. The business of insurance in South Africa relates to any risk policy of a policyholder residing or located in the Republic, irrespective of where the risk is located, and refers also to any risk policy concluded through binder functions, irrespective of where the policyholder is located in the world.

A trust is registered in terms of the Trust Property Control Act 57 of 1988. The Prudential Authority must approve the trust deed before the trust can be registered. The Prudential Authority can also play a definite role in the appointment of trustees. In addition, the trust deed should not be amended or terminated prior to approval by the Prudential Authority. The Prudential Authority may prescribe the roles, responsibilities and functions of the trustees. If a trustee fails to exercise the relevant duties and functions in either the Insurance Act or the trust deed, the Prudential Authority may replace the trustee.[112] It could be that a trust is not the correct instrument for

110 S 40(3).

111 S 40(6).

112 Insurance Act 2017 s 41(1-5); BDO 'Trusts, All you need to know' (No date) https://bit.ly/3FqgXz3 (accessed 1 November 2019), which explains the tax implications for trusts.

keeping assets, for example, immovable assets. The Insurance Act does not, however, define assets and the tax implications relevant to immovable assets are extremely high when sold to the public.

A branch of a foreign insurer or Lloyd's underwriter must inform the Prudential Authority immediately if there is non-compliance with the security to be held in trust or failure to comply within these requirements within the following three months, or failure to maintain the minimum security with reference to the insolvency requirements.[113] The Prudential Authority may, under the circumstances described in the previous sentence, direct a branch of a foreign insurer or Lloyd's underwriter to submit a recovery scheme to the Prudential Authority for approval. This scheme will highlight the steps to be implemented to maintain or restore the security in the trust.[114] If the scheme is not acceptable to the Prudential Authority, the Prudential Authority may suspend or withdraw the licence of the branch or Lloyd's underwriter in South Africa.[115] In addition, if the scheme or steps cannot be implemented, the Prudential Authority will act as a trustee.[116] If the scheme and/or steps are approved, the branch or Lloyd's underwriter must submit a monthly progress report to the Prudential Authority. The Prudential Authority may also restrict or prohibit certain activities or transactions until the security requirements are achieved or maintained appropriately.[117] The Insurance Act may also not limit the actions or methods to be used by the Prudential Authority to ensure compliance with trust security.[118]

113 Insurance Act 2017 s 42(1); See in general BDO 'Trusts, All you need to know' (No date) https://bit.ly/3Wjtnyw (accessed 1 November 2019).

114 S 42(2)(a-b).

115 S 42(2)(b).

116 S 42(3).

117 S 42(5).

118 S 42(7).

3.14 Trust security risks and other solvency capital risks

'Operational risk' refers to the risk of incurring financial losses as a result of failed internal controls due to non-compliance with either domestic law or the failure of people or systems to comply with the law, or otherwise, or external risk events such as an act of God, that have a direct impact on either the trust security or solvency capital requirements of the insurer.[119] These risks are not risks associated with the insurance obligations of an insurer – for example, to pay policy benefits in the event that a policyholder submits a claim. Although such a claim may also have an impact on the operational risk of the insurer in the form of loss ratios, this type of risk is excluded from operational risk in the Insurance Act. Operational risk is only part of the control function of the insurer, and the insurer should monitor financial losses resulting from system errors on a daily basis, as required by the OECD, either by means of a relevant committee or person(s) (actuary) that reports to the board to prevent the losses.[120]

Operational risks include first-party risks. First-party risks are difficult to understand in practice and a practical example could be the losses a cell captive insurer may suffer as a result of an unprofitable cell structure.[121]

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119 Insurance Act 2017 s 1 the definition of operational risk.

120 OECD Guidelines on Insurer Governance (2017) 70-71.

121 Insurance Act 2017 s 1 definition of first-party risks includes *'(a)* in respect of a captive insurer, the operational risks of:
(i) the group of companies of which the insurer is a part;
(ii) any associate of a company that is part of the group of companies referred to in subparagraph (i); or
(iii) any joint arrangement that a company that is part of the group of companies referred to in subparagraph (i) participates in;
(b) in respect of a cell captive insurer, the operational risks of the cell owner and the operational risks of—

The losses suffered by an insurer as a result of an underwriting manager who poorly executes binder functions are not part of the operational risk of the insurer. The same applies to a non-mandated intermediary unless an underwriting manager or non-mandated intermediary is part of the definition of an associate. The International Financial Reporting Standards defines an 'associate' as an investor or shareholder that has significance influence over an insurer, which is not necessarily part of a holding-subsidiary enterprise relationship.[122] If the underwriting manager or non-mandated intermediary has no shares in the insurer, then the losses suffered by the insurer will also not be interpreted as third-party risks.[123] The same applies to 'operational losses' relevant to trust security. A cell captive insurer can insure the first- and third-party risks only if the Prudential Authority has given it permission to act as a cell captive insurer.[124]

3.15 Beneficial interests

Beneficial interests relate to the nominee shareholders and beneficial shareholders of an insurer. Section 1 of the Companies Act 1973 defines a 'shareholder' as a person who has entered his or her name in the register of shareholders. For all practical purposes, the nominee shareholder who holds the shares on behalf of a beneficial shareholder is in fact the true shareholder

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(i) the group of companies of which the cell owner is a part;
(ii) any associate of a company that is part of the group of companies referred to in subparagraph (i); or
(iii) any joint arrangement that a company that is part of the group of companies referred to in subparagraph (i) …'

122 For example, International Accounting Standards Board (IASB) rule 28 https://bit.ly/3U6igY0 (accessed 13 November 2019).

123 S 1 definition of third party risks is 'in respect of a cell captive insurer, risks other than first party risks'.

124 S 25(6)(b)(i-ii).

of the company. Basic principles of the law of agency do not apply to a nominee shareholder. For example, in the law of agency only the principal is allowed to litigate in the event of a dispute relevant to a contract entered into by an agent on his behalf. In company law, a nominee shareholder, as being the true shareholder, is the only person who can make use of the remedies as provided for in the 1973 Act. Even if a nominee shareholder casts votes at meetings according to the instructions of a beneficial shareholder, only the nominee could litigate in the event of a dispute with the insurer. This is a depressing situation and it is clearly illustrated in the *Smyth Investec Bank Ltd and Another* [2018] 1 All SA 1 (SCA). In this case, approximately 42 respondents were beneficial shareholders of the applicant and the Supreme Court of Appeal held that a beneficial shareholder is not a shareholder of the company and therefore has no *locus standi* to litigate in terms of the 1973 Act.[125] Section 1 of the Companies Act 2008 defines a beneficial shareholder, and it would appear that a beneficial shareholder can exercise all the rights and duties attached to shares under limited circumstances (even though it is a shareholder who has not entered its name in the shareholder register – for example, a director). Section 57(1) of the 2008 Act states that a shareholder also includes a person who is entitled to cast votes at a meeting; that is, a beneficial shareholder, and therefore, it may be argued that a beneficial shareholder is also a true shareholder of the insurer. In this regard a beneficial shareholder may have *locus standi* in the law to make use of the remedies relevant to the 2008 Act. Whether this interpretation holds any water, only time will tell.

In terms of section 43 of the Insurance Act, the Prudential Authority may request a beneficial shareholder in an insurer to provide information on the number of shares or the beneficial interest held. Since the beneficial shareholder's name is not entered in a register of shareholders and a beneficial shareholder can make use of multiple nominees to enter their names on a

125 At 11 para 30.

register on the beneficial shareholder's behalf, the beneficial interest or number of shares could be difficult to calculate in practice. Nevertheless, a beneficial shareholder could, for example, be an associate due to the influence that a single person can exercise over an insurer. If the insurer fails to comply with a request from the Prudential Authority as result of the actions of the beneficial shareholder, this is considered an offence in terms of section 69(1)(b). The penalty for such an offence is R10 million.

Beside the above information, the Prudential Authority may request, in terms of the Insurance Act or Financial Sector Regulation Act, any reasonable information in any format, manner and/or intervals for the purpose of the supervision and/or enforcement of relevant legislation. An insurer that submits information to the Prudential Authority must ensure that the information is complete, reliable and comparable from one reporting period to another.[126] The OECD makes provision for vertical and horizontal reporting, reporting in the insurer to the board (horizontal) relevant to the implementation of board strategies, internal controls, risk management and proper communication with the Prudential Authority (vertical) for oversight purposes with regard, for example, to board strategies.[127]

3.16 Disclosures

An insurer must annually disclose within four months after the year end or within a prescribed time frame its annual financial statements (or its annual compliance statements) which contain its qualitative and quantitative information in full, as required by any other law or legislation and in the prescribed manner or form to its shareholders and to the Financial Sector Conduct Authority (FSCA). In addition to the latter, the Prudential Authority may approve the non-disclosure of references to information

126 Insurance Act 2017 s 44(1-2).

127 OECD Guidelines on Insurer Governance (2017) 76.

(equivalent and in scope to financial statements (or compliance statements) under any law or legislation, for example, the protection of trade secrets. The Prudential Authority will only approve non-disclosure if the disclosure affords competitors of the insurer information on how to achieve an unfair advantage in the business of insurance.

The information is also subject to confidential agreements between the insurer and other parties, such as a binder holder, and such disclosure may have a negative impact on the financial stability of the insurer.[128] If the Prudential Authority approves the non-disclosure, it must give directions to the insurer on how to disclose the non-disclosure, for example, to disclose relevant reasons in the compliance reports/statements for why certain information cannot be disclosed to the outside world. However, a 'material development' in the business of an insurer must be disclosed, for example, a merger with another insurer, unless the material development need not to be disclosed due to approval received from the Prudential Authority.[129] Generally, a material development could also relate to non-compliance with the Insurance Act. In addition, security held in trust must be audited and relevant financial statements be sent to the Prudential Authority for disclosure purposes.[130] It is also possible that the Prudential Authority may prescribed additional auditing standards in addition to International Financial Reporting Standards.[131]

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128 Insurance Act 2017 ss 45(1-2) and 46(1-2). It is possible that the Prudential Authority may request additional disclosures in the financial statements of the insurer.

129 S 45(3)(a-c).

130 S 47(1-5).

131 S 47(5); See in general List of IFRS https://www.ifrs.org/issued-standards/list-of-standards/ (accessed 1 October 2019).

A branch of a foreign insurer and/or Lloyd's underwriter must inform the Prudential Authority when:

- laws relevant to the head office of the foreign insurer or Lloyd's have changed, including subordinate laws of that domestic country respectively;
- any non-compliance with the laws of the domestic country; and
- remedial action taken/required to rectify the non-compliance and the Prudential Authority may make additional rules for reporting purposes and/or to enhance financial soundness for the branch of the foreign insurer or Lloyd's underwriter or could take one of the following actions:[132]
    - amend, replace or vary the licence to conduct business as an insurer in South Africa for a specific period only;[133]
    - transfer the business of a specific class of policyholder as a result of a varied licence to another South African insurer. The insurer in this regard must present a scheme to the Prudential Authority on how the insurer will discharge its duties in terms of the transfer, for example, to pay policyholder claims until the transfer is completed, etc.[134]

Section 50 of the Insurance Act 2017 states that an insurer, Lloyd's underwriter or foreign branch of an insurer, may with the approval or directions of the Prudential Authority transfer all or any part of the business of that insurer

132 S 48(1-2).

133 S 26(1-4).

134 S 26(3); P Kruger 'Bulk transfers by FSPs and insurers' (No date) https://bit.ly/3U8zljV (accessed 1 November 2020). In this regard the Prudential Authority may exempt the South African insurer from complying with the General Code of Conduct for Authorised Financial Services Providers and Representatives which is part of the Financial Advisory Intermediary Services Act 2002.

to another insurer.[135] In addition, an insurer may not participate in any fundamental transaction (merger or takeover) without the approval of the Prudential Authority. The same applies to converting a cooperative into an insurer or changing the legal status of any legal person by conversion.[136] The Prudential Authority may approve the transfer of all or part of the assets to another insurer, or may approve a merger or takeover if:

- the transaction will not have an effect on the financial soundness of the insurer;
- the transaction will not have a negative impact on the policyholders or the interests of the insurer; and
- any procedure required by the Prudential Authority has been complied with.[137]

The Prudential Authority may also suspend the licence of an insurer either in part or in full.[138] This will occur only if the insurer no longer meets the necessary conditions under which it was licensed to conduct its business of insurance, has failed to comply with the Insurance Act or with the Financial Sector Regulation Act, has failed to comply with a court order, has failed to comply with a Prudential Authority directive, has failed to implement a ruling from the Financial Services Tribunal, has failed to pay annual levies, and/or has failed to promote the object of the Insurance Act. The

135 S 50(1-2).

136 S 50(3)(a-b).

137 S 50(4-5); See s 10 of the Financial Sector Regulation Act 2017. In this regard the transfer of policyholders is now regulated as a form of merger. In addition, see C Kilian 'What is a legal interest as required by derivative actions? – A look at the *Lewis Group Limited v Woollam and Others* [2017] 1 All SA 192 (WCC)' (2019) *SA Merc Journal* 356.

138 Insurance Act 2017 ss 27(1)(a-h) and 27(3).

Prudential Authority may revoke a suspension the moment the insurer complies with the imposed conditions. In addition, the Prudential Authority may publish a notice of suspension and/or the revocation thereof in the appropriate media.[139]

The Prudential Authority may also suspend the licence of a foreign insurer branch or Lloyds underwriter in terms of section 48 of the Insurance Act, for example, a foreign insurer branch that did not inform the Prudential Authority of any changes in their domestic laws which have an effect on the business of insurance in South Africa.[140] A consequence of a revoked licence is that the insurer may not enter into any new policies but must finalise all claims as a function of the business of insurance. If the insurer is unable to comply with additional conditions to revoke a suspended licence, the Prudential Authority may withdraw the licence of the insurer immediately.[141]

On the other hand, the Prudential Authority may also immediately withdraw a licence in the event of any misrepresentation(s) made on the application form for a licence to conduct the business of an insurer or misrepresentations in any advertisements. A practical example to suspend a licence is when an insurer advertises affordable insurance premiums which are not achievable in practice. This is considered misrepresentation and the Prudential Authority may withdraw the licence immediately.[142] The Prudential Authority may also issue a directive relevant to misleading advertisements pertaining to how a licence would be withdrawn and should the insurer fail to comply with the

139 S 27(4-5); The Financial Institutions Act 28 of 2001, allows for an inspection of the business of an insurer or any other financial institution to investigate non-compliance with relevant legislation.

140 S 48(1).

141 Ss 28(1-3) and 29.

142 S 29(1)(a)(i-iii).

directive the Prudential Authority may also proceed with an application for winding-up the insurer.[143]

In addition, if any information requested by the Prudential Authority is incorrect or incomplete, the Prudential Authority may request additional information that is confirmed to be correct and complete.[144] If an insurer fails to comply with this, it is an offence and a penalty of R50 million is payable.[145]

3.17 Acquisitions or disposals

An insurer must obtain the approval of the Prudential Authority before acquiring a material acquisition or making a disposal. What exactly amounts to a material acquisition is not too clear, however, the Prudential Authority could provide guidelines to the insurer. An example could be to acquire a book of policies from an underwriting manager (i.e. in exchange for a fixed

143 S 29(4)(a-b).

144 S 49(1-2).

145 S 69(6); *Financial Sector Conduct Authority v Malvern* case no 1/2020 para 8.2. In this determination, Malvern traded as an unlicensed insurer and received a penalty of R25m. This case may be accessed at https://bit.ly/3DnXPPn (accessed 1 December 2020); A penalty of R100m was granted to MET Collective Investments Pty (Ltd) in *Financial Sector Conduct Authority v MET Collective Investments Pty(Ltd)* case no 1991/003741/07 para 223 for contravening the Collective Investments Schemes Control Act 2002, and relevant board notices. This case may be accessed at https://bit.ly/2oxRaj6 (accessed 1 December 2020). In brief, it is clear that the Prudential Authority will not hesitate to issue hefty penalties for any contravention of any financial sector legislation, for example the Collective Investments Schemes Control Act 2002.

amount of money).[146] The Prudential Authority may refuse to give prior approval if the acquisition or disposal will negatively affect the financial soundness of the insurer, or if it will affect the risks of the insurance group of companies, or if it will negatively affect the corporate governance framework of the insurer.[147] This regulation does not apply to a branch of a foreign insurer or a Lloyd's underwriter. If an acquisition or disposal is contrary to section 51, then such a transaction is void.[148]

3.18 Dissolution of the business of insurance

3.18.1 General

Chapter 9 of the Insurance Act 2017 deals with the dissolution of a business of insurance. In this context, dissolution is referred to as 'resolution' in the Insurance Act (in Afrikaans, *ontbinding*). However, 'dissolution' is closer to the Afrikaans terminology than resolution. Dissolution does not apply to a branch of a foreign insurer or a Lloyd's underwriter, but it does apply to a trust in which security is held as regulated by section 59 of the Insurance Act, that is, the winding up or liquidation of a trust. This will occur only if the security held in trust is inadequate, the trust fails to submit a plan or scheme to the Prudential Authority or to comply with a plan or scheme as approved

146 Insurance Act 2017 s 51(1-2); See in general *Anderson Insurance Underwriting Managers v Constantia Insurance* [2017] ZAGPJHC 195, where Constantia did not honour a transfer of insurance business and Anderson applied for an interdict to receive monthly binder fees.

147 S 51(3)(a-b).

148 S 51(4); See also s 10 of the Financial Sector Regulation Act 2017 relevant to mergers of the business of insurance, for example relevant to division contracts. Division contracts are explained in *Anderson Insurance Underwriting Managers v Constantia Insurance* [2017] ZAGPJHC 195.

by the Prudential Authority, or the Prudential Authority believes the plan or scheme is inadequate.[149] If an insurer fails to submit a plan, scheme or strategy, or fails to comply with a plan, scheme or strategy, the Prudential Authority may apply for business rescue or for the winding up of the insurer.[150] If the Prudential Authority withdraws a licence or the insurer fails to comply with a directive, the insurer will also be liquidated in terms of section 29(4) of the Insurance Act 2017.

3.18.2 Statutory manager

The Prudential Authority may appoint a s statutory manager as a method of rectifying the financial soundness or otherwise of the insurer. If the Prudential Authority appoints a statutory manager, the insurer may not be wound up or be put under business rescue. The insurer may only proceed with business rescue or winding-up when this appointment is terminated.[151] The appointment of a statutory manager is subject to the provisions of the Financial Institutions (Protection of Funds) Act 28 of 2001. Section 5A of this Act states that the Prudential Authority may, after consultation with the insurer and without the intervention of a court, appoint a statutory manager if the insurer failed to comply with a law or is maladministered. The Prudential Authority may appoint such a manager to protect the interests of policyholders or clients of the insurer (underwriting manager, for example) to enhance the stability of the financial system of the insurer. What is interesting is that the Prudential Authority may appoint a statutory manager to produce fairness and/orderliness in the financial system of the insurer. What exactly this entails is unclear. It is also not very clear when the

149 S 52(3)(a-c).

150 S 52(1-2).

151 Insurance Act 2017 s 53(1).

Prudential Authority will appoint such a manager, and it seems this is largely based on its discretionary power.

In *Anderson Insurance Underwriting Managers v Constantia* [2017] ZAGPJHC 195, Constantia did not honour the agreements concluded with Anderson relevant to the transfer of the underwriter's business to Constantia. The Registrar of the Financial Services Board (as it was known back then) was cited as a party to the application brought by Anderson. Anderson argued that the new CEO of Constantia had no right to cancel the agreements concluded with Constantia, and Constantia argued that Anderson was not profitable; nevertheless, Constantia kept the 'unprofitable' policyholders. It is clear that the law of contract in this regard was breached and it is also clear that the Registrar did not make use of section 5A since it was not law prior to 2018.[152] The OECD guidelines on insurer governance require effective reporting and communication within an insurer for the implementation of board strategies and the OECD requires transparency and efficient disclosures to disclose relevant and reliable information to the board.[153] In this regard the previous CEO of Constantia was not charged as a delinquent director in terms of the Companies Act 71 of 2008, therefore the question arises as to whether Anderson's business was really unprofitable.[154] In addition, how can a newly

152 Financial Institutions (Protection of Funds) Act 28 of 2001 s 5A(1)(a-b).

153 OECD Guidelines on Insurer Governance (2017) 76.

154 A similar situation is evidenced by Liberty Insurance Company, which issued false information to the Registrar as a method of acquiring pension funds from individual pension fund managers. The Registrar did not consider the correctness of the information and Liberty acquired the pension funds without complying with the law. For a detailed discussion on this issue please see Author Unknown 'Administrators sit on more than R42bn in unpaid pension benefits - earning a fee of course' *Daily Maverick* https://bit.ly/3DLhmdY (accessed 28 November 2019). In this article it is argued that Liberty received a management fee for the acquired pension funds, without

appointed CEO change previous board decisions without recognising the implications of breach of contract? Can a board approve a decision not to honour signed contracts? In this matter, transparency as required by the OECD was clearly not practised by Constantia. Nevertheless, during the period 2007–2013, Liberty insurance acquired pension funds as a result of receiving false information provided to the Financial Services Board (FSB). Today it is clear that Liberty made certain errors and that the FSB did not act in the interests of the pension fund contributors by approving Liberty as the sole administrator of approximately 4 600 funds. It seems that pension and/or social security is part of a fundamental human right, that is, the right to dignity, and errors in this regard (relevant to false information to acquire individual pension funds) are clearly contrary to the right to dignity so as to ensure the proper (or fair) treatment of contributors/pension holders.

The Constitutional Court had to consider the preceding situation in *Hunter v Financial Sector Conduct Authority* [2018] ZACC 31, where a firm of auditors was appointed to analyse the 'likeliness of prejudice' as a result of cancelling 4 600 pension funds in South Africa.[155] A legal expert in pension law appointed by the Financial Sector Conduct Authority (FSCA, previously known as the FSB), made some remarks as to a possibility of prejudice by cancelling the administrators of the 4 600 funds.[156] The FSCA argued that there is no duty in the law to investigate whether such a possibility could exist; that is, the likelihood of prejudice.[157] It should be noted that when a financial institution is maladministered, section 5A requires the appointment of a statutory manager. It should also be kept in mind FSB that 4 600 pension funds existed

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any compensation paid to the asset managers, and it neglected to complete its duty to pay pension fund benefits to the contributors of those schemes.

155 Paras 1 and 17.

156 Para 18.

157 Para 24.

without any board of trustees to represent those funds despite those funds in the aggregate having of a large monetary value.[158]

Section 1 of the Financial Institutions (Protection of Funds) Act in reference to the Financial Services Board Act 97 of 1990, defines a financial institution, and it includes a pension fund. The FSB (today known as the FSCA) used section 27 of the Pension Fund Act 24 of 1956 to cancel the registration of the 4 600 funds, arguing that should such a duty exist in the law (likeliness to prejudice). The FSB had properly discharged this duty so as not to cause any prejudice to the contributors to those funds. It is clear that no statutory manager was appointed and the Constitutional Court also did not refer to such a manager. This was because this position was established in the Insurance Act only as from 2018.

The whole purpose of having a statutory manager is to report to the FSCA as to whether the institution/pension fund complies with the law, is financially sound or is properly administered by the trustees and/or whether an employer still exists to make and/or to appoint trustees to such a fund. If the manager believes that it is not practicable to manage the financial institution, the FSCA must consider the necessary steps proposed by the manager for transferring the business or fund to another institution or, should this not be possible, for appointing a curator.[159] If the institution is not satisfied with the discretion to appoint a curator, the manager or institution may approach a court for suitable directions, for example, for the liquidation of the fund.[160] The FSCA may also apply to a court to terminate the services of a statutory manager.[161]

158 Para 1.

159 Financial Institutions (Protection of Funds) Act 2001 s 5A(5)(a-b).

160 S 5A(7).

161 S 5A(8). A statutory manager could also be held liable for fraud, dishonesty or wilful failure to comply with the law in subsection 9 relevant to the management of the financial institution, i.e., the pension fund.

In addition, the OECD requires whistleblowing when the conduct of insurers is unethical or entails questionable conduct. The OECD requires the insurer or financial institution to act upon such information and it is suggested that either a compliance committee or an audit committee should deal with the types of information received from whistle-blowers. A person dealing with whistleblowing information/reports should be properly trained.[162]

3.18.3 Curator

The Prudential Authority can apply to a High Court to appoint a curator, as regulated in section 5 of the Financial Institutions (Protection of Funds) Act, or by agreement with the insurer without any application to the High Court. Section 54(1) of the Insurance Act states that any insurer – which includes a branch of a foreign insurer or Lloyd's underwriter – may request a curator. The court will grant the necessary powers and/or functions to a curator and, in addition, the curator may exercise any decision on behalf of the insurer. For example, changing the rights of shareholders requires a special resolution, which, however, does not need a special resolution when the curator changes the rights and duties of shareholders, among other things.[163] The curator may also make decisions that are generally reserved for key persons, as if it were, for instance, a director, a senior manager, a representative of a foreign branch of insurers or Lloyd's underwriters or a representative of a reinsurer.[164] The curator must immediately after

162 OECD Guidelines on Insurer Governance (2017) 77 and 84. The OECD on page 84 refers to human rights, etc.; M Marchant 'No accountability at Liberty' *Business Live* https://bit.ly/3DNis9o (accessed 1 December 2020). This article states that Liberty cancelled nearly 6 000 pension funds with the illegal approval of the FSB. Why can the funds not be given back to the previous administrators?

163 Insurance Act 2017 s 54(2)(a).

164 S 54(2)(b).

his or her appointment investigate the assets and liabilities of the insurer according to the instructions received from the Prudential Authority.[165] The curator must always act in the best interests of the policyholders of the insurer, and that implies making the insurer profitable in future. In this regard, the curator may sell any assets and/or raise funding to change the liquidity of the insurer.[166] Section 54(2)(e)(iii) allows a curator to raise funding 'despite any contractual obligations of the insurer'. However, this statement is not too clear. Does it mean that the curator can ignore the binder contract of an underwriting manager or cell structure of the insurer to obtain money? Or does it also imply that contractual obligations with a reinsurer may be ignored, such as the payment of premiums for risk that only a reinsurer can insure? It would appear that these questions could be answered affirmatively only when the curator raises money to change the liquidity of the insurer. However, the previous statement does not make any sense in practice; 'despite any contractual obligations' could be seen as a separate requirement in the law to save the insurer from liquidation. Table 3.3 gives a practical example.

Table 3.3: A practical example

Reinsurer commission	For	Loss ratio
7%	For	85% and above
8%	For	84%
9%	For	83%
10%	For	82%
11%	For	81%
12%	For	80%
13%	For	79% and below

165 S 54(2)(c). One should also refer to s 5(6) of the Financial Institutions (Protection of Funds) Act 28 of 2001.

166 S 54(2)(e)(i-iii).

For the purposes of reinsurance commission, it is vital to calculate the premium payable to the reinsurer who accepts the insurer's risk for certain high-risk events. If the agreed premium is R12 million per annum and the overall loss ratio of the insurer during a financial year is 85%, the reinsurance commission at 7% is R840 000, payable to the insurer by the reinsurer. It is possible to pay provisional reinsurance commission to an insurer at 13% at the beginning of the financial year and to adjust the commission at the end of the financial year. For example, the estimated premium paid on R12 million at 13% is R1 560 000. At the end of the financial year, the actual premium was R10 million at 9% commission, which equals R900 000. Thus, the insurer must repay R1 560 000 – R900 000 = R660 000 as adjusted commission. For the explanation provided, the repayment calculation resulting from a provisional payment of commission could be rejected by the curator when the curator decides to pay any premiums as a method of raising funding. This example may illustrate the consequences of the 'despite any contractual obligations' statement in the Act.

Section 54(1)(f) of the Insurance Act 2017, states that the curator may not conclude new policies or enter into new policies with the public as part of the business of insurance. In this case, the binder functions of an underwriting manager to enter into new policies will be suspended and this also applies to the cell structure business of the insurer.[167]

After the curator has taken note of all the assets and liabilities of the insurer, as well as the monthly premium income, the curator must notify the Prudential Authority of a court application relevant to the following:

167 Insurance Act 2017 s 54(2)(g) the curator should also take into possession cash, cash investments, movables, immovables and/or shares/securities for administration purposes which are directly or indirectly controlled by an affiliate or associate of the insurer.

- an application to the court to extend the powers of the curator to any other enterprise, holding enterprise, subsidiary enterprise, associate enterprise or affiliate enterprise or even an underwriting manager or cell structure;[168]
- an application to liquidate the insurer and/or the holding enterprise of that insurer;[169] or
- an application for any relief relevant to key persons of the insurer as regulated in the Financial Sector Regulation Act 9 of 2017 or any form of relief as provided for in that Act.[170]

The Financial Sector Regulation Act may seem impracticable for increasing the powers or functions of the curator. However, section 131(3) of the 2017 Act refers to 'mystery shopping' relevant to the financial products of an insurer. In this respect, if a curator seeks to gather information from an insurer pertaining to 'mystery shopping' and the request is refused, then the curator may approach a court of law to gather information relevant to the 'mystery shopping', which may either include actual products that were acquired/purchased from an insurer or it could simply mean asking questions directly to understand the composition of 'earned premium'. Generally, earned premium may include 'add-on products' such as car hire. When a policyholder submits a claim for car hire, the insurer will pay for car hire even though car hire is, in fact, a product of another insurer and the identity of that insurer is known only to the insurer who collects premiums. 'Mystery shopping' is not defined in the Financial Sector Regulation Act.[171]

168 S 54(2)(h)(i).

169 S 54(2)(h)(ii).

170 S 54(2)(h)(iii).

171 See also in general s 10 of the Financial Sector Regulation Act 2017 relevant to the application of other legislation when considering this Act.

Understanding the composition of a premium could also form part of section 7(1)(c) relevant to the 'treating of customers fairly' or subsection (e) to prevent or understand financial mischief under certain specific circumstances. Tables 3.4 and 3.5 give two examples (this is an acceptable practice in the insurance sector but it could be extremely difficult to understand/calculate loss ratios for insurers where 'mystery shopping' is relevant).

Table 3.4: Example A (mystery shopping)

Earned premium	1 000 000
Less broker commission (12.5%)	(125 000)
Less binder fee (5%)	(50 000)
Less insurer fee (3%)	(30 000)
Less IBNR [172]	(100 000)
Less claims	(450 000)
Total profits/(loss) for insurer	245 000
Loss ratio (755 000/ 1000 000)	75.5%

Table 3.5: Example B (mystery shopping)

Risk premium	600 000
Plus, reinsurance commission	10 000
Less broker commission (12.5%)	(75 000)
Less binder fee (5%)	(30 000)
Less insurer fee (3%)	(18 000)
Less IBNR	(100 000)
Less claims	(450 000)
Total profits/(loss) for insurer	(63 000)
Loss ratio (663 000/600 000)	110.5%

172 IBNR is the acronym for 'claims incurred but not reported' by the underwriting manager.

From the above wxamples, it is apparent that earned premium and risk premium are not defined in the Insurance Act. A 'risk premium' generally refers only to the premium related to a vehicle without car hire and/or other products on the same policy. 'Earned premium' includes all other products in one aggregate premium and it is difficult to understand who the insurers are for those products, such as car hire. In this regard, the policyholder will be transacting with only a single insurer during the claim stages. In addition, the curator could be confused about the 'mystery shopping' relevant to the earned premium, since the identity of those insurers who underwrite car hire is undisclosed to the outside world.

The curator is allowed to follow his prerogative – if there are resources available and with prior permission of the Prudential Authority – to pay policyholders, either in full or *pro rata*, for the settlement of their policy claims.[173] It is even possible to pay back the premiums to policyholders if the curator obtained prior approval from the Prudential Authority. The curator may also conduct investigations to establish hidden assets and/or other hidden liquid instruments of the insurer.[174] The curator may incur reasonable costs or expenses to finance the office of the curator and the costs or expenses will be paid by the insurer. This includes curator remuneration and/or legal and/or auditing consulting expenses in assisting the curator to complete his functions.[175] If the curator cancelled any guarantee which the insurer concluded with a third person before his appointment, the curator is liable for damages to the third person, unless the guarantee is a life policy that must be completed within 30 days after the appointment of the curator, as required by section 54(4) of the Insurance Act.

173 S 54(2)(i).

174 S 54(2)(j).

175 S 54(2)(j-l).

The curator may institute legal proceedings on behalf of the insurer or defend any legal action against the insurer. The curator may also invest surplus cash or freeze existing bank accounts of the insurer and/or bank accounts of previous directors of the insurer.[176] Should the insurer be liquidated, the curator may claim any expenses related to his office as administrative costs from the insolvent estate of the insurer.[177] In addition, only the curator can apply for either liquidation or business rescue of the insurer.[178]

3.19 Business rescue

The Prudential Authority may apply for business rescue when there is a reasonable belief that such an application will be to the benefit of the policyholders. The OECD, on the other hand, regulates the protection of stakeholders, for example, shareholders who are also policyholders of the insurer, in detail. This regulation is more relevant to mutual insurers, however, and South Africa has moved away from mutual ownership in an insurer. A practical example is an association of persons conducting the business of insurance where the individual policyholders are also members of the association. Although this form of business is no longer available in South Africa, the OECD does require fair treatment of shareholders within the context of mutual insurers. From a South African perspective, this will imply fair treatment of policyholders.[179] It seems that a business rescue

176 S 54(2)(l-o).

177 54(2)(q).

178 S 54(5).

179 OECD Guidelines on Insurer Governance (2017) 80; P Kruger 'Final insurance conduct regulations and policyholder protection rules' (2018) https://bit.ly/3zuHZS4 (accessed 1 November 2020). In this regard, new policyholder protection rules were issued to ensure fair treatment for policyholders. For the new policyholder protection rules, more specifically

application brought by an individual policyholder will not be based on an *ex parte* basis. The Prudential Authority should at least be cited as a respondent in the matter; therefore, an *ex parte* application is inappropriate for business rescue. This will allow the Prudential Authority to take note of the application and the contents of the affidavit of the applicant with regard to why business rescue is required. Should the respondent be only the insurer, the applicant must. nevertheless. also send the contents of the application to the Prudential Authority at least 14 days before the matter is heard in court. This will allow for an opportunity to respond to the application and to be cited as an interested party.[180] In other words, business rescue should be an option only when it relates to the fair treatment of policyholders or when there is a reasonable belief that business rescue will result in the policyholders being treated fairly. Should the applicant not follow this process of informing the Prudential Authority, a court will not grant a business rescue application. If the insurer insists on business rescue, before starting the application process the insurer must inform the Prudential Authority to obtain its approval.

The Prudential Authority has 14 days to respond to a request for business rescue and can either accept or reject the request.[181] If the request is accepted, the Prudential Authority must approve the appointed business practitioner and the proposed business rescue plan. Should the Prudential Authority not approve the business rescue plan or the business recue application or the appointment of the proposed business rescuer, then the Prudential Authority may apply for the liquidation or the winding-up of the insurer.[182] If the

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Chapter 2, which deals with fair treatment of policyholders, see https://bit.ly/3zuI7B2 (accessed 1 November 2020).

180 S 56(2)(a)(i-ii).

181 S 56(3)(a-c).

182 S 56(5)(a-b).

business rescue practitioner has been approved by the Prudential Authority, the practitioner may not enter into any new policies in future.[183]

3.20 Winding-up of insurers and trusts

The OECD guidelines on insurer governance do not regulate the winding-up of insurers. In this case, the Prudential Authority may apply to liquidate an insurer if its liabilities exceed its assets or if the insurer fails to maintain financial soundness as regulated by the Insurance Act. The assets could exceed the liabilities, but should specific criteria not be met for financial soundness, the insurer may be liquidated.[184] Generally, an insurer should be liquidated on a just and equitable basis. What exactly is just and equitable? It seems that section 57(2)(c) of the Insurance Act answers this question and states that a liquidation should be in the interests of the policyholders. How is it possible to determine the interests of the policyholders? In this situation, a financial calculation should be made to see whether the outstanding claims of the policyholders can be settled in full or *pro rata*. If it is *pro rata*, then it is not necessarily just and equitable, unless the Prudential Authority reasonably believes that a *pro rata* payment is just in terms of section 58(1) of the Insurance Act. When the Prudential Authority applies for liquidation it is not required to provide security for the winding-up process.[185]

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183 S 56(6).

184 S 57(2)(a).

185 S 57(2)(e); See in general *Afgri Operations Ltd v Hamba Fleet Pty(Ltd)* not reported, case number 542/2016 para 16. The court referred to a case where liquidation was granted even though the just and equitable requirement was not met; *Thunder Cats Investments 92 Pty(Ltd) v Nkonjane Economic Prospecting and Investments Pty(Ltd)* not reported case number 847/2012, where the court considered the phrase 'just and equitable'. In this regard a relationship between shareholders with equal shareholding broke down, and the court ordered the liquidation of the company on a just and equitable basis.

Persons other than the Prudential Authority may also apply to liquidate an insurer.[186] In this regard, it is suggested that the Prudential Authority be cited as a second respondent in the matter to comply with section 58(2). Should the Prudential Authority not be cited in the application process, then a court of law is not entitled to hear the application unless copies of the application were made available to the Prudential Authority at least 14 days before the hearing. In any event, the Prudential Authority may file affidavits pertaining to why the liquidation of the insurer is not reasonably in the interests of the policyholders.[187] It is also possible for an insurer to take a resolution to wind up the business. In this regard, the Prudential Authority has to choose either to accept the resolution of the insurer or to reject it. Generally, the Prudential Authority must accept/reject the resolution within 14 days or any other period agreed to, after submitting the resolution to the insurer.[188] If the resolution was not submitted to the Prudential Authority, it is void. When the application for liquidation has been approved by a court of law, the Prudential Authority must appoint a liquidator or trustee for the insurer's insolvent estate. If a liquidator was appointed without the approval of the Prudential Authority, then the Prudential Authority may apply to a court to place the insurer's insolvent estate under a curator in terms of the Financial Institutions (Protection of Funds) Act.[189]

An insurer could be established in terms of the Friendly Society Act 25 of 1956 and the Co-Operatives Act 13 of 2005. The provisions of the Insurance Act would then not be relevant to those insurers, such as notifying the

186 S 58(2)(a).

187 S 58(2)(a)(i-ii).

188 S 58(3)(a-e).

189 S 58(5).

Prudential Authority to liquidate a society.[190] The provisions in the Trust Property Control Act 57 of 1988 do not apply In the event of a trust. In this regard, the provisions for winding-up as stated in the Insurance Act apply to the liquidation of trusts, for example, winding-up by prior approval of the Prudential Authority.[191] The Prudential Authority must reasonably believe that winding-up is in the interests of the policyholders of a foreign branch of the insurer or Lloyd's underwriter. A person other than the Prudential Authority may also apply to liquidate the trust, and it is suggested that the Prudential Authority be cited as second respondent to the process. If not, the Prudential Authority must receive all affidavits at least 14 days prior to the date of the court hearing.[192] The Prudential Authority may oppose the application if it is not reasonably in the interests of the policyholders. In addition, a court may grant business rescue only if the Prudential Authority is aware of such an application.[193] If the trustees take a decision to liquidate the trust, then the Prudential Authority has a choice to either accept or reject the decision. If the Prudential Authority is unaware of the decision, the decision to liquidate will be void.

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190 Insurance Act 2017 s 57(1); CG Kilian and E Vandeventer 'To replace the Friendly Society Act 25 of 1956 with the proposed Insurance Bill 2015: A new perspective on society member's benefits in exchange for a premium' (2017) *De Jure* 281.

191 S 59(1)(b).

192 S 59(1)(c)(i-ii).

193 S 59(1)(d); See *Jan Walter Slippers v Ingogo Wildlife Studio and Taxidermy CC* not reported case number 83412/17 para 17 pertaining to the reasonableness of winding-up the businesses that were linked to a business trust.

3.21 Exceptions to the Insurance Act

Any approval, determination, exemption or decision of the Prudential Authority is valid if it is in writing.[194] The Promotion of Administrative Justice Act 3 of 2002 applies to the previous sentence. In this regard, the Prudential Authority must give written reasons for its actions and must also inform other insurers that are part of a group of enterprises that are affected by the actions of the Prudential Authority.[195] The Prudential Authority, when taking an administrative decision, must keep the following in mind:

- the objective of the Insurance Act, which is to provide a legal framework for the regulation and supervision of the business of insurance in South Africa and to ensure the financial stability of the insurance industry/economy;
- the nature and complexity of the business of the insurer;
- the transformation objectives in the industry; and
- any submissions made by an insurer and – in the event of an insurance group – submissions relevant to the financial soundness of an insurer that is part of the group, different types of insurance business in the group, the risks of each insurer in the group, or the manner in which compliance is conducted in the group.[196]

The Prudential Authority may exempt an insurer from the Insurance Act for a fixed time period. In a group of insurers, the exemption may also apply to individual insurers in a group pertaining to their individual risks, types of policies, and the like. The Prudential Authority may grant such exemption with or without conditions. An exemption lapses the moment the insurer is

194 Insurance Act 2017 s 62(2).

195 S 62(3)(b).

196 S 62 (4)(a-e).

unable to comply with the relevant condition(s). In this regard the Prudential Authority must publish the exemption on its official website and may at any time withdraw the exemption by giving suitable notice to the insurer. Generally, the Prudential Authority will give exemption when the Insurance Act allows for very strict applications of the law that are contrary to good corporate governance principles, as when the business of the insurer is not very technical and the Act requires the conduct of business to be technical from a legal perspective or as a result of transformation purposes in the insurance sector that will prejudice the economy/sector. However, any exemption must be in the policyholders' interests and directed at enhancing the financial stability of the insurance sector.[197] The OECD requires sound governance practices for a group of insurers, but it also recognises the purposes of exempting a group of insurers as a result of the impracticality of the OECD principles. The OECD recognises the importance of financial stability as a method of promoting economic development and/or stability.[198]

3.22 OECD guidelines

This section addresses the OECD Guidelines on Insurer Governance. In this regard, the section discusses the aspects of policyholder interests; information required; integrity; skill; care and diligence; the insurance business; South

197 Insurance Act 2017 ss 66(1-5) and 71; AVBOB Mutual Assurance Society and SOC insurers are exempt from certain sections of the Insurance Act. For example, they do not have to apply for a licence under the Insurance Act to conduct the business of insurance.

198 OECD Guidelines on Insurer Governance (2017) 77-80 and 84; OECD Job Creation and Local Economic Development (2018) 37 and 101. Insurers in South Africa are currently making use of robot advisers as part of the fourth industrial revolution. There are no mistakes when making use of robot advisers as the adviser follows the policyholder protection rules when selling a policy to the public.

African jurisdiction; a group of companies and key persons; changes in a holding enterprise structure; dividends; and the significant owner and key person.

The OECD Guidelines on Insurer Governance serve as a point of reference for understanding the appropriate principles and the Prudential Authority must also take note of the contents. The OECD requires, among other things, that the governance of insurers comply with high quality standards so as to promote financial stability, protect the interests of policyholders, and develop a legal framework to identify the responsibilities of the Prudential Authority or insurer.[199] The Insurance Act requires that the the Prudential Authority also acknowledges international regulatory and supervisory standards, for example, the OECD's guiding principles relevant to the business of insurance. The OECD does not mention how transformation in the insurance business sector should be regulated; only that the appointment of the directors of an insurer should be done regularly and what skills are necessary for a board to possess.[200] The standards to be issued by the Prudential Authority and non-compliance with any of these, for example, transformation does not constitute an offence in terms of section 69 of the Insurance Act. The consequence could be that the Prudential Authority may not approve an appointment of a director that is contrary to the transformation process,[201]

199 OECD Guidelines on Insurer Governance (2017) 7; In *Masimdumise Gabriel Bhengu v Outsurance* FAIS 06001/14-15/KZN 3 the applicant alleges that Outsurance, which does not make use of a broker network to advise the public on financial products, never explained the policy exclusions to him. As a result, a laptop was not insured and the claim submitted was rejected. Outsurance subsequently had to pay the claim submitted.

200 OECD Guidelines on Insurer Governance (2017) 15-17.

201 Insurance Act 2017 s 63(a)(i); See *Luke Crazzo v Aquarius Insurance Consultants* FAIS 03948/09-10GP3. In this regard an administrator who administered the claims on behalf of the insurer had its licence revoked in 2009. During

but the Prudential Authority cannot impose a penalty or offence for such an appointment.[202] Since South Africa is part of the G20 and a member of the OECD, this simply means that South Africa has insurance legislation similar to that of other G20 countries, except for the provision on transformation.[203] In the following paragraphs explain financial stability or how to produce financial stability in the insurance sector.

3.22.1 Policyholder interests

Policyholder interests play an important role in the insurance industry. To illustrate just how important these interests are, should an entity be conducting the business of an insurer without a licence to act as an insurer, the Prudential Authority cannot merely liquidate the entity if it is contrary to the interests of the policyholders. In this regard, a court must consider whether liquidation is in the interests of the policyholders and may, therefore, reject the Prudential Authority's application for liquidation.[204] A court may liquidate an entity even if it is solvent when it is in the interests of the policyholders. Instead of liquidation the Prudential Authority may ask the entity to arrange to discharge all or any part of its obligations under 'insurance policies'.[205] It is also not an offence to conduct the business of an insurer without a licence.

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the same period, the Prudential Authority informed the policyholders where to submit their claims for payment purposes on a specific date. Somehow, the applicant did not submit his claim within the time frame. The Ombud subsequently ordered the payment of the claim.

202 S 63(4)(a)(ii) and subsection (b).

203 S 65(1-2); OECD Guidelines on Insurer Governance (2017) 7.

204 Insurance Act 2017 ss 67(2)(a-b) and 5(1).

205 S 67(1)(a); Concerning trading as an insurer without a licence, see *Bernette Vivienne Drucknebacher v Pieter De Wet t/a Model Insurance Company* FAIS

3.22.2 Information required

An insurer must submit or make available any information requested by the Prudential Authority. Should the insurer fail to comply with this provision, the insurer will be liable for R5 000 for every day it fails to submit or make available information as required by the Prudential Authority.[206] The Prudential Authority may, however, waive the penalty on the basis of good cause, such as a system error.

3.22.3 Integrity, skill, care and diligence

An insurer must always act with integrity, skill, care and due diligence, in a prudent, responsible and effective manner, and must always communicate with the Prudential Authority in an open and cooperative way.[207] This seems simple but it is extremely difficult in practice to understand these terms. In *Swanepoel v Outsurance* FSOS 02742-18/18/19-GP 3 the Financial Advisory Intermediary Services (FAIS) Ombud was requested to investigate why Outsurance had not updated its policyholder records. A claim was submitted to Outsurance in 2009 and Swanepoel approached the FAIS Ombud only in 2018 because Outsurance had not updated its policyholder records relevant to a 2009 claim. The FAIS Ombud consequently argued that the applicant had no *locus standi* because of prescription. In addition, the Ombud did not focus on the definition of a complaint in section 1 of the Financial Advisory and Intermediary Services Act 2002, and consequently referred the

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04909/11-12/GP. In this regard Pieter De Wet collected premiums from policyholders where he held himself out to be a licensed insurer even though he did not comply with s 7 of the Insurance Act 1998, to be registered as an insurer. The FAIS Ombud subsequently ordered Pieter De Wet to pay the claim submitted by the policyholder.

206 S 68(1)(a-c).

207 Insurance Act 2017 s 4(a-e).

applicant to the Financial Services Tribunal in terms of section 230 of the Financial Sector Regulation Act 2017. The applicant argued that the General Code of Conduct for Authorised Financial Services Providers and their Representatives requires the updating of policyholder records and there is no time frame assigned for the safekeeping of policyholders' records, or for maintaining those records or for administering the records of the applicant. Not to update those records could *prima facie* be contrary to the requirement to act with integrity, skill, care and due diligence. However, the Tribunal simply held that the applicant's approach was vexatious and frivolous.[208]

3.22.4 The insurance business

The business of insurance can be divided into two types – reinsurance business and insurer business. It would appear that section 5(2) and subsections (4) and (5) are relevant to both entities. For example, in the case of an unregistered reinsurer doing business in South Africa as a reinsurer outside the borders of South Africa or an unregistered insurer doing business as an insurer outside the borders of South Africa, irrespective of whether the entity is registered as such outside the borders of South Africa, such an entity is considered to be doing the business of insurance in South Africa. The only requirement is that the business conducted outside the borders of South Africa must be similar to the business conducted inside South Africa. Even if the entity is conducting business indirectly in South Africa or on behalf of an entity, it is

208 N Kilian 'The question is 'Should insurers continuously update policyholder records?' Insurance law requires the principles of administrative law to settle disputes between the policyholder and the insurer' (2019) *PER*; Certain parts of the Protection of Personal Information Act 2013, are not yet law; it is expected that the whole Act will be effective late 2020. In this regard Mr Swanepoel could have lodged a complaint with the complaints committee of POPI to force Outsurance to update the 2009 policyholder records; See 'POPI breaking news' https://bit.ly/3TQQWgG (accessed 1 January 2021).

still considered to be in the business of insurance. If an insurer has outsourced a function of the business of insurance to a person, then it is not considered to be in the business of insurance.[209] The outsourcing of insurance business is not to act as an underwriting manager or non-mandated intermediary completing their binder functions on behalf of the insurer. 'Outsource' has a specific meaning in the law and is defined in section 1 of the Insurance Act and in section 1 of the Financial Sector Regulation Act.[210] An example is the outsourcing of a control function to another person (i.e., compliance officer) or the calculation of loss ratios. In addition, the Prudential Authority will grant permission relevant to sections 5(4) and (5) only when the conducting of the business of insurance on behalf of another person will not affect the financial soundness of the insurer or reinsurer, or will not have a negative impact on the interests of policyholders, or will not create additional risks that will not be managed properly by the insurer or reinsurer.[211] Should the Prudential Authority reasonably believe that the financial soundness will be affected by or will create additional risks that will not be managed properly, it could refuse to grant permission, and request the entity to cease conducting those businesses immediately. However, the reinsurer and/or insurer must submit a business plan to the Prudential Authority pertaining to how the business of insurance will be reorganised by the entity.[212] In addition, the Prudential Authority has a discretion to indicate which businesses fall outside the business of insurance or which businesses fall inside the business of insurance. Thus, a licence is required to act as a financial services provider,

209 Insurance Act 2017 s 5(3).

210 S 1.

211 S 5(6)(a-b).

212 S 5(7)(c-d).

for example, to be licensed as a branch of a foreign reinsurer, Lloyd's underwriter or insurer for that particular business.[213]

3.22.5 South African jurisdiction

Any reinsurer, insurer, foreign branch of an insurer or Lloyd's underwriter licensed to conduct business in South Africa is subject to the jurisdiction of South Africa.[214] A summons may also be served on the representative of those entities only when the representative is cited as a respondent.[215] A representative must at all times reside in South Africa.[216] If a foreign branch of an insurer fails to meet the obligations in terms of an insurance policy, the trust will be used to meet those obligations; that is, to settle the claims of policyholders. This is possible, however, only if the Prudential Authority authorises the settlement or a court issues such an order.[217] Nevertheless, the decision or authorisation of the Prudential Authority can be reconsidered in terms of the Promotion of Administrative Justice Act 2002, and a court order is also subject to review by a higher court. The same applies to penalties. Should a branch of a foreign insurer or Lloyd's underwriter fail to pay a penalty, then the trust is liable for the payment thereof.[218]

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213 Ss 5(8)(a-b) and 6(1-3); See ' What is Lloyd's? ' https://bit.ly/3Wjva71 (accessed 12 November 2019).

214 Insurance Act 2017 s 7(1)(b); See in general, *Lloyds of London Underwriting Syndicate 969, 48, 1183 and 2183 v Skilya Property Investments Pty(Ltd) (316/2002)* [2004] 1 All SA 386 (SCA) paras 1-4. In this case ,Lloyds refused to pay a claim relevant to an aircraft owing to the illegal use of the aircraft.

215 S 7(1)(b-c).

216 Insurance Act 2017 s 34(1-3).

217 S 34(2)(a).

218 S 7(2)(b).

3.22.6 Group of companies and key persons

A branch of a foreign insurer or Lloyd's underwriter cannot form a group of insurers in South Africa. Only an insurer, not an underwriting manager or otherwise, may give 30 days' notice to the Prudential Authority to join a group of insurers or companies/enterprises. An insurer group may consist of a single insurer together with other legal persons and/or other associates.[219] If the group has a holding enterprise with insurers as subsidiaries, then the Prudential Authority must require the holding enterprise to acquire a licence as a financial services provider.[220] Generally, a holding enterprise controls the group, for example, a holding and subsidiary enterprises. It is suggested that the Prudential Authority should review the group of companies on an annual basis to establish any changes in risk.[221] Should there be a significant change in risk, the Prudential Authority may withdraw the designation of an 'insurance group'.[222] Otherwise, the board of directors should inform the Prudential Authority of any significant changes in the risk of the group.[223] This includes significant changes in the structure of the subsidiaries in the group.

The Prudential Authority may direct any controlling enterprise to restructure the group of insurers or insurer that is part of the group by allowing the controlling enterprise to submit a plan for restructuring the group and subsequently approving it. The Prudential Authority may allow for a specific

219 Insurance Act 2017 s 10(1)(a)(i-iii); See also s 10(1)(b).

220 S 10(2).

221 S 10(4).

222 S 10(5).

223 S 11(1-2).

time frame within which the restructuring should occur.[224] The controlling company must submit a monthly progress report to the Prudential Authority. The Prudential Authority could also restrict or prohibit certain transactions of the group until the group is successfully restructured. It is unclear whether these transactions include the binder functions of individual underwriting managers or the transactions of a cell structure. If they do include binder functions, the plan must accommodate an underwriter and should not penalise an underwriting manager unduly in terms of a loss ratio calculation. The same applies to a cell structure. If the controlling company fails to submit a monthly report or the Prudential Authority does not approve a plan to restructure the group, the Prudential Authority may take any regulatory action until the monthly report occurs or the restructuring is in line with the scope and purpose set by the Prudential Authroity.[225] All companies or insurers in the group must assist the controlling enterprise by supplying information to it – on request – as a method of completing the monthly reporting functions of the controlling enterprise.[226] In this regard, a controlling or holding enterprise must enter into individual contracts with subsidiaries in the group for the supply of information and the like at the request of that enterprise.[227]

In a group of companies, the controlling company/enterprise and/or the insurer as a subsidiary thereof must ensure that the key persons appointed by the individual enterprises comply with the fit and proper requirements for key individuals. For example, the appointment of a director is subject to prior approval of the Prudential Authority. Although the appointment could be valid from a company law perspective, the appointment could be voidable

224 S 12(1-2).

225 S 12 (3)(a-b).

226 S 12(4).

227 S 12(4)(b).

or void from an insurance law perspective. The Insurance Act is not too clear on whether an appointment without prior approval is void. In terms of a branch of a foreign insurer or Lloyd's underwriter, the representative should be appointed only if prior approval has been obtained, and the same applies to a trustee of a security trust. The insurer must at all times have an appointed auditor, subject to the prior approval of the Prudential Authority.[228] If 'auditor' refers to a firm of auditors, prior approval is still required. Should the individual appointment of an auditor in a firm change and at least 50% of the directors of the firm remain unchanged, the permission granted to the firm does not lapse. Permission will lapse only if more than 50% of the directors are new appointments.[229] In this situation, approval should be sought from the Prudential Authority.

The Prudential Authority must be notified of the appointment of a senior manager, except for a foreign branch of an insurer or Lloyd's underwriter, within 30 days. This applies also to the head of a control function. This implies that the insurer must notify the Prudential Authority of the appointment of a senior legal adviser, senior auditor, and the like. A senior manager of a claims department is also subject to this provision. It is also possible to extend section 15 to senior managers of an underwriting manager when they are acting on behalf of the insurer as if they were the insurer when one considers the binder functions of the underwriter. The same applies to a representative of a foreign branch of insurers or a Lloyd's underwriters that appoint senior managers and the like. If a key person is no longer fit and proper, the insurer or foreign branch of the insurer must notify the Prudential Authority within 30 days.

228 Insurance Act 2017 ss 14(1)(a-b), 32(1) and 15(1) require that 30 days' notice be given to the Prudential Authority.

229 S 14(c).

The Prudential Authority must also be notified of the termination/resignation of a key person within 30 days after such termination or resignation. This also applies to the termination or resignation of a representative or deputy representative of a foreign branch of an insurer or a Lloyd's underwriter. The Prudential Authority may request that a person who has resigned or has been terminated explain the affairs of the insurer to the Prudential Authority. The Prudential Authority may not prosecute the insurer on the basis of information obtained from such a key person at a later stage.[230] The OECD recommends whistleblowing, but this approach to obtain relevant information is unique.[231]

3.22.7 Changes in a holding enterprise structure

In a holding-subsidiary relationship, both companies could be shareholders in each other. However, a holding company generally holds the majority of the shares in a subsidiary, while a subsidiary could also hold the majority of the shares in another company – a sub-subsidiary relationship. A 'holding company' is, therefore, defined as a significant owner of shares in a subsidiary company. Section 157 of the Financial Sector Regulation Act 2017 explains a 'significant owner' as a person (holding company or otherwise) that controls or significantly influences the business of an insurer or the business strategy of the insurer.[232] There is no percentage of shares that counts as a significant owner. Also, any person acting in a 'partnership' that influences the business or strategies of an insurer is considered a significant owner. In company law it is permissible to conclude shareholder agreements to vote in a particular way. It seems, however, that such shareholder agreements or 'partnership' agreements are contrary to the Financial Sector Regulation Act.

230 Insurance Act 2017 s 16(1-4).

231 OECD Guidelines on Insurer Governance (2017) 76.

232 Financial Sector Regulation Act 2017 s 157(2).

A significant owner can cast a material vote to either remove or to replace a director. Section 157 of the Financial Sector Regulation Act 2017 stipulates that a significant owner can appoint 15% of the members of the governing body.[233] This seems vague. Why not 100%? In other words, it is possible to remove all the directors in time and to replace them with new directors. If a significant owner can appoint 15% of the members/directors of the board, surely they can also appoint and remove all the directors? This 15% is not very clear. A manager of a collective scheme or unit trust is not considered a significant owner.[234] It must be remembered that the name of the unit trust is entered in the register of shareholders, making the unit trust a shareholder of the company. In this respect, should the company declare a dividend, the unit trust will be the sole owner of the dividend and there is no need to allocate the dividend in part to all the investors in a unit trust. In other words, the dividend is excluded when calculating the return on their investment for the investors who make up a unit trust. Most likely, movements in listed share prices will be used as an indicator of growth for an investor. It is unclear why a unit trust is excluded as it can influence the strategies of a business. A practical example is the recent conflict between Coronation Fund managers and the chairman of Shoprite.[235] Coronation wanted the chairman to be removed and/or to dilute his shareholding in Shoprite so as to prevent future influences from the chairman. The Financial Sector Regulator (includes the Prudential Authority) may revoke a declaration that exempts a unit trust from not being a significant owner. On this matter, the regulator must give reasons and a reasonable time must be allowed to the unit trust manager

233 S 157(2)(a-b).

234 S 157(4)(a)(ii).

235 T Cohen 'Shoprite's R3bn payout proposal to Christo Wiese could easily be voted down' *Daily Maverick* https://bit.ly/3DL9N76 (accessed 12 December 2019).

to respond to the proposed revocation of the declaration.[236] It should be noted that such an action from the Regulator could be a public function and thus subject to the Promotion of Administrative Justice Act. It seems that a regulator could revoke a declaration without complying with the law, the only requirement being to motivate why non-compliance is relevant.[237]

3.22.8 Dividends

Dividends are known as distributions. When considering when an insurer should be able to pay dividends, section 4 of the Companies Act must be complied with. In the Insurance Act, section 18 refers to nominee shareholders. A 'nominee shareholder' is a person who has entered his or her name in the register of shareholders of the insurer. The owner of the shares is actually the purchaser of the shares who does not want to enter his/her name on the register. Therefore, the names listed in a register consist of either nominee shareholders or shareholders who are not making use of any nominees. A nominee has no beneficial interest in the shares and only acts on behalf of the purchaser of the shares when, for example, voting on a specific matter on behalf of the owner or purchaser of the shares. In this regard, the Prudential Authority must give permission to register the shares in the name of a nominee shareholder.[238]

Section 18 also refers to the primary and secondary market relevant in the event of acquiring shares. If the insurer issues shares to a purchaser, this is known as the primary market. In the secondary market, the owner of the shares sells the shares to a purchaser who will become the new owner of those shares. In this regard, the shares are transferred and not allotted or

236 S 157(4)(d).

237 S 157(4)(h).

238 Insurance Act 2017 s 18(1)(a).

issued to the new owner.[239] Irrespective of which market was used to acquire the shares, the Prudential Authority must give permission to make use of a nominee shareholder. It is also possible to acquire shares that will not require the permission of the Prudential Authority relevant to nominee shareholders, such as shares that are acquired which do not contain any voting rights. In either event, the relationship between a nominee shareholder and the actual owner of the shares is regulated by an individual contract that is subject to the law of agency. In the event of receiving a dividend, the nominee will be required to transfer the payment received to the owner of the shares in terms of the law of agency.

In a more controversial argument, the 1973 Companies Act defines a 'shareholder' as a person who has entered his name on the register of shareholder. For all practical purposes, the nominee shareholder is the actual owner of the shares, as against the person for whom he is acting as an agent. In this case, the law of agency is not relevant and there is no duty to pay any dividends to the owner of the shares. To illustrate this more clearly: A fund manager controls a unit trust and the trust receives money from individual investors. The trust is actually the nominee shareholder but since the name of the trust is entered on the register, the trust is entitled to receive dividends without any obligation to pay the investors the dividends received. In this regard the growth of the unit trust depends on growth in the listed price of shares and not in the actual dividends *per se*. In other words, dividends are excluded from the calculation of growth in the investors' shares. This may sound reasonable, but when a fund consists of R90 billion, the dividends to be received from such a fund would be enormous, and an investor would be excluded from sharing in those dividends.[240] In addition, the OECD places

239 S 18(1)(a-b).

240 See *Smyth Investec Bank Ltd and Another* 2018 (1) All SA 1 (SCA) 11 para 30; See in general *Brodie v Secretary for Inland Revenue* 1974 (4) SA 704 (A) 712; *Standard Bank of SA Ltd v Ocean Commodities Inc* 1980 (2) SA 175 (T) 177; *Brown*

more and more emphasis on the role of actuaries in the insurance sector, especially the regulatory methods that must be used to calculate profitability for the insurer and when to declare dividends. These methods differ greatly from those provided in section 4 of the Companies Act, that simply uses liquidity and solvency in general terms.[241] Should the insurer not declare dividends even if it is profitable, the OECD requires greater transparency in this regard to inform the shareholders as to why no dividends are to be declared.[242]

3.22.9 Significant owner and key person

A 'significant owner' is defined in section 1 of the Insurance Act, which refers one to section 157 of the Financial Sector Regulation Act. However, section 157 is not too clear on this issue. The Companies Act 1973 states that a significant owner could be a nominee shareholder since it uses direct or indirect control to influence the decisions of the insurer. Indirect control could also have reference to share agreements where two or more shareholders agree to vote in a specific manner.[243] In addition, it is generally impossible to identify the true owner or beneficial owner of shares or the existence of share agreements. Nevertheless, a significant owner could include a key

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v Nanco (Pty) Ltd 1976 (3) SA 832 (W), where in this case a member maintains membership until his or her name is deleted from the register of members.

241 OECD Guidelines on Insurer Governance (2017) 71 and 83.

242 OECD Guidelines on Insurer Governance (2017) 84; As an example, Financial Services Board Directive 140.bii(LT) shows how assets should be valued https://bit.ly/3Uc4N0I (accessed 12 November 2019); A foreign example, The European Standard of Actuarial Practice 2 (ESAP 2), describes the relevance of an actuary function for solvency requirements https://bit.ly/3U9rx1p (accessed 1 November 2020).

243 Financial Sector Regulation Act 2017 ss 1 and 157.

person, for instance, a director, although it is not always a requirement for a director to hold any shares in the insurer.[244] In such a case, the director is just a key person. However, a key person and/or significant owner must be fit and proper to serve as such in the insurance industry. Should a director be unfit, the Prudential Authority may request the director to further his or her academic training, make use of consultants, and/or outsource the rights and duties of a director, or may even remove the person as a director.[245] In the event of a shareholder being a significant owner, the Prudential Authority may do one of the following:[246]

- submit a plan to limit the voting rights of the significant owner;
- reduce the number of voting rights of the significant owner; or
- direct the significant owner to cease to act as such, for example, to exercise no votes.

In addition to the above, section 157(4)(a)(ii) states that a fund manager of a unit trust is not considered a significant owner. The reason for this is unclear since a fund manager could influence the composition of the board or its decisions. As previously discussed is sub-section 3.21.7, a fund manager tried to remove the chairman of a listed company on the JSE even though

244 Insurance Act 2017 s 19(1-3).

245 S 19(1)(a-d); OECD Guidelines on Insurer Governance (2017) 15 and 85. The OECD requires not only education for persons inside the insurer but also that an insurer should be able to educate its policyholders pertaining to the technical aspects of their financial products, or even the law relevant to the rights and duties of policyholders. The OECD does not require, for instance, the removal of a director based on a poor educational background, since a shareholder for instance has the authority to remove directors and/or to appoint directors.

246 Insurance Act 2017 s 17(4)(a-b); OECD Guidelines on Insurer Governance (2017) 72-73.

the listed company was not an insurer and was, in any event, not subject to the OECD or the Insurance Act. While the OECD requires the disclosure of fund managers as significant owners, as well as special investment committees to be headed by the insurer's actuaries, these committees should be relevant only to insurers and the like. In its financial stements, an insurer should also consider disclosing how many fund managers are present in the insurer, etc. The OECD requires more input from actuaries relevant to the business of insurance, for instance, directors should in principle follow the recommendations on what the premium for a specific risk should be instead of decreasing the premium to maintain high volumes of insurance sales. If the insurer fails to provide its board with additional education, the Prudential Authority may alter the licence conditions of the insurer or suspend the licence.[247] with respect to this, it is important to note the purpose of the credit bureau in the future. Should a director or significant owner obtain a poor rating with a credit bureau, it should be considered a red flag for removing the director or reducing the votes of the significant owner.

247 Insurance Act 2017 s 19(2)(a-c); OECD Guidelines on Insurer Governance (2017) 80-85. By introducing the Prudential Authority to limit the role of directors and/or significant owners who are not interested in the good corporate governance structures of the insurer, South Africa followed a legislative model. In this regard, removing a director to limit voting rights is compliant with the OECD's guidelines for promoting good corporate governance practices. It is the first time in South Africa's history that the role of incompetent directors and/or shareholders who are interested only in profits and do not focus on treating customers/policyholders fairly has been limited.

3.23 Requirements to conduct business as an insurer

A Lloyd's underwriter need not apply for a licence to conduct the business of insurance. However, Lloyds will generally make use of a broker or financial services provider to sell policies in South Africa. Such a broker or underwriting manager must, however, be licensed as a financial services provider.[248] Further, a person qualifies for a licence to conduct the business of insurance when the person is a public company. A reinsurance licence also requires the person to be a public company.[249] A state-owned company can also conduct the business of a reinsurer, and an underwriting manager or non-mandated intermediary could either be a close corporation or a private company. In the case of a financial services provider that was registered as a close corporation before the implementation of the Companies Act 2008 and has concluded a binder agreement with an insurer, there is no need to deregister the close corporation.

The business of insurance entails either life or non-life insurance and the categories thereof are listed in Schedule 2 of the Insurance Act. This schedule contains all the possible types or variants of the business of insurance. To qualify for a licence, the person must demonstrate to the Prudential Authority that key persons are fit and proper, submit a sound business plan (financial soundness and public disclosures and complying with the requirements for the operational solvency of the insurer), be able to implement black ownership of the insurer, and be capable of managing the different classes of business as listed in Schedule 2 of the Act.[250] In regard to a branch of a reinsurer, the foreign legislation must accord with the principles of the

248 The definition of a financial services provider is regulated by s 1 of the Financial Intermediary Services Act.

249 Insurance Act 2017 s 22(1)(a-b).

250 Ss 22(1)(c)(i-vii) and 22(2).

Insurance Act and, if they are dissimilar, the reinsurer branch must be able to draft a regulatory framework similar or equivalent to that of the Insurance Act 2017. Also, if the insurer is part of an insurance group, the insurer must indicate that the group will comply with the Insurance Act. For example, if the holding enterprise is not an insurer it must submit to the authority of the Prudential Authority.

Although regulated in Schedule 2, any class of insurance business must not be contrary to public interest. To understand this, a personal lines policy or motor policy is an accepted form of business. A motor policy, on the other hand, generally requires establishment of the market value of the vehicle to assign a monthly risk premium. Should the monthly premiums be used to 'increase cover' of the vehicle until the full market value is achieved, such a policy may be contrary to public interest, and the Prudential Authority may not approve the business plan to register the entity as an insurer.[251] In addition, a new licence application may not use the name of a previous insurer, may not be misleading, and the name may not resemble the name of a current insurer. [252]

3.24 General administrative decisions pertaining to licences

The Prudential Authority must either approve or disapprove the application for an insurance licence within 120 days or a period longer than 120 days, if so agreed to between the applicant and the Prudential Authority.[253] The Insurance Act does not require reasons to be provided for why an application was unsuccessful. For this reason, the *Coldwell Banker v Department of Insurance* case discussed in sub-section 3.24.1 is relevant.

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251 S 22(1)(d).

252 S 22 (3).

253 Insurance Act 2017 s 23(1).

3.24.1 Approval of an enterprise as an underwriter: Coldwell Banker v Department of Insurance

In *Coldwell Banker v Department of Insurance* 102 Cal.App 3rd 381 (1980) 162 Cal.Rptr.487, the California Court of Appeal had to consider the licence to approve an enterprise as an underwriter. The regulatory body did not grant a licence on the basis that the business of 'title insurance' was very small and should an additional licence be granted, the market would be over competitive. The regulatory body or the department of insurance came to this conclusion after interviewing approximately 17 high-profile persons, including economists and a professor in finance.[254] The trial court did consider that rejection of a licence could be subjected to administrative law; nevertheless, the trial court upheld the decision of the department not to grant a licence for reasons other than administrative law, for instance, that the market was very small and granting an additional licence would reduce the profitability of the other insurers considerably.[255]

In South Africa, the Prudential Authority may also require the expertise of witnesses to testify why an additional licence in the market is either suitable or not. The Prudential Authority also may grant a licence subject to relevant market conditions, such as not being able to conduct both life and non-life businesses.[256] Once a licence is granted it cannot be leased (rented) or sold to another person for the purposes of conducting the business of insurance.[257]

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254 At 388, 405.

255 At 396.

256 Ss 23(4)(c)(ii) and 25.

257 S 23(7).

3.24.2 Effect of conditions, variations, withdrawal and suspension of licences

Should an insurer be allowed to sell life insurance policies, the insurer may provide for rider benefits. A 'rider benefi't is generally an option; in return for an extra premium the insurer will provide an additional benefit for a specific risk circumstance. A rider benefit is not part of any conditions to be imposed by the Prudential Authority on an insurer.

An insurer may conduct the business of a cell structure only if the insurer is registered as such or has acquired this condition in a separate application made to the Prudential Authority. A 'captive insurer' is an insurer that has been approved to conduct business as a cell structure. A captive insurer may not insure third-party risks and simultaneously insure third- and first-party risks in the same cell structure. This implies, for example, that a personal lines policy (motor policy) may have motor hire in the event of an accident. Usually, another insurer is liable for the motor hire, although the claimant does not need to submit a separate claim to that insurer. This arrangement is acceptable if and when the Prudential Authority has given permission for the practice. However, the said permission does not address the difficulties associated with risk premium or earned premium.[258] Nevertheless, this does not appear to be relevant to an underwriting manager that is not part of a cell captive insurer. A reinsurer may conduct both life and non-life insurance and, in addition, may provide a medical scheme.[259]

The Prudential Authority may also set conditions pertaining to reinsurer arrangements and the maximum size of an insurer, prohibit certain clauses from being used in policies, and limit the maximum payable benefits under

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258 Insurance Act 2017 s 25(1-6).

259 S 25(7)(a-b) but may not simultaneously conduct business relevant to individual investments, fund investments or income drawdown in line with Table 1 of Schedule 2.

a policy. The memorandum of incorporation document of an insurer must specify the main business of the insurer, subject to the approval of the Prudential Authority.[260] What is unclear is section 25(8)(g), which stipulates the maximum amount of premiums that an insurer may receive. This could mean the maximum premiums to be collected per month as a result of selling new policies or be among the conditions that specify the maximum size of the insurer. The conditions do not impose a duty on the insurer to collect its premiums on a monthly basis. This simply means that an independent financial services provider could still be used to collect premiums on behalf of the insurer on a monthly basis.[261] This could cause difficulties, since the insurer relies on software from the collection company that will allocate the correct premium amount to a specific policyholder. Generally, the collection company gives a bordereau (a report from an insurance company to its reinsurer listing either the assets covered or the actual claims paid) to the insurer, which should be encrypted to prevent any form of intentional amendment by the collection enterprise. The OECD is silent on the principles of good corporate governance relevant to collection enterprises. The Prudential Authority also does not prescribe any conditions pertaining to the preferred software to be used by collection enterprises in future to prevent fraud. The need for reliable software cannot be overstated. Without reliable software, an actuary and/or an auditor is a nullity.[262] The Prudential

260 S 25(8)(a-i).

261 The collection of premiums is an intermediary service, and a company should be registered as a financial services provider in order to collect premiums. See the definition of intermediary services in the Financial Advisory and Intermediary Services Act 2002.

262 Ss 25(7)(i) and 25(9)(c). The Prudential Authority may require a condition to render the business in a sound financial position, without specifying the preferred form of software to be used by the insurer, underwriter, etc.

Authority could also impose a requirement that the insurer be transferred to black ownership, although any person is free to register as an insurer.[263]

The Prudential Authority may revoke or suspend an insurer's licence. In this regard, the Prudential Authority may add or vary any licencing condition(s). Generally, a suspension would lead to an application made by the insurer to revoke the suspension. On the other hand, the Prudential Authority may – in the interests of the public – amend existing licences to include transformation of the ownership of the insurer. If the insurer is part of a group of enterprises, and to maintain the financial soundness of the group, the Prudential Authority could amend or add or delete certain licence conditions pertaining to how the group must conduct the business of insurance.[264] It is also possible to prevent an insurer from continuing with a certain type of insurance business if it is in the interests of the public to do so, or to prevent an insurer from continuing to sell policies for a specific period of time. In this case, the insurer must be able to transfer the existing policyholders to another insurer.[265] It is not clear whether an insurer may receive monetary compensation for transferring the policies. However, it is clear that goodwill does exist in such circumstances and goodwill has an economic value. How the value should be calculated is unclear. Should an insurer receive excessive policyholder complaints, the Prudential Authority may also amend the licence conditions to promote the orderly resolution/ conduct of that insurer's business.

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263 S 25(10)(b). This condition may be controversial and is only relevant when white persons register as an insurer and not when black persons register as an insurer. Why so much emphasis is placed on transformation in the Insurance Act is unclear and vague.

264 S 26(1)(a-g).

265 Ss 26(3)(c) and 50.

It is possible for the Prudential Authority to act on unreliable information and the consequences thereof could be dire. It is also possible to suspend a licence entirely or in part based on information pertaining to *prima facie* a condition not being continuously met, a condition failing to be met, failing to comply with the Insurance Act, failing to comply with a directive or court order, or failing to comply with the Financial Sector Regulation Act. It could also include failing to rectify the non-compliance of a key person with the necessary fit and proper requirements imposed on the key person, ignoring a decision of the Financial Services Tribunal, or failing to pay the annual licencing fees within 60 days after they become due.[266] The licence of branches of a foreign insurer or a Lloyds underwriter may also be suspended if they neglect to inform the Prudential Authority of any changes in their foreign law or actions taken by a foreign regulator due to non-compliance with those foreign laws. In this regard, the Prudential Authority, prior to suspending the licence, will require additional monthly reporting or impose additional requirements to establish financial soundness.[267] It is possible to review the decision of the Prudential Authority to suspend, revoke, or amend a licence by making use of the Promotion of Administrative Justice Act. In terms of the Financial Sector Regulation Act, the Prudential Authority includes a financial sector regulator and, as a 'decision-maker', a regulator's decision is not subject to section 230 of the Financial Sector Regulation Act pertaining to sections 18(2) and 30(1) of the Financial Sector Regulation Act. In all other circumstances the Prudential Authority's decision may be reviewed by the Financial Services Tribunal.[268] However, the review of the decision by the Tribunal does not suspend the decision until the Tribunal

266 Insurance Act 2017 s 27(1)(a-h).

267 Insurance Act 2017 s 48(1-2).

268 See Financial Sector Regulation Act 2017 s 218 for the definition of a decision-maker and a decision. An example in s 18(2) and s 30(1) relates to solvency requirements if and when the Reserve Bank requires a

makes a ruling,[269] unless a separate application is made to the Tribunal to suspend the decision of the Prudential Authority.[270]

The Prudential Authority may withdraw a licence in the event that it granted a licence on the basis of incomplete information submitted by the applicant at the time of registration of the licence or as a result of unreliable/false information submitted at the time of registration, or if the insurer fails to implement the business plan submitted for licence purposes after the licence was granted.[271] Should the insurer fail to commence with business within 12 months of receiving the licence (or the book of policies was transferred to another insurer and it failed to administer those policies), the Prudential Authority may withdraw the licence. The Prudential Authority may also withdraw the licence if the insurer notifies the Prudential Authority of its intention not to enter into any policy in future. Before the licence is withdrawn, the Prudential Authority must instruct the insurer not to sell any of its assets or to acquire any other liability without the consent of the Prudential Authority (and/or not to make any arrangements to transfer the book of policies to another insurer).[272] The withdrawal is valid only on the date of publication of the notice in the Government Gazette informing the public that the licence of the insurer has been withdrawn.

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financial sector regulator, i.e., Prudential Authority, to impose additional requirements thereto.

269 Financial Sector Regulation Act 2017 s 231.

270 See above.

271 Insurance Act 2017 s 29(1)(a)(i-v).

272 S 29(2-4).

3.25 Offences

The fine for committing an offence is either R10 million or R50 million. For a R10 million fine, contravention of sections 5(1), 10, 16(4), 32(4), 32(5), 32(6), 29(2) or 29(3) or 43(2) is required. A R50 million fine is relevant to sections 10(1), 10(2), 17(4) and 29(4).

In brief, these sections refer to the following:

- Section 5(1) – if a person conducts the business of insurance without a licence;
- Section 10 – who must apply for a licence;
- Section 16(4) – requires a key person who resigned to inform the Prudential Authority of any irregularities in the insurer's business;
- Section 32(4) and (5) – the auditor must inform the board of an insurer and/or Prudential Authority of any irregularity in the business of the insurer or branch of the reinsurer or Lloyd's underwriter or controlling enterprise or security held in trust;
- Section 29(2) and (3) – requires a controlling enterprise to notify the Prudential Authority of the fact that the insurer has not commenced with business within 12 months or commenced with a process of dissolution of the business of insurance;
- Section 43(2) – any person must provide information to the insurer when the insurer is requested to provide information to the Prudential Authority;
- Section 17(4) – to request an insurer or significant owner to submit a plan for reducing the voting rights of the significant owner, among other matters; and
- Section 29(4) – if the insurer disposes of its assets or acquires additional liabilities just before withdrawal of the insurer's licence.

The OECD requires that countries belonging to the G20 tailor their rules/ legislation so as to manage risk appropriately and to prevent a financial crisis for an insurer.[273] The OECD does not require shareholders to reduce their voting rights in an insurer.

273 OECD Guidelines on Insurer Governance (2017) 3.

CHAPTER 4

Pension funds and relevant international pension funds: Corporate governance principles

Neels Kilian

4.1 OECD arrangement/governance

This chapter compares OECD corporate governance practices with domestic pension law. To give a brief background to OECD governance practices, states that participated in the OECD country pension regulations questionnaire/survey indicated that their combined value was more than $44 trillion (nearly $30 trillion belongs to a single OECD country, the USA). The OECD is largely concerned with how pension fund schemes allocate cash or assets or allocate benefit payments/contributions to pension fund managers or pension funds. Contrary to general belief, pension funds, or their fund value, are not saved in a single bank or banks in South Africa. For this reason, a fund in general is not cash liquid. The OECD is currently doing research to understand the regulations that prevail in every OECD country – where exactly employer pension funds are invested and in which assets and why. These regulations differ significantly.[1] However, good corporate governance

1 OECD Annual Survey of Investment Regulation of Pension Funds (2019) 4, 7 and 83. In Australia, no specific percentages are required to invest a fund, but trustees must consider diversification, i.e., equity, bonds, deposits, etc. In South Africa, maximum percentages are applied, i.e., 75% in listed equities and 10% in unlisted equities.

practices, as recommended by the OECD guidelines on Insurer Governance and the OECD Core Principles of Occupational Pension Regulation, as examples, should still be followed by pension funds.

Since most pension funds consist of equity or listed shares, both globally and in the OECD jurisdiction, in 2018, equity decreased by –3.2% (negative), while in the USA equity decreased by –6.7% (negative). In other words, the funds grew very little because of poor financial results (worldwide) in that year. In the long term, equity in Canada increased by 4.8% (positive), in Estonia by –0.7% (negative) and in Latvia by –1% (negative).[2] Although–3.2% sounds very little against the $44 trillion held by the USA, it amounts to a decrease of $1.4 trillion. No guidelines can prevent worldwide equity losses, but losses may be reduced to a certain extent by regulating the maximum amounts that must be invested in equity, for example, in South Africa, an equity fund should not exceed 75% in investments. This may limit, to a degree, the risk associated with equity losses.

On the other hand, the OECD has no preferred method that should be followed by pension funds, for example, bank saving deposits only, and merely makes recommendations by means of working documents, and the like. A working document may state that a domestic bank simply does not have the capacity to pay interest on pension fund money (cash). For this reason, for example, most banks limit fixed deposits/money market deposits to R25 million for private individuals (private pension schemes), which is very small compared to the overall pension fund market in South Africa.

In addition to the abovementioned equity growth in pension funds, those funds that increased in value have been located in countries that have indicated a decrease in unemployment, such as Canada. The more people who are employed, the greater the monthly payments to pension funds.

2 OECD Pension Markets in Focus (2019) 7; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 16.

Also, more and more funds are moving from defined benefit to defined contribution payments.[3] In their simplest form, the differences between defined benefit payments and defined contribution payments are as follows: defined contributions are subject to administrative fees and fees that are charged by fund managers. Because fees are levied, the contribution to a fund is reduced and, therefore, the future pension payments (as a general example) reduced, contrary to defined benefit payments.[4]

Generally, most public sector employers enter their employees for pension fund contributions.[5] In the private sector, however, employers do not generally create a pension fund. In the private sector employees have to contribute to their own pension fund plan or scheme, which is usually referred to as a private plan or an annuity and is generally managed by fund managers (trustees) of unit trusts. South Africa has the largest pension fund pool (private and public) in Africa, which is, to a certain extent, greater than

3 OECD Pension Markets in Focus (2019) 7-8 and 28-29. In Australia, the rate of return is 5.6%, one of the largest pension funds returns in the world. The returns on employee plans are below inflation for most countries or even 0%, for example, in the Czech Republic. Of 51 countries, only 19 have had a positive annual return for the last 15 years. This simply means that nearly 31 countries either experienced negative growth or no growth at all. The annual average for South Africa for the past 15 years is 4%; C Kloppers 'The difficulty in predicting optimal Regulation 28 compliant portfolios: Explained with the benefit of perfect hindsight' (2019) *Financial Markets Journal* https://bit.ly/3DpKxlo (accessed 15 October 2020). In South Africa, funds struggle to increase in value (return on investment) or to top the consumer price index - in other words, to exceed inflation. Defined contributions are fixed monthly contributions and defined benefits are fixed monthly payments to retirees.

4 OECD Pension Markets in Focus (2019) 8; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 32.

5 OECD Pension Markets in Focus (2019) 15-16; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 33.

some European countries.[6] More than 50% of OECD countries depend on voluntary private pension plans. This means that in developed countries, employers do not want to consider retirement plans for their employees, who have to shoulder the burden of investing in private (annuity) plans.[7] Where an employer invests in a pension fund, the rate of monthly contribution is not fixed. For example, in South Africa it varies between 3% and 7.5% (or even higher) of the salary package of the contributor (employee). This may be compared to Iceland's 15% and Norway's 2%, which is the lowest.[8] In South Africa, once an employee elects to contribute 3%, this contribution may be increased over time to 7.5%, subject to the rules of the pension fund. The OECD suggests a full explanation of these 'pension rates' and the possible risks associated with 3% compared to 7.5% with regard to future pension/ benefit payments.[9]

Benefit payments to retirees also differ among OECD countries. For example, in Switzerland, 25% of the fund value can be paid out as a lump sum to the contributor on retirement – very similar to South Africa. In other OECD countries, only monthly payments are allowed.[10] In Chile, for example, the

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6 OECD Pension Markets in Focus (2019) 10; GD Willows 'A comparison of retirement saving using discretionary investment and regulation 28' (2018) *South African Journal of Economic and Management Sciences* 128.

7 OECD Pension Markets in Focus (2019) 18; The OECD refers to funded pensions and private pensions https://www.oecd.org/finance/private-pensions/ (accessed 23 October 2020); OECD Guidelines Relating to Private Pensions (2016) with reference to the preface of this document.

8 OECD Pension Markets in Focus (2019) 21.

9 OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I paragraph 3.5.

10 OECD Pension Markets in Focus (2019) 25; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 35.

fund managers of a private fund may transfer the value of the fund to other fund administrators (who are specialists) that specify how monthly benefit payments should be calculated and paid. They do not invest benefits after the date of retirement for growth purposes; their sole purpose is to administer the monthly payments.[11] Generally speaking, the fund administrator, as a state agency, is responsible for benefit payments, for instance, the 'state social insurance agency', as it is commonly referred to. South Africa is one of many countries that utilises fund managers instead of administrators for the payment of benefits – as in Switzerland, where 1.6% of the funds are transferred to administrators to administer monthly payments only to retirees.[12]

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11 OECD Pension Markets in Focus (2019) 25.

12 The Pension Funds Act 24 of 1965 ss 13B(1A)(a-c) and 13B(1B)(a-c). The fund must apply to the Prudential Authority indicating a fund manager who will manage the contributions or the investment of the contributions in various classes on behalf of the fund. The Prudential Authority may or may not approve the application. The easiest method for controlling fund assets is to open a bank account for the fund. However, not all banks are willing to keep such large amounts of money in exchange for an interest rate. The Prudential Authority must be informed on the application form whether the fund manager is honest, is competent, is financially sound and satisfies any other requirement as requested by the Authority. The Authority may verify the information submitted pertaining to a relevant fund manager and the Authority may set limitations on what a fund manager can or cannot do. For example, the fund manager may be prevented from investing any contributions in derivatives such as hedge funds. In addition, the Prudential Authority may request any additional information or submit any enquiry to a fund manager or fund as regulated by s 24. The Prudential Authority may also carry out on-site visits as regulated by s 25 of the Pension Funds Act. After a visit, the Prudential Authority may provide guidelines for making the fund compliant with the Act. For example, investment in certain assets may be prohibited.

The OECD notes that most countries invest their pension fund contributions in bonds and equities, which constitute the fund. This means that a fund has no or very little cash.[13] In Namibia and Australia, more than in any other OECD country, fund managers are more likely to prefer equities to bonds. Bonds include government bonds, public bonds and private bonds. When contributions are invested in equities, for example, this is referred to as a collective investment scheme or, as generally referred to in South Africa, a unit trust.[14] Albania started an exchange only recently, therefore, most funds are invested in government bonds instead of equities. As a method of limiting the risks associated with equities, OECD countries use of bonds and gold to spread investments. In some OECD countries, pension funds also specialise in granting loans or investing in immovable property to increase their value. In most OECD countries, fund managers do not disclose exactly where they invest their funds and are unwilling to disclose this to the OECD. In this regard, the OECD lists 'others' as an investment category although it is unclear as to what 'other' assets entail, and whether this includes derivatives, bitcoin and/or gold. In his repect, the OECD proposes greater supervision or governance of these 'other' asset schemes in future.[15] Such asset schemes are sometimes high-risk investments in respect of other asset categories

13 OECD Pension Markets in Focus (2019) 29; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 32.

14 OECD Pension Markets in Focus (2019) 30-31; Intergovernmental Fintech Working Group and Department of Treasury (Crypto Assets Regulatory Working Group on Crypto Assets 2020) 27. In brief, bitcoin, for example, is an asset for Pension Funds, and the person who trades bitcoin on behalf of a fund manager or pension fund should be registered as a financial services provider.

15 OECD Pension Markets in Focus (2019) 31 and 39; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 37. Examples of investments in 'other' assets are investments in unlisted securities especially in the transportation business, or solar investments.

such as derivatives or bitcoin. Section 10 of the Pension Funds Act provides for 'other' assets and approval of such assets by the Prudential Authority is arbitrary. The Act has no clear investment guidelines and as a result the Prudential Authority may approve any other asset. This chapter will not investigate 'other' assets' but briefly discusses other assets and Regulation 28.

4.2 Regulation 28

Before focusing on Regulation 28, it should be noted that the OECD is currently busy with surveys to understand the business of pension funds and fund managers. Therefore Regulation 28 is not subject to any OECD pension fund guidance pertaining to the maximum investment percentages in different categories of assets. What the OECD does require is that a written statement of the investment policy should exist between the pension fund and the fund manager. The investment policy will give guidance to the fund manager on the risks, characteristics and diversification of assets the fund wants to avoid or participate in. The fund manager must act as a 'reasonable person' when executing the investment policy. It was previously stated that 'other' assets need further regulation in future. What exactly are 'other' assets? In brief they could be one or all of structured products, gold coins and/or bitcoin. An example of a structured product could be an insurance policy with a guarantee. However, in South Africa, for instance, because religion plays an important role in investments, gold coins are relevant assets. Investing in interest-bearing assets such as fixed deposits would be contrary to the Islamic religion.[16]

16 Comments on the proposed Regulation 28 https://bit.ly/3zpc19R (accessed 1 October 2020); C Kloppers 'The difficulty in predicting optimal Regulation 28 compliant portfolios: Explained with the benefit of perfect hindsight' (2019) *Financial Markets Journal* https://bit.ly/3TQBgdn (accessed 15 October 2020); OECD Survey of Large Pension Funds and Public Reserve Funds

In recent years, global financial risk has been the reason why Regulation 28 was promulgated by section 36(1)(Bb) of the Pension Funds Act; that is, to spread investment risks. Regulation 28 briefly states the following: a pension fund may not exceed the following maximum percentages for investment purposes – 75% for equities, 25% for property, 90% for a combination of equities and property, 5% for an employer, 15% for large capitalisation listed equities, 10% for single other equities, 20% for a single bank, 40% for off-shore investments and 2.5% for 'other' assets.[17] These categories of assets are referred to as prudential entities (PE).

(2019) 37; OECD Guidelines on Pension Fund Asset Management (2006, working paper) para 3 that pension funds must be regulated by domestic laws, for example the Pension Funds Act 1956 and regulatory bodies thereto, for example the Prudential Authority; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I paragraph 3.2-3.3. The emphasis falls on the board of a pension fund to disclose its risk appetite. For example, the fund must grow conservatively at 3% per annum, etc.; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex II para 3 relevant to a written investment policy between the fund and asset manager; OECD Good Practices for Pension Funds' Risk Management Systems (2011) 4. The OECD requires diverse asset categories.

17 For detailed discussion and critique, Author Unknown 'Municipal councillors fund lost 35% of its money on Klerksdorp property deal' *Business Insider* https://bit.ly/3zRCptl (accessed 15 October 2020). Here the government pension fund (PIC) bought vacant farmland for more than R500m and the newspaper article hints at a scam that benefited only the seller of the land, not the contributors to the fund; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 35; I Viljoen 'Balanced funds vs flexible funds' performance: The impact of pension fund investing restrictions' (2015) *Journal for Economic and Management Sciences* 145. In this regard, the author focusses on Regulation 28 and offshore investments are increased from 25% to 30%; See P Caims 'FSB confirms change to Regulation 28 – retirement planning' (2018) *Personal Finance* 3.

4.3 Registration of a fund

The OECD requires pension funds to be registered. In South Africa, the registration of a pension fund is very similar to the registration of friendly societies, which were able to conduct the business of pension schemes in the past. The rules of the specific society had to be registered, with the most important registration requirement being that these rules were 'financially sound' in terms of the Friendly Societies Act 25 of 1956. This Act does not define when rules are 'financially sound', nor is a society registered as a company in terms of either the Companies Act 2008 or its predecessors. The registration of a pension fund is also subject to provisional and final registration procedures, similar to a friendly society. Generally, the 'financial soundness' of the rules has reference to Regulation 28. Accordingly, if any fund rule is unclear, the Prudential Authority may request additional information from the employer that submitted the application for the registration of a pension fund to explain the vague rule. Should the applicant fail to submit additional information or fail to verify any information, the registration process will lapse 60 days after the date of application.[18] On the other hand, the provisional registration is valid for five years. After five years have lapsed, the Prudential Authority may extend the provisional registration by another 12 months but the extension may

18 Pension Funds Act 1956 ss 4(1-7), 20(1) and 23. If any requested document was not submitted to the Prudential Authority, it is held that the whole Act was not complied with. Thus, it may even be assumed that the fund is not registered. If a document was submitted and not signed by the required person as stipulated by the fund rules, the Act was not complied with. The rules of the fund must be certified by the Prudential Authority and the certification thereof can be used as *prima facie* evidence as being the original rules; OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 36. China, for example, may register a fund only if it is a defined benefit fund and investments are to be made only in listed shares and bonds; OECD Good Practices for Pension Funds' Risk Management Systems (2011) 4.

not exceed five years in the aggregate. If the Prudential Authority is certain that the fund will be financially sound, it will issue a final registration certificate. The same applies to a friendly society. The rules of the fund will also be endorsed by a stamp indicating their authenticity. If the rules are not stamped then section 4 has not been met and this may cause problems when applying for final registration.

The rules of the fund may be changed or amended as regulated by the rules or the Pension Funds Act. If the rules contain no regulation, then changing the rules lawfully will be problematic unless the fund is registered as a company. In this regard, a special resolution is required to change/amend the memorandum of incorporation. In addition, if the change affects the rights of creditors, the rules may not be changed unless the Prudential Authority approves the change. No fund may conduct the 'business of a pension fund' unless it is registered or has been provisionally registered as a pension fund.[19] The moment the fund is provisionally registered, the fund becomes a legal person.[20] The rules may also specify the termination of 'membership' of such a fund, as indicated in section 4B(3). In such a case, the rules may specify the transfer of the payment of benefits in future to another fund for the sole purpose of paying monthly benefits to retirees.[21] The Act is not very clear on

19 Ss 5(8), 4A(1-4) and 11. It is also possible for the state to register a fund to which it contributes financially. The minister, after consultation with the Prudential Authority, must create a management board/trustees for such a pension fund; S 12(1-2). The contents of the resolution to change the fund's rules must be sent to the Prudential Authority within 60 days after the date of resolution.

20 See s 5(a), also referred to as a body corporate; C Marumoagae 'The need to provide members of retirement funds which are not regulated by the Pension Funds Act access to a specialised dispute resolution forum' (2019) *De Jure* 100.

21 Pension Funds Act ss 30V and 31(1)(a-d). Subsection d does not make sense; a person is not allowed to conduct the business of a fund. The phrase 'pension

when the business of a fund must be commenced. In the event that the state registers a pension fund, section 4C requires only provisional approval of the state's application. This implies (perhaps) that all the assets held by any other pension fund or fund manager must be transferred to the state fund immediately to commence with business. The person who held those assets must take the necessary steps to show that the ownership of those assets will be held in future by the state pension fund and no fees or transfer fees may be charged for such a transfer of assets.[22]

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fund' should disappear when the fund is provisional or finally registered; nevertheless, we suggest that the name of a fund should include the phrase 'pension fund.' Thus, if it is not a company it is still a legal person and the name of the fund must be subjoined with this phrase. If it is a company, then besides Pty (Ltd) or Ltd, the name must still make use of the phrase 'pension fund.'

22 R Jooste 'Provident fund members' payouts are at risk' *Daily Maverick* https://bit.ly/3SYopok (accessed 5 May 2020). In this regard Eskom requested an administrator to make the data of contributors available to the Eskom pension fund board because the board wanted to change fund managers. The manager argued that transferring all contributors to another fund manager would take approximately three years. Eskom wanted an immediate transfer and consequently the Eskom pension fund board approached the High Court for an order. However, after reading the complexities relevant to a transfer to a new fund manager, Eskom did not continue with litigation. One could argue that the members of the Eskom pension fund were inexperienced and did not acknowledge the complexities relevant to a transfer. The actual reason why a transfer should occur remains unclear; R Jooste 'A (very) revealing analysis of Eskom pension fund's investment and administration costs' *Daily Maverick* https://bit.ly/3zRCA7Z (accessed 5 May 2020). The costs of paying the board members of the Eskom fund were extremely high when compared to the remuneration of the board members of other funds. This in part increases the fund's administration costs. The Eskom pension fund is approximately 280 times bigger than the average private pension fund, and to move such a fund in a matter of months would amount to recklessness. In this regard it is suggested that the rules of the Eskom fund must be disclosed

4.4 Owner of assets

The pension fund, as a legal person, is the owner of its assets irrespective of any other contrary clause in the rules/memorandum of incorporation or in any other provision in the law.[23] It should be remembered that when a fund is registered as either a private or a public company, the rules of the fund will be the memorandum of incorporation. It is not a requirement to register a pension fund in terms of the Companies Act 2008, as a legal person. On the other hand, a pension fund may be registered by an application submitted to the Prudential Authority overseeing the Pension Funds Act in a similar style to registering a friendly society. Standard rules are the following: no person will have any claim against any assets of the fund unless the person becomes a retiree or is entitled to claim as a nominee. If a fund is in the process of being registered and the assets are provisionally retained by a trust, the ownership of the assets ends immediately the fund is registered.[24] The transfer of asset ownership is *sui generis*; no cession or formal transfer is required from the trust to the pension fund. This applies to both provisional and final registration of the fund.[25] In addition, if a trust was the owner of immovable property, the title deed at the deeds office must be amended when the fund is provisionally registered as the new owner of the property/ assets without paying any registration fees or transfer fees.[26] The fund must

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on its website to allow the public to understand whether the fund board members are experts in law, economics and/or finance, how members are elected, removed, etc.

23 Pension Funds Act 1956 s 5(1)(b).

24 S 5(1)(c).

25 S 5(1)bis; OECD Good Practices for Pension Funds' Risk Management Systems (2011) 5. Not to comply with domestic law is considered a risk factor by the OECD.

26 S 5(1)bis.

maintain a record of all the assets, books, and books of account necessary to maintain/sustain the fund and the assets may also be administered/managed on behalf of the fund by one of the following persons:[27]

- a long-term insurer;
- an assets/fund manager of a unit trust/collective investment scheme;
- a bank;
- a nominee company;
- any investment vehicle approved by the Prudential Authority; or
- an authorised user, for example a broker who trades securities/derivatives on an exchange (JSE).

The above persons are subject to Regulation 28. For example, assets may be invested by a nominee company or a fund manager on behalf of the pension fund and equity may be invested by a board member on behalf of the contributor in different categories of assets. In relation to a nominee company, the principal business of such a company is to act as a representative of the pension fund – for example, to maintain and administer the property/assets of the fund. The nominee company or the pension fund may not incur any liabilities unless they are liabilities on behalf of the fund or the fund is liable for any expenses of the nominee company.[28] For a pension fund to be able to

27 S 5(2)(a-e); C Kloppers 'The difficulty in predicting optimal Regulation 28 compliant portfolios: Explained with the benefit of perfect hindsight' (2020) *Financial Markets Journal* https://bit.ly/3FuEUFi (accessed 15 October 2020). The sophisticated software required to keep records of funds and the like; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 3.4. The fund board must know the specifics of such a software programme.

28 Pension Funds Act 1956 ss 13B(5) and 5(3)(a-b). The person who administers/manages the fund must always avoid conflict of interest between the fund

make use of a nominee company, the Prudential Authority must approve the relationship between the nominee company and the pension fund.

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manager and the pension fund, in order not to benefit the fund manager at the expense of the pension fund and to manage the fund in a responsible manner, keep proper records, employ adequately trained staff, supervise staff properly, have a compliance officer, manage the risk a pension fund is exposed to, provide information to the Prudential Authority as requested, and within a reasonable time communicate to the fund any requested information. One of the problems concerning annuities is establishing who is entitled to the dividends received from listed companies, the pension fund or the fund manager? The definition of a shareholder simply states the name of a person who is entered on the register of shareholders – generally, it is the name of the fund manager because of the varieties of categories of assets (commonly referred to as unit trusts). In practice, the fund manager is entitled to those dividends, which could be millions, without benefiting the pension fund. Or lawful conflict of interest? For a general discussion, see *Smyth v Investec Bank Ltd and Another* 2018 (1) All SA 1 (SCA) at 11 para 30. It is possible for the Prudential Authority to consider the payment of dividends as irregular, and s 13B(6)(a) may require the Prudential Authority to act against the fund manager, for example to make such dividend payments available to the fund. It is also possible to move from one fund manager to another as regulated in s 13B(6)(b). It may also be possible to prescribe that the costs of the new fund manager be defrayed from the financial resources of the pension fund. In addition, the Prudential Authority may suspend the services or withdraw the services of a fund manager. During suspension, the fund manager must still continue to manage the fund but may not enter into new agreements as a fund manager for other pension funds. What are these contracts called? Fund managing contracts or underwriter contracts. The answer is not too clear. In terms of s 13B(8), a fund manager may never destroy any records or books such as the records of contributors who are no longer contributors to a pension fund. The fund manager must always inform the Prudential Authority of a material fact that may have a negative impact on the financial soundness of the pension fund as regulated by s 13B(10).

The above fund manager or nominee company is referred to as a 'ring-fenced' (RF) company. In this regard, almost all fund managers are RF companies since their memorandum of incorporation is ring-fenced with regard to acting as a representative of a fund. For example, the fund manager cannot incur liabilities in terms of any contract that is contrary to the pension funds rules. In this regard, as a direct result of the RF status, the Turquand rule will not be relevant. It is also possible that a fund manager may open a bank account in the name of the fund manager to keep money on behalf of the pension fund (the same applies to a nominee company) and to administer the money or cash on behalf of the pension fund.[29] It is not possible, however, to amend the memorandum of incorporation of a fund manager – although it can be changed by following the procedures in the Companies Act 2008 – as the Pension Funds Act, for example, prohibits the flouting of the RF status of fund managers. In this respect, the Prudential Authority must approve any amendments to the constitution of a fund manager.

4.5 Associated businesses

The Pension Funds Act does not define 'associated businesses'. In brief, in company law a provision is made for pre-incorporated contracts. It seems that 'associated businesses' may relate to pre-incorporated contracts. In this regard, whilst the fund is in the process of being registered another pension fund may manage the assets of the proposed fund. After provisional registration, the Prudential Authority must receive a proposal on how the assets will be managed in future between the two pension funds.[30] Proposals must be sent within 12 months. If no proposal is received within 12 months, the Prudential Authority may, on the basis of equity, decide how the assets should be managed between them. To achieve equity, the Prudential Authority

29 S 5(4).

30 Pension Funds Act 1956 s 6(1).

may contact any actuary or auditor to submit any reports or valuations. After considering the reports and valuations, the Prudential Authority must disclose how the funds will be managed in the future and any interested party may submit statements/questions to the Prudential Authority within 30 days after the Prudential Authority's announcement.[31] It is also possible for a board member who controls the fund to submit any statements/questions to the Prudential Authority before making an investment decision. Once the Prudential Authority decides, for example, to continue with the terms of the pre-incorporated contract, that decision is binding on all parties.[32]

4.6 Board of directors

To understand whether a fund has any directors, trustees or members, one must bear in mind that trustees are relevant to trusts and unit trusts. A fund is not a trust but reference could be made to trustees who manage the pension fund.[33] This is relevant if a fund is registered in terms of the

31 Ss 6(4)(a-c), 20(2)(a-c) and 20(3). If the actuary is not a natural person, the document/report signed by the legal person will be accepted as fully signed. In all other circumstances a legal person who wants to sign a document/ report must comply with the requirements of s 20(2)(a-c), for example be the head of a committee of persons, the head of an association of persons, or any person designated by the Prudential Authority to sign documents/ reports. Any original document/report to be submitted must be submitted in triplicate and one copy must be certified as being a true copy of the original. The Prudential Authority may require more than three copies, if so prescribed; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I paragraph 3.7. The OECD suggests procedures to monitor the effectiveness of schemes.

32 S 6(5-6); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 15.

33 Ss 4(1) and 5(1)(A). To be a pension fund, a fund must apply to be registered as a fund in terms of the Pension Funds Act. A private company, on the other

Pension Funds Act or the Friendly Societies Act, as the fund is neither a company nor a cooperative.[34] This also applies to a society registered in terms of the Friendly Societies Act, as it is neither a company nor a cooperative. These business entities are *sui generis* and are simply referred to as bodies corporate (legal persons). The term 'body corporate' should not be confused with management agencies of sectional title schemes where the managers of a sectional title property form part of the body corporate. However, it is possible to register a company and then to apply for registration as a fund in the registered name of the company.

The rules of the fund are included in the memorandum of incorporation, which is commonly referred to as the constitution, and may simply comprise a document accepted by the Prudential Authority in the event of registration in terms of the Pension Funds Act. When the rules are accepted, the fund is regarded as a body corporate managed by the board of trustees, directors or members, known as 'board members'. In terms of the Companies Act 2008, a member is a shareholder but clearly the term 'shareholder' is inappropriate in regard to the Pension Funds Act. Therefore, if the fund has registered a memorandum of incorporation the 'members' are referred to as the board of directors in terms of the Companies Act 2008.[35] Because a friendly society or a fund incorporated by means of friendly society rules is not subject to

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hand, must apply in terms of the Companies Act to be registered as such a company; P Delport *New entrepreneurial law* (LexisNexis 2014) 283; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 3.1 requires a plan written by both the board of the fund and the fund manager as to how the fund manager must manage the assets.

34 See in general the Co-operatives Act 14 of 2005.

35 CG Kilian and E Snyman-Vandeventer 'To replace the Friendly Society Act with the proposed Insurance Bill: A new perspective on society members' benefits in exchange for a premium' (2017) *De Jure* 281-302. Here the legal nature of a society is discussed and whether a society is a company in terms

the provisions of the Companies Act 2008, the board is not subject to the statutory fiduciary duties of directors as regulated by the Companies Act 2008, as they pertain to the business judgement rule and proper purpose doctrine, for example.

The following issues are regulated to a certain extent by the Pension Funds Act: members of the board must act with care, diligence and good faith, avoid conflict of interest, be impartial to all contributors and retirees, act independently, carry out its fiduciary duty and comply with the Pension Funds Act and the rules of the fund.[36] In company law, the fiduciary duties include acting honestly and in the best interests of the company (which includes shareholders). Regarding a fund that is not registered as a company, it seems that the fiduciary duties relate only to the fund– for example, to ensuring that the fund is financially sound. If members of the board are accused of breaching their fiduciary duties, the members may make use of section 7F of the Pension Funds Act as a defence. Under these circumstances, the member will argue that he has not breached his fiduciary duty because the fund is in a reasonably sound financial condition and he acted honestly and/or independently when making decisions on behalf of the fund. Consequently, the court or Pension Funds Adjudicator must consider all relevant circumstances to excuse the member from a claim of breach of fiduciary duty on the basis of fairness.[37] The OECD recommends

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of the Friendly Societies Act. One must remember that the Friendly Scoieties Act and the Pension Funds Act were both promulgated as law in the 1950s.

36 S 7C(1)(a-g); S Jones 'Lodging your complaint with the Pension Fund Adjudicator' (2005) *Personal Finance* 10; O Barrow and N Gubula 'Pension fund trustees: Are their obligations too onerous? ' (2008) *Without Prejudice* 44.

37 S 7F(1)(a-b); OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 2.1; LT Nevondwe 'Time limits lodging complaints to the Pension Funds Adjudicator' (2008) *Business Law* 12.

that the expertise of consultants be used to complete the duties of skill, care, etc., especially when the board is not educated in finance or economics. The OECD also recommends that the board members of a pension fund should be experts in the field of investments, etc. and the reasonable person test to determine breaches of skill and the like should not be that of an ordinary person but of an 'expert investor'.[38]

If the rules are registered in terms of the Pension Funds Act, the Prudential Authority will specify how members of the board will be elected (by poll or a show of hands) and when a member's office will become vacant. In this regard, four members are required to manage the fund and two of those members must have the right to elect future members.[39] The rules must also specify how long it must take to fill a vacancy, the election procedures, the term of a member's office, what is considered a quorum, the relevant procedures at board meetings, how to vote as a member of the board, voting rights, procedure in the event of a deadlock, and the powers of the board.[40]

The Pension Funds Act does not indicate how long a member must serve on the board. The term may be limited by the rules. Since the Companies Act is not always relevant, the Prudential Authority may prescribe rules for how the members of the board should maintain or improve their financial skills. Generally, members must go for training or improve their skills within six months of their appointment.[41] When a member is removed – as against

38 OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex II para 2.4.

39 Ss 7A(1) and 7A(1A).

40 S 7A(2).

41 Pension Funds Act 1956 ss 7A(2) and 7A(3)(a-b); OECD Guidelines on Pension Fund, Asset Management (2006, working paper) Annex I para 2.1; O Barrow and N Gubula 'Pension fund trustees: Are their obligations too onerous?' (2008) *Without Prejudice* 44.

voluntary removal or termination – the member must, within 21 days, submit a report to the Prudential Authority explaining the reasons why he/she has been removed by the board. In addition, the member must inform the Prudential Authority of any material risks relevant to the fund.[42]

4.7 Exemption from the requirement of a quorum of four board members

Although a quorum for a meeting is four unless otherwise stated by the rules of the fund, the Prudential Authority may exempt a fund from this provision and permit it to conduct board meetings where the board is unable to obtain a quorum, for example, if a member is either ill or unable to attend a meeting as a result of his or her death. In such circumstances, the Prudential Authority will allow the number of board members to be reduced to three.[43] In this regard, section 7B(1) states that the three members must be able to appoint at least 50% of the members. In addition, the Prudential Authority may exempt a board from electing new members when a fund is a retirement annuity fund or a beneficiary fund.[44] However, the Prudential Authority may at any time terminate this exception.[45] Every fund must elect one of the members to act as a principal executive officer and may also appoint a deputy

42 Ss 7A(4)(a-b) and 21(1)(a-b). If a rule is being changed or the financial condition of a fund/scheme is unclear, the Prudential Authority may request additional information as it may deem necessary.

43 S 7B(1)(a-b); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 6.

44 S 7B(1)(b)(i-iv). Or a fund for the benefit of employees of different employers or a provident preservation fund.

45 S 7B(2).

principal officer.[46] It is not necessary for a principal executive officer to be a South African citizen, just a South African resident. If the principal officer is absent or unable for any reason to complete his functions as an officer, the rules of the fund pertaining to these circumstances must be followed – for example, appointing another person within a specified time period and/or complying with the Prudential Authority's instructions.[47]

4.8 Duties of the board

The board does not manage the pension fund. The individual fund managers acting on behalf of the board manage the fund on a day-to-day basis. The board merely controls the fund and oversees the activities of the fund in accordance with its laws and rules. In other words, the board cannot incur financial liabilities on behalf of the pension fund as is the case with the normal business activities of enterprises. The fund must show profit, not because of management but as a result of the financial markets in which the assets are placed. Once an asset performs poorly, the board can give directions to a fund manager on how to manage the assets in future.[48] The board must keep proper records of all board meetings (minutes), contribution books and operations to make sure that the fund is subject to proper control systems, for example, appropriate software programs; ensure effective communication between the pension fund and retirees (or their nominees concerning their rights, benefits and duties); make sure employers or contributors pay

46 Pension Funds Act 1956 ss 8(1) and 8(2)(b); O Mokoena 'Pension fund boards and the principal officer' (2011) *Professional Accountant* 1.

47 Ss 8(2)(a) and 8(2)(e).

48 Pension Funds Act 1956 s 7C(1); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 4. The implications of having a poor fund manager for the risk associated with investments should be considered by the board of the pension fund.

their contributions on time; obtain expert advice; and make sure that the fund complies with the Financial Institutions (Protection of Funds) Act 28 of 2001.[49]

It is possible for a principal executive officer to delegate his functions to any other person or to the deputy principal executive officer as prescribed by the rules with or without any conditions attached. The principal officer who delegated his authority is still bound by the rules and may immediately terminate any delegation.[50]

In the event of a new principal executive officer being appointed, the fund must inform the Prudential Authority of his or her identity within 30 days after the date of appointment. The rules or memorandum of incorporation cannot state that a principal officer is appointed for life or may serve a minimum fixed term of ten years, for example. The Prudential Authority may object to a new appointment within 30 days and, as such, the proposal to appoint a certain officer may be rejected. In this regard, the appointment is subject to a condition; whether this is a suspensive or resolutive condition is unclear.[51]

In *Private Security Regulatory Authority v Commission for Conciliation Mediation and Arbitration* [2011] ZALCJHB 91, the labour court had to decide whether a condition in section 14(4)(c) of the Private Security Industry Regulation Act 56 of 2001 is in fact a condition. In other words, a director must undergo

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49 S 7D(1)(a-g); C Kloppers 'The difficulty in predicting optimal Regulation 28 compliant portfolios: Explained with the benefit of perfect hindsight' (2020) *Financial Markets Journal* https://bit.ly/3WhJ8Gb (accessed 15 October 2020). Here the author explains the relevant software programme used by fund managers.

50 Pension Funds Act 1956 s 8(2)(c–d); O Mokoena 'Pension fund boards and the principal officer' (2011) *Professional Accountant* 1.

51 S 8(3-4).

a security clearance check and if he does not the office must be terminated. The court held, perhaps *obiter*, that deciding whether the condition was suspensive or resolutive was not relevant to the circumstances.[52]

In addition to this example of a condition, the reasons why the Prudential Authority may reject an appointment are subject to review in terms of the Promotion of Administrative Justice Act 3 of 2000. The Prudential Authority has the power to remove a principal officer as a result of incapacity, for example. This decision is also subject to review in terms of the Promotion of Administrative Justice Act.[53] The Prudential Authority must submit its decision to the board and the board must within 30 days remove the board member. Once removed, the board (or board member) may use the Promotion of Administrative Justice Act to have the Prudential Authority's decision reconsidered.

To understand whether a principal officer is able to complete the functions of a board member, the Prudential Authority must consider the following: competence and soundness of judgement pertaining to the type of fund; diligence in performing those functions; previous conduct in financial matters, for example, previous convictions pertaining to theft, fraud, or any breach of any law; previous positions held as principal officer of a fund where the fund suffered financial losses; or any other matter.[54] It is also possible that the Prudential Authority may confer with consultants to provide an expert

52 Paras 15, 21, 37.

53 S 8(5). With regard to a court order of director delinquency, since the Companies Act 2008 is not considered to be financial sector legislation, reviewing the removal of company directors is not subject to the Financial Sector Regulation Act 2017, or the Promotion of Administrative Justice Act 2002.

54 S 8(5)(c)(i-iv); O Mokoena 'Pension fund boards and the principal officer' (2011) *Professional Accountant* 1.

opinion on whether the principal officer is competent or incompetent. The same applies to other board members.

The pension fund may terminate the services of a principal officer, as regulated by the rules of the fund. Whether a principal officer or board may use the Promotion of Administrative Justice Act to reconsider that decision remains unclear, since the decision to remove is not always part of a public function. One could argue that because a fund is registered by the Prudential Authority in terms of the Pension Funds Act, the fund's rules are open for inspection, which indicates a public function.[55] In any event, the principal officer may terminate his office voluntarily and within 21 days must submit to the Prudential Authority the reasons why he or she terminated this office.[56] The principal officer must also inform the Prudential Authority of any irregularities pertaining to the fund as a possible reason why he terminated his services.

4.9 Auditor, actuary and actuarial surplus account

Every fund uses the services of an external auditor. The rules of the fund will generally set out the process for appointing an external auditor. An auditor may not be a member of the board.[57] What is interesting here is that the Pension Funds Act does not prescribe a maximum period for serving as an external auditor, although the rules may specify that auditors be rotated every

55 See in general *National Horse Racing Authority of Southern Africa v Cyril Naidoo* 2010 (3) SA 182 (N). In this case, Mr Naidoo relied on the constitution of the National Horse Racing Authority to support why he should not be disqualified as a horse trainer as part of administrative law.

56 S 8(6)(a-b).

57 Pension Funds Act 1956 s 9(1).

five years to ensure independance.[58] If the fund terminates the services of an external auditor, the auditor must within 21 days of the date of termination explain to the Prudential Authority why the services were terminated. The Prudential Authority may also receive voluntary communication from an external auditor – whilst acting as such – pertaining to any irregularity that prejudices the financial soundness of the fund.[59] In addition, within six months of the end of the fund's financial year, its financial statements must be submitted to the Prudential Authority and the external auditor must also submit any special reports pertaining to the fund's managerial activities to its contributors. The Prudential Authority may, however, reject the financial statements, subsequently providing reasons as to why they were rejected, such as that the fund did not comply with the six-month period within which to submit the financial statements.[60] On the other hand, the Prudential Authority may do away with this six-month requirement in terms of section 2(5)(a). Should the Prudential Authority later decide to implement the six-month requirement, such a decision is subject to the Promotion of Administrative Justice Act 2000.[61]

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58 Ss 9(2) and 9(4). The Prudential Authority must approve an external auditor's appointment within 30 days of establishing a fund.

59 S 9(5); If an external auditor is a partnership, a change in the composition of partners will have no effect on the auditor appointed by the Prudential Authority.

60 Ss 15(1), 15(2-4) and 22(1-3). Any person may request to inspect the financial statements of the fund and/or reports relevant to the fund or be provided with details as to the address of the fund, etc. These documents and the other information are considered public information and are available to any member of the public. The Prudential Authority may charge a fee to inspect the documents.

61 S 2(5)(a-b).

Another word for an actuary is a valuer, as indicated in section 1 of the Pension Funds Act. A valuer can act as such only if the Prudential Authority believes he or she has sufficient actuarial knowledge to perform the duties of a valuator. Every fund must use the services of and appoint a valuer. A valuer is generally a natural person residing in South Africa. If the valuer resigns, then the fund must appoint a new valuer. It seems that a valuer is not an external expert but an employee of the fund unless the rules state otherwise. It is possible that the rules may rotate an internal valuer on a regular basis in terms of section 9A(3) of the Pension Funds Act. It is also possible to appoint an external valuer as a legal person to assist the internal valuer on a regular basis.

In its simplest form, an 'actuarial surplus' is the difference between the assets and liabilities of the fund. The actuary places a valuation on the assets and liabilities of the fund and the surplus or leftover is referred to as the actuarial surplus. This surplus belongs to the pension fund,[62] which includes retirees, former contributors or the employer as a contributor on behalf of its employees, who may benefit from this surplus.[63] This surplus may be used, for example, to increase the monthly benefits payable to retirees, to increase the monthly benefit payments by contributors (employees), to reduce the monthly contributions of contributors or to cover the expenses which would have been deducted from the monthly employer contributions.[64] However, this is possible only if the rules of the fund make provision for these scenarios/deductions.[65] Should a former contributor who left the fund after 1 January 1980 not be found, a portion of the surplus should be transferred to a reserve account to satisfy the claims of former contributors

62 Pension Funds Act 1956 s 15A(1).

63 S 15A(2).

64 S 15D(1)(a-d).

65 S 15D(2).

or their nominees – if they are to be found at all.[66] If, after an increase has been paid in benefits to retirees, the actuarial value of the fund is still in surplus, the surplus may be split to benefit former contributors (who left the fund and have been found), existing pensioners/retirees and the employer. The Prudential Authority may prescribe equitable guidelines in this regard[67] and a 75% board resolution is required to approve the split,[68] although this is relevant only to funds that commenced with their business operations prior to 7 March 2002 and where the funds had to submit a scheme within 18 months to the Prudential Authority. In future, the actuarial surplus could still in principle be used to benefit former contributors.

Generally, fund rules adopted after 7 March 2002 do not contain such rules and the employer and/or contributors have no discretionary power to reject the split/apportionment of the surplus. It would appear that even if the rules in principle do not allow for a split, they may not be used to prevent a split of the surplus.[69] This also applies to a surplus that benefits an employer. The employer may insist that the board use the surplus to allow the employer a contribution holiday; or decrease the payment of contributions by an employer to compensate for any losses in the past resulting from their payment of medical costs to employees; to improve the future benefit payments for all contributors; or, in the event that the fund is liquidated, to pay in cash the surplus to the employer as creditor of the fund; or to avoid the retrenchment of the employees by an employer; or to transfer a portion of the employer's surplus to the contributors' surplus account; or, where an

66 S 15B(4)(b).

67 S 15B(5)(c).

68 S 15B(7); RWD Davis and S Kendal 'Surplus? What surplus? Did the pension funds second amendment Act achieve its aims?' (2012) *South African Actuarial Journal* 55.

69 S 15C(2).

employer used the surplus improperly, to repay the surplus to the fund.[70] In this regard, if the contributors elected certain persons representing the employer to act as board members, those members may not cast votes in relation to the employer's surplus account.[71]

4.10 Disclosures

What a valuer sees or reads of a pension fund must be disclosed in the utmost confidentiality to the Prudential Authority. The same applies to a principal executive officer, board member, fund manager, deputy principal officer or any employee of the fund. These disclosures and the disclosures to be made are regulated by the Protected Disclosures Act 26 of 2000.[72] If any of these persons make disclosures they must not suffer any prejudice or occupational prejudice. If one considers the preceding sentences, it seems that the identity of the person who made the disclosure will eventually be disclosed to the pension fund or board members, thus confidentiality cannot be guaranteed. For this reason, a person who suffers prejudice must make use of the remedies provided in section 4 of the Protected Disclosures Act 2000. Section 9B(3)(a) uses the word 'must' instead of 'may' to regulate a penalty for such contravention. The seriousness of this issue is not always appreciated, especially because a fund could consist of billions of rand, and any disclosure can in effect destroy the reputation of the board member(s) or fund manager of the pension fund. To approach a court to rectify the reputation of such a person may be too late.[73] Moreover, if the rules of the fund are changed

70 S 15E(1)(a-i).

71 S 15E(1)(i).

72 Pension Funds Act 1956 s 9B(1); Protected Disclosures Act 26 of 2000 ss 8 and 9.

73 S 9B(3)(a-b).

and this affects the financial soundness of the fund, a valuator report must be sent to the Prudential Authority explaining what must be done in future to make sure the fund remains financially sound in terms of section 12(3) of the Pension Funds Act. Should these changes not be communicated to the Prudential Authority, any employee of the fund or board member of the fund may disclose this to the Prudential Authority.

4.11 Remedies

An aggrieved person may use any remedy as regulated in any piece of legislation or the common law. However, section 4 of the Protected Disclosures Act allows that person to approach a labour court directly without firstly applying for a conciliation and mediation process and to approach any court directly to hear any protected disclosure relevant to the circumstances. In addition, as a way of preventing any form of litigation, instead of the legal processes provided for in the Protected Disclosures Act a complaint may be considered by the pension fund board.[74] A disclosure includes a criminal activity that has been committed by the fund, that is the board, the fund manager, an employee of the employer or a contributor, or that will most likely be committed by these persons; or the fund or fund manager has failed to comply with a legal obligation; and the likelihood that injustices and/or unfair discrimination will occur between contributors pertaining to the benefits of the fund, as regulated by the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000. The last example becomes relevant when contributors have contributed the same amount and receive different benefits as retirees. An example could be that of a Transnet dispute, where retirees who contributed to their pension fund as employees for more than

74 Pension Funds Act s 4(1)(a-b). An option is also provided to follow other informal processes such as the CCMA, and in the event that the matter fails conciliation then the labour court may adjudicate it.

30 years received a monthly benefit payment similar to a person who had contributed for only ten years or fewer to another fund.[75]

4.12 Consolidating the rules

Although a fund may change its rules (only if the rules contain such a provision), the Prudential Authority will accept those changes only if the financial soundness of the rules will not be affected. The Prudential Authority will return the resolution to the principal executive officer with an official stamp. If there is no stamp, then one may argue that the change in the rules is invalid.[76] The resolution can be attached as an annexure to the existing rules since it is not always possible to re-type all the rules and resolutions in a single document. This document (resolution) must also be approved by the Prudential Authority, stating that it is a true copy of the rules or, in the event of previous board resolutions that are consolidated into a single document, that they are a true copy of the rules.[77] If any uncertainty exists as to whether it is a true copy or not, the Prudential Authority may request additional information from the fund board members. This also applies to any vague resolution to change the fund rules, where the Prudential Authority may request additional information as to why the rules should be changed. The

75 Press release from Geyser and Coetzee Attorneys available online at https://bit.ly/3FuDfQ5 (accessed 1 December 2020), where a class action of approximately 60 000 pensioners/retirees of Transnet reached a settlement agreement to increase their monthly benefit payments – average monthly benefit payment of R1 450 after 30 years of employment. Why no principal executive, valuer, etc. made a disclosure to the Prudential Authority remains unclear since it is obvious that those benefits were not in line with the benefit payments of other independent funds, where contributors had contributed to the funds for more than 30 years.

76 Pension Funds Act 1956 s 12(4).

77 S 12(5).

board must give the requested information within six months. If not, the board resolution is invalid and no consolidation of the rules may occur.

4.13 Rules as a contract

If the rules are contained in a memorandum of incorporation, the memorandum constitutes a contract between the shareholders themselves, between a shareholder(s) and the company, and between a director(s) and the company. Since a fund has no shareholders, it is difficult to know how to interpret a shareholder as a contributor to a fund, since contributors do not take part in annual general meetings of the fund nor are they entitled to dividend payments. In this matter, the Prudential Authority should incorporate clearer sections in the Pension Funds Act, for example, to register a fund in terms of the Pension Funds Act only. On the other hand, the rules accepted by the Prudential Authority to establish a fund are binding between the fund and its board members, between the fund and its officers, and between the fund and employers or retirees claiming benefits or their nominees (beneficiaries in the event of the death of a retiree). An officer includes a member of the board, any manager, the principal executive officer, the treasurer, and a clerk or employee of the fund, and excludes auditors and valuers.[78] However, the board may ignore the rules pertaining to actuarial surplus accounts when those surplus accounts are specifically regulated by the Pension Funds Act, for example, section 15E(1)(a), which regulates a holiday payment contribution for the employer.

78 Pension Funds Act 1956 ss 1 and 13; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 2.2. The OECD states that a fiduciary duty should exist between the board and the contributor and/or retiree, and when the board must make an investment decision, the principles of due diligence must apply; O Mokoena 'Pension fund boards and the principal officer' (2011) *Professional Accountant* 1.

4.14 Contributors

A 'contributor' is generally an employee whose employer registers a fund or is part of a pension fund and makes contributions on behalf of the employee to the fund on a monthly basis. In the event of a private annuity plan, however, the contributor (employee) contributes for retirement purposes directly to a fund manager. With a pension fund, the employer pays the necessary contributions to the fund on behalf of the employee. It is unclear, however, whether a fund will always have a bank account to accept the payments, depending on the size of the annual contributions. Generally, a fund manager will manage the contributions received on behalf of the fund. In the event that an insurance company acts as an administrator, the contributions will be paid to the insurer, which in turn will pay the contributions to the fund manager. In other words, depending on the circumstances either the insurer or the fund manager will receive the payments directly from the contributor. In addition, the rules of a pension fund will generally state three contributing options for employees – a 3%, 5% or 7% contribution to the fund – from which the employee must choose the most suitable.[79] Generally the employer will send a bordereau of the contributions it has paid to the insurer or to the fund manager, which discloses the individual employee contributions to the pension fund. Such a bordereau must be sent to the insurer or fund manager within 15 days of the date of payment and it is suggested that a copy of the bordereau also be sent to the pension fund.[80] The bordereau must be balanced

79 Pension Funds Act 1956 ss 13A(1)(a-b) and 13A(3)(a-b). Payments must be made directly into the fund's bank account within seven days of the end of the month or forwarded to a fund manager also within seven days of the end of the month; GD Willows 'A Comparison of retirement saving using discretionary investment and Regulation 28' (2018) *South African Journal of Economic and Management Sciences* 55.

80 S 13A(2)a-b); OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 2.2-3.1. The OECD requires rigorous

with the actual funds in the bank received by either the fund manager or insurer and must highlight the number of contributors, etc. In the event that the pension fund receives contributions directly, the fund must transfer the contributions received to the insurer, which will then transfer them to the fund manager where the same principle applies – the pension fund issues a bordereau in this regard.

The OECD requires the board of the fund to be in constant communication with either the insurer or fund managers and to understand the business of a fund manager and the purposes of a pension fund. A 'written investment plan' should be drawn up by the pension fund and the fund manager, and the fund manager must execute this plan while the pension fund board must monitor this plan on a monthly basis as a function of its good corporate governance principles.[81] The contents of such a written plan (or contract) should explain the following as required by the OECD:

- the investment objectives of the pension fund;
- the asset allocation proposed by the pension fund;
- the diversification of assets proposed and implemented by the pension fund;
- the liquidity of the pension fund;
- the possible foreign investment exposure;

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involvement with the fund manager and/or employer to know exactly what the numbers are and what the assets are.

81 OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I paragraph 3.7. To know when to change the investment strategy of the fund; OECD Guidelines on Pension Fund Asset Management (200, working paper) Annex II paragraph 3, which explains a written policy in more detail; OECD Good Practices for Pension Funds' Risk Management Systems (2011) 10.

- the valuation methods to be used;
- how derivatives will be monitored by the fund manager;
- targets for asset liability matching targets to be achieved by the fund manager;
- performance management and reporting to the pension fund board;
- the control procedures implemented by the fund and fund manager;
- how the fund manager should report to the pension fund board; and
- how the fund manager should approach leverage for a pension fund.

4.15 A closed/transfer fund

Section 13A(4) of the Pension Funds Act creates an opportunity for pension funds to discontinue monthly contributions ,such as contributions paid by employees.[82] This is possible in the event that the fund rules make provision for contributions to be discontinued for a fixed term or the rules are amended by a resolution of the board to implement a discontinuation of contributions for a fixed term. The obligation to contribute is unaffected prior to the date of implementation of the resolution. It is also possible to reduce the monthly contributions by changing the rules of the fund by means of a resolution,

82 Pension Funds Act 1956 ss 13B(8)(a-c), 13B(9) and 13B(10). An employer may include a close corporation or a company, and the members of such a close corporation or the directors of such a company are personally liable to make the contributions available to the fund. If the fund is the result of a friendly society which is not a company, every person/trustee who manages the society is personally liable to make available the contributions to the fund. In the event of a trust, every trustee who manages the trust is personally liable as well. The board of a fund must request the identity of all directors of an employer in order to keep them personally liable for any unpaid employee contributions. The board of a fund must report any contributions not paid (or the unclear identity details of a director) to the Prudential Authority.

which is effective only on that date. In company law, a special resolution is required to change the memorandum of incorporation that constitutes the rules of the fund. According to the Pension Funds Act, a simple majority vote is required to amend the fund rules. Section 7D requires that minutes of resolutions be properly kept and that any future changes be evidenced by the minutes. In the event that a provisional fund is not registered as a final fund or an employer has closed down the business making future contributions impossible, the Prudential Authority can transfer the assets of a provisional or final fund to another pension fund for purposes of control. The transfer is invalid unless:[83]

- an actuarial or valuer statement has been submitted to the Prudential Authority; if not, the Prudential Authority may require any other special report from a valuer;
- the scheme is reasonable and equitable pertaining to the benefit expectations or additional payments of benefits or payments of minimum benefits in future;
- the proposed transfer would not cause a fund to be financially unsound or unable to meet the requirements of the Pension Funds Act, or if the fund is financially unsound, to obtain a condition from the Prudential Authority for compliance purposes before the transfer can occur;
- the rules of the individual funds before and after transfer are carried out; and

83 Ss 14(1)(a-e) and 14(5) the Prudential Authority may request any information relevant to the transfer or amalgamation, which must be submitted within 180 days. If not, the proposed transfer/amalgamation lapses. S 14(1)(a-e) is not relevant when ss 14(8)(a-b) and 14(9) are relevant, for example, when contributors were duly informed of the transfer and any objection to the transfer has been successfully resolved by the board of the fund or the Prudential Authority gives an exemption as regulated in s 14(1).

- the Prudential Authority issues a certificate to each principal executive officer. The certificate confirms that the transfer requirements were met.

The Pension Funds Act does not provide any guidelines for cases where there is no pension fund board; in other words, where there are no board members to control the fund, and what should happen in such circumstances is unclear. It is of great concern to the South African economy when funds have no boards. It is, however, unclear whether a duty rests on a fund manager to inform the Prudential Authority that, for example, an employer has closed down or closed down as a result of liquidation and that the 'fund' still exists but without any board members. Generally, a fund may be transferred to another fund in the event. However, the Prudential Authority may withdraw the certificate in the event of a *bona fide* error evident in the valuation of the fund and, in such circumstances, transfer the fund to another fund.[84] In addition, if an agent or middleman has effected, facilitated or recommended an amalgamation between two or more funds, the agent may not ask any fee or commission or monetary value of any nature whatsoever for his

84 S 14(6)(a-c); See also s 14(1)(a-e) a fund may amalgamate with either another fund or an unregistered fund. The new fund created by the amalgamation is referred to as a 'resultant body' in terms of s 14(2)(a-c). The 'resultant body' is a combination of all the assets or, as the case may be, a portion of the assets, and it must be financially sound in future. A resultant body is valid only in the event that the Prudential Authority issued a certificate within 60 days after the date of amalgamation. Assets include liabilities and the 'assets' can either be increased or decreased and must be communicated to the Prudential Authority from the date of transfer and/or date of final settlement. The deeds office, using the services of a conveyancer, must endorse/amend any title deed in the name of the 'resultant body' and the officer in charge at the deeds office may not ask any registration fees or stamp duty, etc. A creditor of an individual fund remains a creditor of the 'resultant body' as regulated in s 14(4*);* OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 3.1.

assistance or advice.[85] Further, the employer's actuarial surplus account may be transferred to another fund if the following conditions are met: the employer remains in control of the surplus once transferred; employees are contributors to the new fund and retirees enjoy similar benefits; and the Prudential Authority approves the transfer. However, the Prudential Authority will approve such transfers only if they comply with the principle of fairness or equity.[86] Clearly, these prescriptions are not relevant where a business has closed down and a 'fund' still exists without any board members.

How then should such funds be transferred? The OECD states that the Prudential Authority should always consider the profitability of the fund, the liquidity of the fund, the risk management principles and the relevant prudential principles. In terms of the prudential principles, the Prudential Authority must communicate to the contributors to such a fund the possibility of dissolving the fund and make recommendations for transferring the benefits to the contributors.[87]

4.16 Payment of contributions and minimum benefits

The payment date for contributions is generally regulated by the rules of the fund. For example, it might be the first day of each month. In the event of the payment of late contributions to the fund's bank account, the fund may use an interest rate to calculate a 'top-up contribution' fee. Why an interest rate fee applies is unclear since a member is not in principle affected by any

85 S 14(7(b).

86 Ss 15E(2)(a-d) and 15F(1-3).

87 OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex 1 paragraph 1.1; SAICA 'Avoid pension fund fraud' (2009) *Enterprise Risk* 34.

late payments unless the bank account is one where interest is payable on the actual contributions received. In the event of the loss of such an interest rate, a prescribed interest rate will equal the difference but this applies only to contributions paid into the fund's bank account. An interest rate may also apply in the event that contributions are transferred from one fund to a fund manager within a specified period.[88] If fund managers receive late contributions, generally no late payment fees apply. It is possible that the fund manager will, in the event of non-payment, require payment for two months in the following month.

Any registered pension fund must provide the following minimum benefits:

- A contributor who ceases to contribute to the fund as a result of resignation is entitled to benefits not less than the minimum individual reserve.
- If the fund is liquidated the contributor is entitled to the minimum individual reserve.
- If a fund is changed from a benefit category to a defined contribution category, the amount to be credited to the contributor must not be less than the minimum individual reserve.
- At least once every three years, benefits must increase in value and must be paid to the pensioners or deferred pensioners of the fund, keeping in mind that the increase should not be less than the minimum pension increase on the first contribution benefit payment date.[89]

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88 Pension Funds Act 1956 s13A(7)(a-c) ; Y Dukander 'Who looks after your pension funds?' (2012) *HR Future* 22.

89 Pension Funds Act 1956 ss 14A(1)(a-d) and 14B(3)(A)(ii) comparison pension/benefit increases at least once every three years; See also s 14B for how to calculate the member's minimum individual reserve, for example MC + EC –X + IC + OC = minimum individual reserve. MC is the amount of contributions paid, EC the contributions paid by the employer, X the

Before the board takes a decision to liquidate a fund and, as a result, monthly benefit payments are decreased, a retiree or contributor may not approach a court of law to redress the future allocation of monthly benefits or to appoint new board members.[90]

Irrespective of what is stated in the fund rules, former contributors and current contributors (whether they are entitled or not to receive an additional benefit in future) may not participate in the employer surplus account unless the employer gives permission to the fund board.[91] In addition, contributors who have left a fund must receive 'credit' pertaining to the contributor surplus account or investment reserve account, as the board deems appropriate, or alternative benefits in the event that the board is unable to calculate a reasonable benefit relevant to the contributor surplus account or investment reserve account.[92]

If there is a credit balance in a contributor's fund or in the employer surplus account, and after an actuarial valuation the fund is less profitable than was

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expenses according to the Board, IC the credit due to amalgamation or change of the category of the fund from benefit to defined contribution as a credit note, and OC any amounts lawfully debited or credited from the contributor's individual account. See s 37D(1-6) for relevant deductions such as income tax, default in the repayment of a loan that was granted, divorce maintenance orders, etc.

90 S 14A(2-3). Or to terminate the participation of an employer in a fund, as an additional example. S14A(2) refers to a commencement date but this is not discussed since it relates to the enforcement or commencement of the Pension Funds Second Amendment Act 2001; RWD Davis and S Kendal 'Surplus? What surplus? Did the pension funds second amendment Act achieve its aims?' (2012) *South African Actuarial Journal* 55.

91 Pension Funds Act 1956 s 15G(2).

92 S 15G(1).

estimated before the valuation, the credit balance must be reduced to reflect the deficit or difference in valuation. The only requirement is that the credit balance must not be reduced in excess of the deficit.[93]

The investment reserve account, member surplus account and employer surplus account must be applied in the following order of priority in the event of the liquidation of a fund:[94]

- All credit balances in the above accounts may be used to secure the contributors' rights to receive a reasonable benefit payment in future as a result of the distribution of the money in the fund.
- Any remaining surplus in any account must also be used to benefit the contributors or former contributors (retirees) of the fund.
- Any remaining balance/credit balance in the employer surplus account must be used to pay the employer unless the employer is liquidated. If the employer is liquidated before the fund is liquidated, the money in the fund must be used to meet any deductions from the contributors' salaries, such as deductions that have not been paid to the fund previously, to pay any outstanding employer contributions not paid to the fund and/or distribute the surplus to the contributors at the date of the liquidation of the fund, as well as to former contributors.

It is of interest that the employer surplus account may be used to prevent job losses or to prevent retrenchments. The Prudential Authority must grant permission for this and subsequently any credit/surplus in the employer surplus account may be used to pay a certain amount of money to the employees

93 Pension Funds Act 1956 s 15H(1-2). If the deficit exceeds the credit balance, then the balance must be reduced to zero only; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 5.1. Such a report/valuation must be very transparent.

94 Pension Funds Act 1956 s 15I(a-c); L Mohale 'Deductions made from employees' pension fund benefits' (2010) *Without Prejudice* 46.

at risk of retrenchment to keep them employed.[95] Certain requirements are relevant to this process. For example, 75% of the employees must vote in favour of such a decision to be taken by the board of the fund, the employees should have a reasonable opportunity to consider the proposal, and more than 10% of the employees must be subject to retrenchment.[96] The OECD suggests that 'surpluses' or 'valuations' must be explained in simple terms to allow the employees an opportunity to understand the above in practice.

4.17 Special tribunal

The board of a fund may request that a special tribunal be established to apply the provisions of section 15B of the Pension Funds Act in practice. The purpose of the tribunal is to consider the value of the actuarial surplus account with or without focusing on the provisions of section 15B of Act. In this regard, the tribunal may consider the valuation of the fund as it was

95 Pension Funds Act 1956 s 15J(1-3)(a-d).

96 See in general, Author Unknown 'Gordhan signals pension pot offer for Eskom will be considered' *Moneyweb* https://bit.ly/3DM1Yy8 (accessed 15 October 2021). This article reports that Eskom is considering using pension fund money to prevent job losses and to keep employees employed. Eskom is in such financial trouble purely because of poor financial management, resulting in employees having to fund the future of this state enterprise an keep themselves employed. Accordingly, the Pension Funds Act should be amended to prevent poor management on the part of state enterprises from leading to pension fund money being used to keep employees employed. The government has known since 2005 that the Eskom board was unable to maintain the state-owned enterprise in a financially sound condition and should have taken appropriate steps to prevent fund money from being used for this purpose.

on the date of the surplus apportionment.[97] The tribunal must subsequently take reasonable measures to inform all affected parties of the determination relevant to the surplus apportionment and must resolve any objections/ complaints in this regard fairly.[98] The tribunal may require the services of an additional actuary to calculate the apportionment surplus on that specific date to know the actual value of the surplus.[99] Should the surplus be nil, it is highly likely that the board will request the tribunal to investigate the actuarial valuation of the fund.[100]

The tribunal consists of at least one actuary, at least one lawyer, and at least two persons who have knowledge of pension fund financing, such as fund managers. The fund must recommend these people to the Prudential Authority, which must then make a final decision relevant to their employment.[101] At least two-thirds of the tribunal should comprise a quorum and the tribunal must appoint a chairman. In addition to the need for a quorum, at least two-thirds must agree to an appropriate determination/ judgement before issuing the determination to the complainant. Further, the board of the fund must submit a statutory actuarial valuation report,

97 Pension Funds Act 1956 s 15K(1)(c); See in general M Lukhaimane 'Pensions tribunal, still a force to be reckoned with' (2018) *Money Marketing* 10.

98 S 15K(6C)(a).

99 S 15K(6C)(c-d).

100 S 16; The fund must be valued by an actuary every three years. A copy of the valuation certificate must be sent to every employer who participates in the fund.

101 Pension Funds Act 1956 ss 15K(2)(a-c) and 15K(3-6). The Prudential Authority may also appoint replacement persons in the event of the death or incapacitation of a tribunal member.

the surplus apportionment date of the fund and any other valuation/report necessary to make any tribunal determination.[102]

Where the tribunal issues a determination in terms of section 15B, the determination must be made available to the complainant within a prescribed period.[103]

The tribunal may follow certain procedures for resolving a dispute between the parties. For example, legal representation may be allowed and any person may be afforded the right to attend the hearing.[104] The chairman of the tribunal may also issue summons to any person to present material information to the tribunal, or to produce a book or document, etc. The chairman will also administer an oath to witnesses.[105]

4.18 Fund investigations

A fund must be investigated by an actuary every three years and the valuation report must be submitted to the Prudential Authority within 12 months from the date on which the fund's financial year ends.[106] If a fund was registered

102 S 15K(6A)(a-c).

103 S 15B(3).

104 S 15K(7).

105 Ss 15K(8-9)(a-d) and 15k(10). A summons will be served in the same manner as a civil court issues summons. The fund must keep a proper record of the tribunal procedures in either electronic format or hard copy.

106 Pension Funds Act 1956 s 16(1); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 18. The Prudential Authority may request 'dummy trades' from the fund to see how investments in asset categories operate. The pension fund may also request a 'dummy trade' from the fund manager; P Caims 'Does Regulation 28 make sense?' (2015) *Personal Finance* 1.

before the implementation of section 16 of the Financial Institutions Amendment Act 1984, the first valuation report must be submitted after the fifth financial year. This is required if the fund was previously investigated. In the event that the fund was not previously investigated, a report must be submitted to the Prudential Authority from the date of the fund's third financial year.[107] Should the Prudential Authority believe that a fund is not financially sound, it may request the fund to be investigated irrespective of whether it had previously been investigated or not and irrespective of the financial year.[108] In addition, the board must give an actuarial report to the Prudential Authority confirming the correctness/reliability of the report.[109]

The payment of benefits to retirees depends on actuarial valuations/ calculations. If the rules of the fund specify that the amount of benefit payments is subject to the board's discretion, the Prudential Authority may investigate the fund and may make recommendations to the board. In addition, a member of the board may approach the Prudential Authority with an instruction to investigate benefit payments.[110] In the event that the actuarial value of the fund is remarkably less in value than the fund's value as disclosed in the financial statements, in other words, if there is no level of similarity between the actuarial report and the financial statements, the Prudential

107 S 16(2-3A).

108 S 16(5). With regard to a fund in terms of s 18, the Prudential Authority may request an investigation to be carried out not based on financial soundness but because the fund is not complying or is unlikely to attain its objects as regulated by this section. In addition, this may relate to Regulation 28.

109 S 16(8).

110 S 16(6)(a-b); See C Kloppers 'The difficulty in predicting optimal Regulation 28 compliant portfolios: Explained with the benefit of perfect hindsight' (2019) *Financial Markets Journal* https://bit.ly/3SVm3Gp (accessed 15 October 2020). Concerning the type of software used by fund managers for valuation purposes.

Authority will generally investigate without giving prior instructions to the fund.[111] For the purposes of gathering reliable fund information the OECD requires that appropriate actuarial valuation methods and assumptions be used in calculating the value of the fund.

4.19 Financially sound condition

The financial soundness of a fund is largely regulated by Regulation 28 – the proportion of assets to be invested in equities. If a fund uses only equities (or listed shares) and the listed share price decreases, the fund is technically in a poor financial state. The money invested in equities and their return on investment (in the form of dividends) is generally used to calculate any increases in benefit payments. If the dividends received, for example, are less than the benefit payments, the fund is technically insolvent, excluding the monthly contributions.[112] Thus, in terms of Regulation 28, the proportion of shares that decreased in value should not in principle affect the liquidity of the fund, as the spread of assets in different categories helps to limit those shares that are performing poorly. The Prudential Authority may issue additional guidelines for calculating the liquidity or financial soundness of a fund and for how to avoid stock market failures. However, any decrease in assets requires a financial scheme/plan to be submitted to the Prudential Authority indicating how the decrease in the fund will be rectified in future.[113] The Prudential Authority may subsequently reject

111 S 16(9)(a-b); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 5.

112 Pension Funds Act 1956 s 18(1).

113 S 18(1A-2); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 18. A 'dummy trade' can be used to illustrate how the deficit will be rectified in future.

the scheme and/or amend the scheme until it is satisfied with it.[114] If the implemented scheme cannot change the financial soundness of the fund, the Prudential Authority may withdraw its approval and the board of the fund must within three months submit a new scheme.[115] If the fund returns to a position of financial soundness, the obligations to adhere to the scheme will be terminated immediately. However, the Prudential Authority may subsequently investigate the financial soundness of the fund at any time.[116]

4.20 Business rescue

Business rescue applies to funds and/or fund managers and/or insurers acting as fund 'administrators'. If the fund is a registered company or is an unregistered company – a body corporate - Chapter 6 of the Companies Act will apply *mutatis mutandi* to body corporates and companies and to section 18A of the Pension Funds Act. This application of the provisions of the Companies Act to a fund that is not a registered company is unique.[117] Business rescue should therefore be in the interests of the contributors

114 S 18(3); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 19 indicates what information the Prudential Authority may request from the fund - for example minutes of board meetings, how an audit of internal processes was selected by the fund, and what accounting procedures were followed.

115 S 18(4)(a-c).

116 S 18(5)(a-c). The investigation is funded by the fund; M van der Merwe 'Regulator: Amend retirement fund rules urgently to curb coronavirus impact on pensions' *Fin24* https://bit.ly/3gUZLYa (accessed 13 November 2020). This article maintains that pension funds should amend their rules to take note of fund liquidity and directions should be given to fund managers on how to invest in equities, etc. to spread the risk to prevent a total market collapse.

117 Pension Funds Act 1956 s 18A(1).

and/or in the interests of retirees entitled to benefit payments in future. A pension fund or fund manager cannot unilaterally apply for business rescue; the Prudential Authority must give its permission this to be done. Similarly, when an individual applies for business rescue on behalf of a fund or a fund manager, the application can never be an unopposed motion since the Prudential Authority must be informed of the application and be joined as a respondent stating an opinion as to why the application is (or is not) in the interests of the fund or fund manager. The Prudential Authority must, in addition, approve the business rescue practitioner, the business rescue plan and the managerial power to be exercised by the business rescue practitioner.[118] Where the Companies Act refers to creditors, the creditors are actually the contributors to or the retirees of a fund – and there may be thousands of them. When a business rescue practitioner is appointed, no new benefits may be paid unless a court directs the practitioner otherwise.[119]

4.21 Investments

Besides Regulation 28, assets in excess of 5% of their value in a specific asset category may be invested in the employer – for example, in a subsidiary company of the employer or a holding company of the employer. This is evidence of a company–shareholder relationship. Therefore, irrespective of the relationship between an employer and a group of enterprises or companies, it is possible to invest in the employer's business.[120] If the Prudential Authority consents and issues additional relevant conditions, it is

118 Ss 18A(2) and 18A(5). Unless the Prudential Authority abides by an unopposed motion resulting from the circumstances explained in the applicant's affidavit.

119 S 18A(6).

120 Pension Funds Act 1956 s 19(4); C Kloppers 'The difficulty in predicting optimal Regulation 28 compliant portfolios: Explained with the benefit of

possible to invest no more than 10% of the asset value of the employer in the employer's business. However, the Prudential Authority must be shown that the board has consulted with retirees and contributors of the fund and they are in favour of such a loan to or investment in the employer.[121]

In addition, the directors and officers of the subsidiary company and the members and officers of the holding company that authorised or permitted the investment are considered parties to the transaction and are personally liable to the subsidiary or holding company for any damages in the event the investment is unreasonable for either the subsidiary or the holding company. For example, the investment may be contrary to the business interests of the subsidiary and as a result the subsidiary may suffer financial losses.[2]

A fund, if so permitted by the fund's rules, may give a loan to a contributor or retiree or give a guarantee in favour of a retiree or contributor to allow these persons to erect immovable properties on vacant plots or to make additions/ alterations to existing immovable properties where the property belongs either to them or their spouses. It is also possible to use the investments to redeem a previous loan issued by the fund.[122] However, a mortgage should be registered in the title deeds in favour of the fund. Thus, in the event of the non-payment of the loan the fund can always sell the immovable property. If it is a loan only, the fund may enter into a pledge agreement to allow the fund

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perfect hindsight' (2019) *Financial Markets Journal* https://bit.ly/3gXQXAT (accessed 15 October 2020).

121 S 19(4A).

122 S 19(5)(a)(i-iii). Ownership of an immovable property could be obtained in terms of private law - for example, through occupation or through customary law. It is also possible to make use of the investments to acquire ownership of immovable property by means of a loan; See s 37D deductions to be made from a benefit, i.e., loans, guarantees and divorce decrees/maintenance orders.

to use the benefits of the contributor or retiree in the event of non-payment of the loan. It is also possible for an independent third person to grant a loan to either a retiree or a contributor, and the fund must secure payment by issuing a guarantee to this person.[123] In the event of non-payment, the fund may use the benefits (of a retiree) or the investments (of a contributor) to repay the guarantee.

A guarantee shall not be in excess of 90% of the fair value of the immovable property. In terms of a loan, the loan should equal the lesser amount of the lowest payable benefit – should the contributor cancel his monthly contributions – and the fair value of the immovable property is part of this consideration. With regard to both a mortgage and a pledge, the lesser amount of 90% of the fair value of the immovable property and the lowest benefit amount in the aggregate applies in the event of cancellation. It is possible to increase the 90% mortgage to 100%, but an additional contract of guarantee would be required between the fund and the contributor.[124] See Tables 4.1, 4.2 and 4.3 for examples.

123 S 19(5)(b)(i-iv).

124 S 19(5)(c-e). Immovable property has reference to the definition in the Upgrading of Land Tenure Rights Act 112 of 1991 (for example, hypothecated property), and s 19(5A)(a-b) 'Where a transaction for the purchase of an immovable property is pending and a purchase price has already been agreed upon, or where such an immovable property was acquired by purchase not more than six months before the date on which the estimate is made, the fair value of the property *shall not be fixed* at an amount higher than the true purchase price of the property, as declared or to be declared by the parties concerned for transfer duty purposes' and (b) 'where a transaction for the erection of, or additions or alterations to, or to maintain or repair a residence is contemplated, the estimate of the fair value of the immovable property shall not be fixed at an *amount higher than the fair value* contemplated in paragraph (*a*) plus an amount equal to the cost of such erection, additions, alterations, maintenance or repairs, as

Table 4.1: Guarantee for immovable property only

Immovable property	Value	90% value	Guarantee to give for repayment and maximum loan
House	R100 000	R90 000	R90 000

Table 4.2: Pledge to obtain a loan only – lesser amount of fair value and lowest payable benefit

Minimum projected value of contributions on date of cancellation	Maximum projected value of contributions on date of cancellation	Fair value of the immovable property	Loan to be obtained
R45 000	R60 000	R90 000	R45 000

Table 4.3: Both guarantee and pledge for immovable property – maximum loan amount

Immovable property	Minimum projected value of contributor on date of cancellation	Maximum projected value of contributor on date of cancellation	Maximum loan	Aggregate of guarantee and pledge
R50 000 x 0.90	R45 000	R60 000	R45 000	R45 000 + R45 000

Only a loan/guarantee to obtain immovable property or to make alterations/improvements to immovable properties may be obtained from the fund. No other loans or guarantees may be made to a contributor to a fund – for example, to purchase gold as a property. The issuing of loans or guarantees is simply to secure the loan amount in the event of non-payment. For example, the fund can always sell the immovable property to obtain money for the fund, since immovable property does not (always) depreciate in value. In addition, a loan may not be granted to obtain shares in a company controlled by a member of the fund or if an employee represents the employer to obtain shares in that

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the case may be'; OECD Guidelines on Pension Fund Asset Management (2006, working paper) Annex I para 5.5.

company. This is simply to avoid conflict of interest.[125] However, one fund may invest in another fund, even if the employer is not a participant in that fund.[126] A fund may not purchase shares in another company as a method of controlling that company in future (being the majority shareholder) unless the Prudential Authority has given permission for such a transaction.[127]

4.22 Prudential Authority may interfere in the control of a fund

It is difficult to understand when the Prudential Authority will interfere in the control of a fund or interfere in the decisions of the fund board. Section 26 does not make provision for an application by a contributor to ask for interference. All that section 26 provides is that the Prudential Authority may interfere, not 'must' interfere. The Prudential Authority will not interfere in the asset al location of the fund (unless the maximum investment is exceeded) or in the likely event that a category is contrary to good investment principles. The 'other classes' may be linked to investments contrary to good investment principles, for example, high-risk instruments such as derivatives. How the Prudential Authority will know this is unclear. Maybe they will do so by focusing on annual financial reports or valuator reports, since the 'other classes' are not always clear. Generally, for marketing purposes the fund

125 Pension Funds Act 1956 s 15(5B)(b); OECD Survey of Large Pension Funds and Public Reserve Funds (2019) 37, 42,44. A Swiss fund may have loans in the energy sector, the transportation sector and social infrastructure. There is no definition of what a social infrastructure investment entails. It could include microfinance as in the case of Switzerland; G Gondo 'Should pension funds be financing infrastructure in Africa?' (2018) *Development Finance Agenda* 10.

126 S 15(5C).

127 S 15(5D)(a-b).

manager uses gold as an example to explain other classes in its brochures. A valuator will not give specifics pertaining to the rights and duties of individual contributors; it merely gives an opinion on the overall performance of the assets of a fund. It could be that the Prudential Authority will read the rules of the fund to establish whether an irregularity in the investment practices or method of conducting business of the fund has occurred. The Prudential Authority may give guidelines to the board or fund manager/administrator on how to prevent the irregularity in future or direct that the rules of the fund be amended. While a section 25 Prudential Authority visit may produce evidence of irregularities, the Prudential Authority will have to ask specific questions to pick up an irregularity. A quick on-site visit will simply serve to pose questions relevant to compliance with the Pension Funds Act in order to prevent non-compliance in future.[128]

4.23 Removal of a board member

Generally, the rules of the fund will stipulate the process for removing a board member or for disqualifying a board member from acting as such. In addition, the Prudential Authority may remove a member on the basis that the member is no longer fit to hold that office. The Prudential Authority may also appoint a temporary member to serve as a board member. It may also request the board to amend its rules to accommodate board member removals and disqualifications.[129] If the fund is a registered company, the Companies Act 2008 imposes additional disqualification criteria for directors

128 Pension Funds Act 1956 s 26(2)(a-b) – if the fund has not appointed an appropriate board after written notice provided by the Prudential Authority, the Prudential Authority may appoint a board on behalf of the fund. After appointing a board, the Prudential Authority may give each board member a specific management duty.

129 S 26(3-5).

and it is possible to approach the Companies Tribunal to have board members removed.

4.24 Deregistration and dissolution (liquidation) of the fund

The Prudential Authority may deregister a fund if the fund ceases to exist. What precisely is meant by these words is unclear. A fund can exist without a board – for example, when a fund manager still manages the assets in a situation where the employer who registered the fund is no longer in business and can no longer appoint pension fund board members, or the rules of the fund do not make provision for electing future members in this regard.[130] In these circumstances a contributor is entitled to receive benefits from the fund unless it has merged with another employer and the fund has been moved to a combined fund that will pay benefits in the aggregate at a future date. In the event of there being no employer or board members, what must happen to those assets that are not combined? Is there a duty on a fund manager to inform the Prudential Authority? The Pensions Fund Act states that the Prudential Authority may apply for a court order, although this is not a requirement.

Recently, the previous Financial Services Board (FSB) instructed Liberty Insurance to act as a 'fund manager' for all funds that did not have any pension board members. This caused a controversy in the media, which felt that Liberty and the FSB had acted unscrupulously by allocating all these funds to Liberty only. To circumvent such negativity, it is suggested that the FSB should instead have applied for a court order to move the ceased funds (approximately 4 600 funds) not to Liberty alone but to other insurers as well. Moreover, the FSB did not issue any guidelines to Liberty for the appropriate processes and procedures that had to be followed in contacting

130 S 27(1)(a-b).

previous contributors or even retirees who were unaware of any existing benefits.[131] Further, the FSB did not ask any fund managers any questions as to why they had not previously disclosed the status of these 4 600 funds to the FSB. In our opinion, should a pension (without any board members) be managed by a fund manager without informing the FSB of the status of the fund, this amounts to fraud.

A fund can be dissolved in whole or partially. If a partial dissolution is relevant, the rules of the fund will play a predominant role. In this regard, the rules to be accepted by the Prudential Authority when a fund is to be registered must specifically refer to dissolution – in part or in whole. If a fund is to be dissolved, section 28 requires the services of a liquidator to distribute the assets of the fund appropriately to the contributors and/or other retirees.[132] According to the Pension Funds Act, the moment the Prudential Authority dissolves the fund and approves a liquidator, that is for all practical purposes the date upon which the liquidation process has started. This section 28 is probably contrary to business rescue, and the circumstances under which a fund should be dissolved are unclear. For example, a decrease in listed share prices indicates a technical insolvency, as discussed earlier. Why the FSB did not dissolve the ceased 4 600 funds via liquidation instead of moving them to Liberty Insurance as discussed in the previous paragraph remains unclear.[133] However, as soon as a liquidator is appointed, it must submit a signed statement of the affairs of the fund, for example, of the liabilities and

131 Author Unknown 'Liberty's conduct called into question in pension fund dispute' *Moneyweb* https://bit.ly/3Wfq1wA (accessed 21 February 2020); Author Unknown 'Understanding unclaimed benefits' https://bit.ly/3WgccOx (accessed 10 January 2020); SAICA 'Avoid pension fund fraud (2009) *Enterprise Risk* 34.

132 Pension Funds Act 1956 s 28(1-2).

133 S 28(2-3); OECD Good Practices for Pension Funds' Risk Management Systems (2011) 8.

assets of the fund. In this regard, there is a reasonable expectation that the 'creditors' of the fund, particularly the contributors and/or retirees, should receive a benefit and/or minimum prescribed benefits.[134] It could be argued that the FSB did not want to act as custodian of unclaimed benefits of a ceased fund because it was not in the business of administering funds.[135] Ssections 18 and 29 regulate the winding up of a fund on the basis of insolvency (based on the financial soundness of the fund only) by making an application to the court. Creditors may also apply to wind up a fund but they must be able to provide security to effect the application for liquidation.[136] Once the winding up is completed under these circumstances, the Prudential Authority will cancel the fund.[137]

4.25 Adjudication of complaints

In the event of a dispute with a fund, irrespective of what the rules state, the Pension Fund Adjudicator has jurisdiction to hear the matter without any form of legal representation. However, this is so only if the complaint has first been submitted to the board of the fund for consideration. Only when the complainant is not satisfied with the reply from the fund or no reply has been received may the complainant approach the Adjudicator for

134 S 28(4). In subsection 5 the statement of affairs could be a valuator's report.

135 Ss 28(12A)(b) and 28(A); the Prudential Authority may prescribe the remuneration to which a liquidator is entitled that is not the fee regulated by the Insolvency Act 24 of 1936.

136 S 29(1).

137 Ss 29(8) and 29(A) liquidation of an unregistered fund is regulated in terms of the Insolvency Act 24 of 1936, the Companies Act 71 of 2008 and the Close Corporations Act 68 of 1984, among others. In this regard, the court must appoint a liquidator to oversee the liquidation process; S 30 regulates the distribution of funds.

a decision.[138] The decision is a civil order and is similar to any order a court of law may make.[139] The parties to a complaint include the complainant, the fund, or any person attached to the fund, or the fund manager/administrator and any application made to the Adjudicator to join a person as a party to the complaint or any other person who, in the opinion of the Adjudicator, should be joined to the dispute.[140] A dispute excludes the actuarial surplus and decisions of the board relating to it or any decisions of a special tribunal, even if the decisions are correct from a legal perspective. The Adjudicator may decide on any procedure for resolving a complaint and even an inquisitorial procedure may be followed.[141] After conducting the investigation, the Adjudicator will decide, which is similar to a judgment in a court of law.[142] A party may appeal the determination in any high court of South Africa to have the decision reconsidered.

4.26 Penalties and directives are not subject to review

Any person (legal or natural person) who does not register a fund as a pension fund, or any employer that neglects to pay contributions to a fund (a director

138 Pension Funds Act 1956 s 30A(1-4).

139 S 30E(1-3). It is also possible to refer the complainant (office of the Adjudicator) to another organisation approved by the Prudential Authority to resolve the dispute. If unsuccessful, the complainant may approach the Adjudicator.

140 The prescriptions of ss 30G(a-d), 30H and 30I are relevant to a complaint and in the event of civil litigation the adjudication process is stopped.

141 S 30J.

142 Ss 30L to 30P. For offence see s 30V. For example, poor behaviour on the part of the complainant could lead to an offence with either a fine or imprisonment or both – a maximum fine of R1 million and imprisonment for one year.

is personally liable to ensure that an employer will effect payment on time) or administers a fund as a fund manager without obtaining the approval of the Prudential Authority, or who uses the phrase 'pension fund' in the name of the business unless it is registered as a fund is liable to a R10 million fine and/or a maximum term of imprisonment of 10 years.[143] This also applies in the event that the Prudential Authority requests information and the board of the fund does not disclose the information requested. The non-disclosure and administrative penalty in section 37(2) overlap to a certain extent. If the Prudential Authority requests information and the person fails to provide the necessary information, the Prudential Authority may issue an administrative penalty. It seems the Prudential Authority has a discretion in this regard, since not providing any requested material could easily be interpreted as 'intentional' non-compliance subject to imprisonment and/or a R10 million fine.[144] It is possible to appeal to the Tribunal for Financial Services regarding the administrative penalty (and/or contravention of a financial sector law, for example, the Pension Funds Act) in terms of the Promotion of Administrative Justice Act. The Prudential Authority is a decision maker in terms of the Financial Sector Regulation Act 9 of 2017.[145]

After consultation with the Prudential Authority, the Reserve Bank may request the Prudential Authority to issue directives to regulate the actuarial surplus or solvency of the fund with additional guidelines. These directives

143 Pension Funds Act 1956 s 37(1)(a-c).

144 Decisions of the Financial Sector Regulator (Prudential Authority) in terms of s 218 of the Financial Sector Regulation Act do not include the Pension Fund Adjudicator's determinations. Therefore, an adjudicator is not considered a decision maker in terms of the Financial Sector Regulation Act. In this regard, when the decision of an adjudicator is reviewed by a court of law in terms of the Promotion of Administrative Justice Act.

145 Ss37(2) and 37(4) regulates an administrative penalty of R1000 per day for every day there is non-compliance.

are not subject to administrative law and are not decisions in terms of section 30(1) of the Financial Sector Regulation Act. However, the Prudential Authority must follow section 167 of this Act when issuing administrative penalties, etc.[146]

4.27 Benefits may not be pledged, ceded or otherwise

Even if the rules of the fund provide for it, a benefit may not be transferred to another person in terms of a pledge or hypothecated or be subject to a court execution order for arrear debt, unless provision has been made in the Income Tax Act 1962 or the Maintenance Act 1998, or the amount to be pledged or arrear debt or otherwise is less than R3 000 per annum. The contributor's contribution is also excluded from section 65 of the Magistrates' Courts Act 1944, when a court must decide on the financial position of the contributor as a debtor. Section 37A continues that should an expense be deducted from a benefit in terms of section 19 of the Act, for example, where the benefit is used as security in the event of purchasing immovable property or otherwise, the deduction will reduce the benefit and this benefit will, therefore, be recalculated by the board. This includes any set-off. However, set-off is not applicable in the event that the contributor was unable to make any contributions to the fund during a specific period.[147] Even if the contributor is sequestrated and irrespective of any other provision

146 One of the mitigating factors for s 167 to be considered by the Prudential Authority is why a specific section of the Pension Funds Act was contravened and whether the contravention occurred without any fault or mistake. The Pension Funds Act requires directives on how to comply with the Act or additional information for compliance in terms of s 33A.

147 S 37A(3)(d). Deductions do not apply to arrear contributions; L Mohale 'Deductions made from employees' pension fund benefits' (2010) *Without Prejudice* 46.

in insolvency law, the benefits are excluded from the estate of the insolvent person unless they form part of section 19 deductions or have been pledged as stated above.[148]

4.28 Benefits payable on the death of a contributor

A benefit is not part of the estate of a deceased contributor. Section 37C stipulates how such a benefit will be considered in terms of the law. For example, the fund will trace a dependant of the contributor, or a dependant contacts the fund, or the fund becomes aware of a dependant via the employer, a benefit is payable on the basis of equitable considerations, or *pro rata* payments are made to such dependants.[149] If a fund is not aware of the death of a contributor or is, for example, unable to trace any dependants to such a benefit within 12 months after the date of death, the fund will follow the written instructions of the contributor's will to pay a nominee (who is not a dependant) as stipulated above. In this regard, if the estate of the contributor has more liabilities than assets, the benefit payment will be used to supplement the difference and if any surplus remains after the payment, the nominee is entitled to the difference as payment.[150] If the fund cannot trace or allocate any dependants and there is also no written instruction to pay a nominee or the nominee has died, then the benefit will be paid to the

148 Ss 37B and 37D. A benefit may be paid monthly or paid as agreed to by the nominee and the board of the fund, as regulated in s 37C(4-5). Such an agreement does not apply to a beneficiary fund.

149 S 37C(1)(a). A dependant must notify the fund within 12 months of the death of the contributor.

150 S 37C(1)(b); K Lehmann 'Death and dependency: The meaning of 'dependent' under s 37C of the Pension Funds Act 24 of 1956' (2009) *South African Law Journal* 650.

unclaimed benefit fund.[151] If a contributor has a dependant and a nominee has been made beneficiary of the fund (excluding a dependant) and the nominee (who is not a dependant) is entitled to receive a 100% benefit, then the board may use its discretion to established an equitable division of the benefit payment between the nominee and the unlisted dependant.[152] This also applies to a dependant listed as a nominee. Generally, if the written instruction nominates a trust, then for all practical purposes a payment made to a trust is assumed to be a payment made to a nominee and/or dependant of the contributor.[153] When an employee invests in private annuities, the employee must be aware of the differences between a living annuity and a guaranteed annuity. Generally, the guaranteed annuity pays a fixed benefit to the retiree, and in the event of death, the spouse (or any other dependant or nominee) is not entitled to inherit any benefits (or benefit surplus).

If the nominee is a minor, the fund may use its discretion to calculate the stream of payments payable to the minor and how such payments would be effected in their best interests. For example, when the minor reaches majority, the balance of the benefits (stream of payments) as well as the rate of return earned by the fund will be used as indicators to pay the benefit in full to the major as regulated by section 37C(3) of the Pension Funds Act. This also applies when paying a nominee, if any, if the minor dies.

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151 S 37C(1)(c). This is possible only if the contributor's estate has not been registered with the Master of the High Court in terms of s 9 of the Administration of Estates Act 66 of 1965. If the estate is registered, payment will be made to the estate.

152 S 37C(1)(bA).

153 S 37C(2)(a-b). A beneficiary fund must be registered as such in terms of the Pension Funds Act. If the beneficiary is not registered, no benefit payment may be made.

CHAPTER 5

Diligence and (business) human rights

Nicola Jägers & Neels Kilian

5.1 Introduction to (due) diligence

Over the last decade, the notion that companies have a responsibility to respect human rights in their business activities has caught on among human rights advocates, civil society, states and companies. The 2011 UN Guiding Principles on Business and Human Rights (UNGPs) have taken centre stage in this development. According to the UNGPs, corporate responsibility to respect human rights rests on societal expectation rather than hard legal obligations. This concept has found broad acceptance and the corporate responsibility of respect is now considered to constitute a global standard of expected conduct applicable to all businesses. To discharge this responsibility, companies are expected to undertake a process of human rights due diligence, an ongoing management process aimed at meeting their societal responsibility to respect human rights, for example their employees' rights.

More recently, a shift is evident towards a greater role for the law in requiring companies to undertake human rights due diligence. Across Europe there appears to be growing momentum among governments or states to adopt legislation mandating human rights due diligence. France was the first country to adopt such a requirement under its Duty of Vigilance law in 2017. The Netherlands followed suit in 2019 with a due diligence law focused on child labour. Finland announced that it would adopt mandatory human

rights due diligence legislation and promote such an initiative during its presidency of the EU in the second half of 2019. Various other governments are considering similar legislative proposals, including Austria, Switzerland and Luxembourg. Civil society is seizing the opportunity to push for robust legal instruments to mandate corporate respect for human rights, and minority rights for specific races within a state. Moreover, some companies and major investors are speaking out in favour of such legislation.

This chapter discusses how state practice may contribute to the transformation from a voluntary standard for measuring corporate compliance with social expectations into a legally binding normative standard.

5.2 The United Nations Guiding Principles on Business and Human Rights suggests due diligence

From the mid-1990s, due diligence became more prominent in the public discourse, with companies increasingly being required to conduct due diligence procedures beyond the restricted realm of corporate risk assessment, to include issues such as corruption.[1] Over the last decade, the concept of human rights due diligence (HRDD) has risen to prominence as a means to shape better business behaviour with regard to human rights. Currently, companies do not have direct obligations under international law. Increasingly, states are regulating the corporate impact on human rights by demanding HRDD from companies. The concept of HRDD was first introduced by the UNGPs, which was adopted by the Human Rights Council in 2011.[2] These principles suggest human rights due diligence as a way for

1 O Martin-Ortega 'Human rights due diligence for corporations: From voluntary standards to hard law at last' (2014) *NETH. Q. HUM. Rts.* 49-50.

2 UN Office of the High Commissioner for Human Rights (OHCHR) Guiding Principles on Business and Human Rights: Implementing the

companies to operationalise respect for human rights. HRDD refers to the process by which companies can identify, prevent, mitigate and account for the adverse impact of their corporate activities on human rights – to avoid corrupt business practices. Regulatory monitoring bodies and the judiciary may use the concept of HRDD to assess corporate conduct, such as a breach of company privacy. Principle 15 of the UNGPs provides that to meet their responsibility to respect human rights, business enterprises should have in place policies and processes appropriate to their size and circumstances, including the following:

- a policy commitment to meet their responsibility to respect human rights;
- a human rights due diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights; and
- processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute.

Human rights due diligence is further explained in principle 17 as follows: To identify, prevent, mitigate and account for how they address their adverse human rights impacts, business enterprises should carry out HRDD. The process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed.

Human rights due diligence:

- should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships;

Protect, Respect and Remedy Framework HR/PUB/11/04 (2011) https://bit.ly/2Bva4uB (accessed 11 January 2021).

- will vary in complexity with the size of the business enterprise, the risk of severe human rights impacts, and the nature and context of its operations; and
- should be ongoing, recognising that the human rights risks may change over time as the business enterprise's operations and operating context evolve.

According to the commentary on principle 17, human rights risks 'are understood to be the business enterprise's *potential* adverse human rights impacts.'[3] These potential impacts should be addressed through prevention or mitigation whereas actual impacts should be a subject for remediation. This HRDD can be included in broader enterprise risk-management systems. However, as the commentary to UNGP 17 makes clear, the process of HRDD must go beyond simply identifying and managing material risks to the company itself, to include risks to rights-holders. This is where HRDD differs from due diligence as it is known in other areas of law, regulation and governance, such as the due diligence required in the case of mergers and acquisitions.

As McCorquodale and Bonnitcha point out, the term, 'due diligence', as used in the UNGPs, was well chosen to help build consensus, as it is a phrase familiar to business people, lawyers and states.[4] In international human rights law, due diligence is the standard for measuring the compliance of states with their obligation to regulate the conduct of non-state actors. In the traditional corporate governance context, due diligence is a process for managing business risk to the company. Human rights due diligence, however, refers to identifying and addressing the human rights risks to others as a result of

3 Emphasis added.

4 J Bonnitcha and R McCorquodale 'The concept of due diligence in the UN Guiding Principles on Business and Human Rights' (2017) *European Journal of International Law* 899.

corporate activity. Thus, HRDD is a hybrid concept straddling international human rights law and corporate governance. The HRDD in the UNGPs refers both to a process and the standard of care expected of companies to meet their responsibility to respect human rights – not only the rights of their employees but also other companies (business human rights). In its Interpretive Guide on the corporate responsibility to respect human rights, the UN Human Rights Office of the High Commissioner defines HRDD as comprising, 'an ongoing management process that a reasonable and prudent enterprise needs to undertake, in light of its circumstances (including sector, operating context, size and similar factors) to meet its responsibility to respect human rights.'[5]

According to the UNGPs, HRDD applies throughout the value chain. This is a broader concept than the idea of a supply chain as it refers to the entire life cycle of the product or service and includes business partners beyond suppliers.[6] Since their adoption in 2011, the UNGPs – and thus the concept of HRDD – have found wide support. The UN Working Group on the issue of human rights and transnational companies (TNCs) and other business enterprises ('the UN Working Group') has noted that: '[s]ince the endorsement of the Guiding Principles by the Human Rights Council in 2011, corporate human rights due diligence has become a norm of expected conduct.'[7] The UNGPs have been incorporated in various international

5 UN Office of the High Commissioner for Human Rights (OHCHR) The Corporate Responsibility to Respect Human Rights: An Interpretive Guide, HR/PUB/12/02 (2012) https://bit.ly/3U8Fnkx (accessed 1 March 2021).

6 UNGP 13 and its commentary.

7 See in general UN Office of the High Commissioner for Human Rights (OHCHR) (No date) https://bit.ly/3WiSfXe (accessed 14 April 2021).

and regional standards, including the OECD Guidelines.[8] The OECD due diligence responsibilities also apply to the supply chain,[9] and the OECD has produced detailed supply chain due diligence guidance for various sectors, such as conflict minerals,[10] the agricultural sector[11] and the garment and footwear sector. [12]

Moreover, HRDD, described by the architect of the UNGPs, Professor John Ruggie, as the principle of 'do no harm',[13] resonates with national standards, such as, a 'duty of care' in the law of delict (tort) and other similar concepts in civil law. There has been a string of domestic court cases on the question of

8 See in general OECD Guidelines for Multinational Enterprises (2011) foreword; See also the OECD Guidelines for Multinational Enterprises: Responsible Business Conduct Matters (2017) foreword; See also OECD Guidelines for Responsible Business Conduct for Institutional Investors (2017) foreword.

9 See in general OECD Guidelines Commentary on General Policies (2011) 14.

10 See in general OECD Due Diligence Guidance for Responsible Supply Chain of Minerals from Conflict-Affected Areas (2016) foreword.

11 See in general OECD-FAO Guidance for Responsible Agricultural Supply Chains (2016) foreword.

12 See in general OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector (2017) foreword.

13 UN Human Rights Council's Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Companies and other Business Enterprises: Protect, Respect and Remedy, a Framework for Business and Human Rights A/HRC/8/5 (7 April 2008) para 24; UN Human Rights Council's Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Companies and other Business Enterprises: Clarifying the Concepts of Sphere of Influence and Complicity A/HRC/8/16 (15 May 2008) para 3.

whether parent companies owe a duty of care for human rights harm caused by subsidiaries in other parts of the world.

A particularly interesting illustration is the landmark ruling by the court in The Hague in the Netherlands in May 2021.[14] The court ordered oil corporation Shell to drastically cut its greenhouse gas emissions independent from any government action. The court stated that companies have an individual responsibility to combat climate change in their value chains, clearly linking climate change to human rights. According to the court, liability could arise based on a provision of the Dutch Civil Code, according to which a corporation has a duty to prevent harm to others by operating in accordance with the prevailing unwritten standard of care in society. To define this standard of care, the Dutch court drew heavily upon the UNGPs and OECD Guidelines. In other words, according to the court, a corporation, company, or enterprise has an individual legal responsibility to comply with the UNGPs and thus with HRDD.

5.3 State responsibilities

The UNGPs do not provide explicitly for the way in which states should ensure that companies live up to their responsibilities with regard to respecting human rights. Since the adoption of the UNGPs, several countries have started to turn to law mandating human rights and environmental due diligence for companies. A broad spectrum of approaches exists. Some rather modest approaches require reporting or disclosure obligations, while others are more ambitious (e.g., by including a duty of care throughout the global supply chains of the parent company). Some of these laws apply HRDD requirements in general; others target specific risks, such as slavery or child

14 The Hague District Court *Milieudefensie et al. vs Royal Dutch Shell PLC* judgment of 26 May 2021, C/09/571932 / HA ZA 19-379.

labour, and/or other matters. Some apply only to companies of a certain size; others apply to all companies.

As explained, HRDD consists of four elements:

1) Identifying and assessing actual and potential human rights impacts.
2) Integrating and acting on the findings.
3) Tracking the effectiveness of actions taken.
4) Communicating how impacts are addressed.

There have been various regulatory and legislative developments addressing HRDD in full, namely, encompassing all four components of HRDD or with regard to a specific component, such as the requirement to communicate by means of transparency and reporting. The sections that follow discuss a number of these laws.

5.4 Transparency and reporting are essential

Transparency is considered a crucial component of human rights due diligence. As HRDD is based on a societal expectation that stakeholders will mobilise to monitor compliance with this expectation, stakeholders must be aware of any efforts being undertaken by the corporation. The UNGPs thus emphasise the importance of transparency and disclosure.[15] A wave of domestic and regional laws and regulations has appeared where the home states of multinational companies have mandated social and environmental disclosures. These transparency requirements relate mainly to issues such as corporate sustainability, slavery, conflict minerals, revenue transparency and corporate governance.[16] These domestic and regional regulations have

15 See, for example, UNGP 3(d) and 21.

16 See R Mares 'Corporate transparency laws: A hollow victory' (2018) *Neth. Q. Hum. Rts.* 189-213.

extraterritorial effect, as they require companies to report on and disclose practices in their global supply chains.

Early domestic examples of such regulations are the California Supply Chain Act 2010 [17] and the UK Slavery Act 2015.[18] These domestic regulations, as discussed in the two sub-sections that follow, require companies to disclose the presence of human trafficking and slavery in their global supply chains and their efforts to eradicate these practices. The discussion then turns to regional regulation in the European Union regarding non-financial disclosure. None of the regulations addressed are particularly prescriptive nor detailed in their requirements of companies.[19]

5.4.1 California Supply Chains Act 2010

The 2010 California Transparency in Supply Chains Act requires companies to report on their specific actions in eradicating slavery and human trafficking in their supply chains. The Act applies to retailers doing business in California with worldwide sales in excess of $100 million.

17 California Transparency Supply Chain Act 2010.

18 UK Modern Slavery Act 2015.

19 For reasons of restricted space, the discussion is limited to the analysis of the domestic disclosure laws addressing slavery and trafficking as adopted in the UK and California. Note that there are multiple disclosure laws in other countries relating to other fields that are not further discussed here. For example, regarding so-called 'conflict minerals' the US Dodd-Frank Act 2010 – S 150221 – and its 2017 counterpart EU Regulation (No. 2017/821) – aim to cut the link between trade in minerals and conflict by requiring companies to track the source of the minerals used in their products and report if they find minerals from conflict zones. Another example is the 2010 EU Timber Regulation (No. 995/2010) that seeks to impose due diligence obligations in this particularly sensitive sector. These regulations mix due diligence measures (trace) and transparency (report) requirements.

These companies must 'conspicuously' disclose on their website the extent to which they engage due diligence in their supply chains. A company must disclose *inter alia* whether it engages in the verification of product supply chains to evaluate and address the risks of human trafficking and slavery; and must conduct audits of suppliers to evaluate supplier compliance with company standards for trafficking and slavery in supply chains. Moreover, the Act requires disclosure on whether the company gives company employees and management direct responsibility for supply chain management, with training on human trafficking and slavery, particularly with respect to mitigating the risks in the supply chains of products. This information must be disclosed on the website of the corporation/company or provided on request if the company does not have a website. As explained by Mares, the California Supply Chain Act has served as a model for later domestic disclosure regulation targeting modern slavery and trafficking such as the 2015 Modern Slavery Act.[20] The California Transparency Act provides an opt-out provision. It requires companies to disclose to what extent if any. The effectiveness of the California Supply Chain Act has been criticised, however.[21]

20 The UK Slavery Act 2015 subsequently served as a model for the Australian Modern Slavery Act 2018; See R Mares 'Corporate transparency laws: A hollow victory' (2018) *Neth. Q. Hum. Rts.* 189-213.

21 See for example a 2015 report which found that the average disclosure compliance score under the Act was 60%, and the average affirmative conduct score relating to the extent of corporate-driven action was 31%; See California Transparency in Supply Chain Act 2010 and Development International Corporate Compliance with the California Transparency in Supply Chains Act 2010 (2 November 2015) http://media.wix.com/ugd/f0f801_0276d7c94ebe453f8648b91dd35898ba.pdf (accessed 1 May 2021).

5.4.2 UK Slavery Act 2015

Since 2015, the United Kingdom (UK) has had the Modern Slavery Act, which requires companies to report what they are doing to combat slavery in their global supply chains. The Act applies to all companies doing business in the UK, whether or not they are incorporated in the UK. The Modern Slavery Act defines as an offence the holding of a person in slavery or servitude, requiring a person to perform forced or compulsory labour, and arranging for or facilitating the travel of a person with a view to that person's being exploited. Companies with a certain turnover carrying out business or part of a business in the UK are required to prepare an annual 'slavery and human trafficking statement' on the steps the company has taken – if any – to ensure that slavery and human trafficking have not taken place in its supply chains or in its own business. If no steps have been taken, companies are required to report this. The Act does not require companies to undertake a full HRDD process as it is limited to issuing a statement on what steps the company has taken regarding eradicating slavery and human trafficking. Nor does the UK Act prescribe what should be reported in the statement. The Act merely refers to what a statement 'may include'. As is the case of the California Supply Chain Act, the UK Modern Slavery Act allows companies to state that they have taken no steps to address modern slavery in their supply chains. In sum, the UK Slavery Act has a 'disclose or give notice' provision. If the company has a website the 'slavery and human trafficking statement' must be published on this site. If it does not have a website the information must be disclosed by providing a copy of the statement to anyone who makes a written request for one. These duties are enforceable by the Secretary of State's bringing civil proceedings. A failure to comply with a judicial injunction may result in a finding of contempt of court, sanctioned by a fine.

5.4.3 Legislation in other countries

In 2018, Australia introduced its Modern Slavery Act 2018,[22] which was largely modelled on the UK Slavery Act 2015. The Australian Act requires companies carrying out at least part of their business in Australia (and with consolidated revenue over a certain threshold) to report on the steps that they have taken to identify and address the risks of modern slavery. Similar legislation regulating modern slavery in supply chains has been proposed in New Zealand[23] and Hong Kong.[24]

5.5 The European Union and the 2014 EU Non-Financial Reporting Directive

The EU Non-Financial Reporting Directive (NFRD)[25] was approved in 2014 and requires all European Union (EU) Member States to transpose the goals of the NFRD into their national laws. By 2017, all EU Member States had enacted the Directive. According to the Directive, releasing non-financial information 'is vital for managing change towards a sustainable global economy by combining long-term profitability with social justice

22 Modern Slavery Act 2018.

23 The New Zealand Transparency in Supply Chains Bill 2017 https://bit.ly/3DKA0Tf (accessed 1 February 2021).

24 Norton Rose Fulbright 'Modern slavery and human trafficking: A comparative analysis of existing and emerging legislation in the United Kingdom, Australia, Hong Kong and Singapore' (2018) https://bit.ly/3gP317j (accessed 1 February 2021).

25 Council Directive 2014/95/EU of 22 October 2014 amending Council Directive2013/34/EU of 26 June as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L330/1(Council Dir. 2014/95/EU, OJ L330/1).

and environmental protection.'[26] This Directive applies to companies of over 500 employees, which covers approximately 6 000 companies across the EU, including listed companies, banks, insurance companies and other companies designated by national authorities as public-interest entities. The Directive requires these large companies to publish information on so-called 'non-financial issues', including the principle risks of adverse human rights, business or company rights and environmental impacts that are linked to the company's own business operations. Information on policies, outcomes, risks and due diligence processes should also be released.

This EU Directive does not require these companies to undertake due diligence, but rather creates a reporting requirement. Moreover, the directive includes a 'comply or explain' mechanism whereby companies may choose not to report by explaining why they are not reporting. 'Comply or explain' requirements allow flexibility for companies and are well known in corporate governance codes. Such requirements are stricter than the opt-out provision (California Transparency Act) or the mere 'disclose or give notice provision' (UK Slavery Act) but have been criticised in the context of human rights.[27]

It has been concluded that in practice, in the implementation of the EU NFRD, companies have displayed the 'tendency to focus on the materiality to shareholders rather than risks to those affected.'[28] The EU has also evaluated the Directive, reaching the conclusion that the current implementation of the Directive does not result in consistent and standardised information, thus

26 Council Directive 2014/95/EU preamble para 3.

27 For a discussion of these laws see R Mares 'Corporate transparency laws: A hollow victory' (2018) *Neth. Q. Hum. Rts.* 204 and the studies referred to.

28 See C Jeffrey 'Comparing the implementation of the EU non-financial reporting directive in the UK, Germany, France and Italy' (2017) https://bit.ly/3TTVByo (accessed 12 April 2021).

showing weaknesses regarding the comparability, reliability and relevance of the non-financial information provided.[29]

At the time of writing, a process is underway in the European Commission to reform the NFRD. Part of this process is to explore the development of a new EU sustainability reporting standard which will be informed but not constrained by existing international standards.

Making reporting on corporate social responsibility issues mandatory, as is the case with the Non-Financial Reporting Directive, has been seen as a reflection of the increasing departure from voluntary norms towards binding, legal obligations in this field.[30]

5.6 General mandatory human rights due diligence

Since 2017, France has had the *Loi Sur le Devoir de Vigilance des Multinationales*[31] (Duty of Vigilance Law) – a law that establishes a duty of care and a general liability in the field of human rights and the environment for the largest companies in the country. At the time of writing, this is the only legislative example worldwide that imposes a general mandatory due diligence requirement on companies for human rights and environmental impacts.

This law differs from earlier regulation in the field, such as the California Transparency Act and the UK Modern Slavery Act discussed earlier. The

29 European Parliament's Implementation Appraisal Non-Financial Reporting Directive (2021) PE 654.213, 4 and 5.

30 K Buhmann 'Neglecting the proactive aspect of human rights due diligence? A critical appraisal of the EU's non-financial reporting directive as a pillar one avenue for promoting pillar two action' (2018) *Business and Human Rights Journal* 23-45.

31 Duty of Vigilance of Parent and Instructing Companies, France. Law No. 2017-399 (27 March 2017).

French law establishes a duty of due diligence for larger French companies. These companies are required to disclose and implement a so-called vigilance plan that includes reasonable measures to adequately identify risks and prevent serious violations of human rights and the environment. The law not only requires companies to take measures to identify risks in their supply chain and to prevent them; such measures should also be both adequate and effectively implemented. The duty of vigilance applies to certain large French companies (employing more than 5 000 employees in France, or 10 000 globally). The law extends to the activities of French companies' subsidiaries, subcontractors and business enterprises in the supply chain, as long as the company maintains 'an established commercial relationship', which refers to 'a stable, regular commercial relationship, taking place with or without a contract, with a certain volume of business, and under a reasonable expectation that the relationship will last.'[32] The law attaches certain sanctions in case companies fail to adopt the vigilance plan. French courts may oblige the corporation to comply with it and, if a corporation fails to do so after a three-month period, any interested person may file a case before the court. Moreover, where a corporation fails to adopt a vigilance plan and a risk materialises that the plan might have prevented from occurring, the civil liability of the company may be engaged.

The first two legal proceedings based on the French Duty of Vigilance Law were brought against the French oil company, Total. The first case was filed by French and Ugandan organisations with respect to Total's oil projects in Uganda. This case resulted in a decision of lack of jurisdiction in January 2020. According to the court, the duty of vigilance has a direct link to management and, therefore, belongs in the commercial court.

32 S Cossart, J Chaplier and T Beau de Lomenie 'The French law on duty of care: A historic step towards making globalization work for all' (2017) *Business and Human Rights Journal* 320.

In the second case against Total, the claimants argued that the company or corporation was a major contributor to climate change and the measures taken by the company to prevent the resulting human rights, health and safety, and environmental damage were inadequate. The claimants relied on the Duty of Vigilance Law. In an order issued on 11 February 2021, the judge this time confirmed the jurisdiction of the civil court. The court argued that because of the nature and objectives of the duty of vigilance, the jurisdiction of the commercial court could not be exclusive despite a link to a company's management. With this decision, the court made it clear that the purpose of the duty of vigilance is to go beyond strict company compliance procedures, thus allowing for broader societal control of the vigilance measures taken by a company.[33]

5.7 The Netherlands, due diligence and child labour

The Netherlands has had limited duty of care legislation in the field of child labour, but in May 2019, the Dutch Child Labour Due Diligence Law[34] was passed. The scope of the Dutch law is far-reaching as it includes both Dutch and foreign companies selling goods or supplying services to Dutch end-users without limitations in terms of size or turnover. This may include companies selling goods or providing services online to the extent that they explicitly address the Dutch consumer. The law will require companies to issue a statement declaring that they have exercised due diligence to prevent their goods and services from being made with the use of child labour. The declaration is to be filed with a monitoring body and will be published on

33 At the time of writing, this case is ongoing.

34 *Eerste Kamer der Staten-Generaal Iniatiefvoorstel-Kuiken Wet Zorgplicht kinderarbeid* (Dutch Child Labor Due Diligence Law (2019) 34 and 506. The law is expected to be promulgated during 2022.

its website. The law specifies that the inquiry of the corporation into the practices of its suppliers should involve reasonable efforts. The corporation or company is not expected to seek information that is not accessible with such reasonable efforts. If based on such assessment, the corporation identifies the occurrence of child labour or has reasons to suspect that child labour is occurring, it should adopt an action plan in accordance with its due diligence obligations. If a corporation fails to adhere to the law, sanctions of an administrative, civil and criminal nature can be imposed. Non-compliance may result in fines and criminal sanctions, including imprisonment, if the failure to comply persists for five years.

5.8 The Netherlands, broad due diligence legislation

In 2021, four political parties submitted a draft law to the Dutch Parliament entitled the 'Bill for Responsible and Sustainable International Business Conduct'. As of 1 January 2023, if it is passed, companies will be required to exercise due diligence to prevent and address company-related human rights violations and environmental impacts throughout their supply chains worldwide. According to the proposed law all companies established in the Netherlands or commercially active in the Dutch market will have to exercise this due diligence. Only large companies , namely, those with more than 250 employees, a balance sheet total of €20 million or net turnover of more than €40 million, will be required to go through all the steps of due diligence. There are easily more than 3 000 such companies in the Netherlands. However, if damage to people and the environment is suspected in another country, measures must be taken to prevent or limit that damage and to arrange for recovery. This will apply to all companies. The proposed Act will include administrative measures and also civil and criminal liability. If according to a person concerned (this can also be a social organisation) a company does not comply with the requirements, the person may submit

this to a civil court. Repeated violations may constitute an economic and criminal offence. Finally, the law will establish a regulator that can impose administrative coercion or administrative fines. If and when the Responsible and Sustainable International Entrepreneurship Act enters into force it will replace the Dutch Child Labour Due Diligence Law.

5.9 Germany, due diligence and *lieferketten-gesetz*

The development of a draft law on human rights and environmental due diligence by the German Government followed after the outcome of a monitoring process ,which revealed that less than 20% of German businesses had voluntarily implemented appropriate human rights due diligence. Subsequently, the government developed and ultimately agreed on the draft Due Diligence in Supply Chains Law, known as *Sorgfaltspflichtengesetz* or *Lieferketten-gesetz* in Germany.[35] The law is currently being negotiated, but if adopted, it will enter into force in 2023 and will apply to businesses with headquarters in Germany with more than 3 000 employees. The law requires human rights and environmental due diligence for companies' own operations and direct suppliers. For this group, the company would be obliged to regularly assess human rights risks and develop effective strategies to mitigate and prevent them. Regarding the human rights risks related to indirect suppliers further down the supply chain, the law will require the company to take such steps when it acquires 'substantiated knowledge' of a potential violation. Non-compliance will be subject to a fine and companies

35 The draft text of the law (as of 3 March 2021): *Entwurf eines Gesetzes über die unternehmerischen Sorgfaltspflichten in Lieferketten* https://www.bmas.de (accessed 23 March 2021).

fined above a certain threshold may face exclusion from participating in public tenders.[36]

5.10 Other national initiatives in Europe

This section briefly discusses some other initiatives in Europe.[37] These include developments in Switzerland, Finland, Denmark, Norway and Italy where (some form of) due diligence legislation is on the political agenda. In Switzerland, the so-called 'Swiss Responsible Business Initiative' was launched in 2015 by a coalition of civil society organisations seeking to introduce an article into the Swiss constitution making human rights due diligence mandatory for companies. The Initiative was narrowly rejected in 2021. As an alternative, a reporting-centred indirect counterproposal adopted by the Swiss parliament will likely enter into force in 2021. The Government of Finland committed to considering a law on human rights and environmental due diligence.[38] Preliminary political steps have also been taken in Denmark, where a parliamentary motion calling for the introduction of a bill on HRDD

36 At the time of writing, the law has not yet been adopted and the exact requirements might thus still be adjusted.

37 This discussion is brief as many of the developments are taking place at the time of writing and thus much uncertainty remains. An excellent resource that may be used to follow these rapid developments is the Business and Human Rights Resource Center.

38 The Finnish Government committed to mandatory HRDD in its official programme. In June 2020, the government released a study on possible regulatory options for mandatory due diligence in Finland. The government programme also includes a commitment to promoting due diligence legislation at the EU level.

is currently under consideration.[39] In addition, the Italian government has committed to assessing legislative reform introducing HRDD. In Norway as well, political steps have been taken towards mandatory HRDD. In addition to the steps taken in European parliaments, civil society across Europe has actively campaigned for mandatory due diligence laws in Austria, Belgium, Italy, Luxembourg, the Netherlands, Norway, Sweden and the UK.

5.11 European Union, human rights and environmental due diligence

In 2020, the European Commissioner for Justice, Didier Reynders, announced that the European Commission would present a legislative initiative in 2021 to mandate due diligence for companies to prevent negative impacts on human rights and the environment abroad and in their supply chains. This initiative is part of a broader sustainable corporate governance initiative which, besides introducing mandatory human rights and environmental due diligence, aims to reform directors' duties.[40]

In addition to the developments in the European Commission, the European Parliament has launched its own initiative encouraging the European Commission to adopt a directive which would include a corporate duty to conduct due diligence in line with the UNGPs. The European Parliament

39 In January 2019, three Danish political parties put forward a parliamentary motion that calls on the government to introduce a Bill on HRDD for all large companies, as well as companies in high-risk sectors.

40 In preparation for this legislative initiative the European Commission commissioned a study on due diligence requirements through the supply chain. This report provides a wealth of information on the many ongoing developments in the field of mandatory human rights due diligence across Europe and beyond; See European Commission Study on Due Diligence Requirements throughout the Supply Chain (2020) https://bit.ly/3flsMf6 (accessed 1 April 2021).

stressed the need for civil liabilities for the human rights harms a company causes or contributes.

5.12 The envisioned mandatory human rights due diligence in the draft treaty on business and human rights

On 26 June 2014, the UN Human Rights Council adopted a resolution establishing an Open-ended Intergovernmental Working Group on transnational companies and other business enterprises with respect to human rights. Its mandate was to 'elaborate an international legally binding instrument to regulate, in international human rights law, the activities of transnational companies and other business enterprises.'[41] Ever since, slow progress has been made towards drafting a text for such a treaty to be negotiated. If an internationally legally binding instrument is eventually adopted, this could result in state parties being required to adopt national legislation mandating HRDD. A second, revised draft of a legally binding instrument was released in 2020. Article 6 of this draft text entitled 'Prevention' provides for mandatory HRDD, as discussed in the following paragraph.

State Parties shall effectively regulate the activities of all business enterprises domiciled within their territory or jurisdiction, including those of a transnational character. For this purpose, States shall take all necessary legal and policy measures to ensure that business enterprises, including but not limited to transnational companies and other business enterprises that undertake business activities of a transnational character, within their territory or jurisdiction, or otherwise under their control, respect all

41 UN Human Rights Council's Elaboration of an International Legally Binding Instrument on Transnational Companies and Other Business Enterprises with Respect to Human Rights A/HRC Res. 26/9 (2014).

internationally recognized human rights and prevent and mitigate human rights abuses throughout their operations. And, for the purpose of Article 6.1, state parties shall require business enterprises, to undertake human rights due diligence proportionate to their size, risk of severe human rights impacts and the nature and context of their operations.

The provision continues by reflecting the HRDD steps as provided for in the UNGPs. Moreover, the draft treaty text provides some guidance on the HRDD process by pointing out the importance that companies undertake regular environmental and human rights impact assessments throughout their operations; integrate a gender perspective; and conduct meaningful consultations with those affected by their business activities. Interestingly, the draft treaty text points out the need to integrate HRDD in contracts.

Notably in Europe, the development towards binding HRDD obligations for companies appears to be well underway. As there is a broad scope of approaches to mandatory human rights and environmental due diligence and as many of these processes are still ongoing at the time of writing, many questions remain to be answered. De Schutter identifies a number of outstanding areas of controversy.[42] First, there is the question of to what degree the duty of states to control the activities of companies beyond their national territory extends. Second, there is the issue of proximity. Does a duty of care exist only if the control exercised by the company involved is considered close enough to the adverse human rights or environmental impact? Thirdly, to what extent should exercising HRDD shield a company from legal liability claims? And lastly, the question of to what extent HRDD obligations may differ depending on the size of a corporation.

42 See the detailed discussion 'Towards mandatory due diligence in global supply chains' prepared by Professor Olivier De Schutter at the request of the International Trade Union Confederation (ITUC) https://bit.ly/3SKdvSZ (accessed 5 May 2021).

According to the UNGPs, HRDD applies to all companies, yet in the various domestic laws discussed above, we see differences in applicability arising with regard to the size of the company. These questions remain unsettled but it can nonetheless be concluded that in Europe, both at the level of states and at that of the European Union, a clear development is underway towards a transformation of the voluntary standard to measure corporate compliance with social expectations into a legally binding normative standard mandating large companies to exercise human rights and environmental due diligence. Legislation, and certainly internationally coordinated legislation, can ensure a level playing field. All companies must adhere to the same standards. Such legislation, certainly on the European level, will help create more legal certainty about what the standard of due diligence entails for companies now that a patchwork of court rulings and national legislation threats is emerging across the world.

5.13 Business (and) human rights due diligence in South Africa

The OECD has developed a method, in the form of recommendations or guidelines, for understanding the business activities of OECD companies/ corporations/enterprises, referred to as the due diligence report. Due diligence is a method of preventing the breach or abuse of privacy (and or other business human rights) and may be used to identify corruption and how to prevent corruption or to address labour rights and/or environmental protection, etc. However, the OECD does not monitor corruption or environmental protection (air quality *per se*), as the financial institutions or companies in a state have to monitor corruption individually and must create internal mechanisms that will be employed to prevent future corruption, for example.[43] To understand whether a company, enterprise, factory in a

43 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 16; H Nien-he 'The obligations of transnational

supply chain or multinational enterprise complies with the requirements of responsible business conduct, due diligence addresses the potential impact of the violation of business human rights, such as the right to privacy by persons who do not represent regulatory state institutions or organisations. The OECD multinational enterprise guidelines explain how the relevant business right of companies should be considered as a way of preventing the violation of that right by third persons, regulatory state organisations (or bodies) or other companies; in other words, the relationship between the measurement of air quality by third persons who do not represent a regulatory body so as not to breach the company's right to privacy, for example.[44]

In measuring carbon emissions (or air quality) and the impact they have on the environment, due diligence will indicate how the company, enterprise or factory should conduct its future business activities more sustainably. Not being able to measure the carbon emissions of any private company (by a person who is not a representative of a regulatory body) on the basis that such measurement would infringe on or breach the company's right to privacy is impracticable.

Generally, the measurement of carbon emissions as a right does not exist in non-OECD countries. This is simply because such measurement is seen as not having financial value or because the environmental impact is seen only many years or decades later. For these reasons, no due diligence is required in those non-OECD states. Should carbon emissions in non-OECD states be measured, such an approach would probably be used as a basis to justify the future existence of a clean environment, and would to a certain extent justify

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corporations: Rawlsian justice and the duty of assistance' (2004) *Business Ethics Quarterly* 14.

44 The OECD Privacy Framework (2013) 53. The OECD framework covers both private and public sectors; *The Trustees for the Time Being of Groundwork Trust v The Minister of Environmental Affairs* reported case number 39724/2019 para 11.

a violation of the company's right to privacy to measure its carbon emissions. In this regard, due diligence is seen as a method of preventing, mitigating or anticipating high-risk factors in order to create a more sustainable business environment in future.[45] Accordingly, this right (privacy) is also briefly explained as a social risk.

The OECD tries to protect social risks through various methods, such as treaties concluded between OECD member states whereby individual states (and companies or enterprises of a state) should protect business human rights of companies in their business dealings. On the other hand, the most well-known treaty is the Paris treaty on Climate Change.[46] In the implementation of this treaty that protects the environment, for example, due diligence is required from every signatory (states who signed the Paris

45 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 3; J Calitz 'Section 417 and 418 of the Companies Act 61 of 1973 – Relevance prevailing over the right to privacy in *Gumede v Subel* 2006 (3) SA 498(SCA)' (2006) *Obiter* 403; D Bilchitz 'The necessity for a business and human rights treaty' (2016) *Business and Human Rights Journal* 203-227; E De Wet and A du Plessis 'The meaning of certain substantive obligations distilled from international human rights instruments for constitutional environmental rights in South Africa' (2010) *African Human Rights Law Journal* 1.

46 Art 6(4)(b) Paris Climate Agreement https://unfccc.int/sites/default/files/english_paris_agreements.pdf (accessed 25 November 2020). This treaty refers to both the public and private sectors of an economy and their role in avoiding climate change; OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 3; S Deva and D Bilchitz (eds) *Human rights obligations of business: Beyond the corporate responsibility to respect?* (Cambridge University Press 2013) 329 and 336–341; FJ Kelly and JC Fussell 'Air pollution and public health: Emerging hazards and improved understanding of risk' (2015) *Environ Geochem Health* 633.

treaty) to understand the effect of climate change in future.[47] Although South Africa is not yet a member of the OECD, South Africa does regulate the environment to some extent. The Air Quality Act 39 of 2005 (as amended by the Air Quality Amendment Act 20 of 2014) makes provision for the measurement of air quality, for example by an air quality representative.[48]

A company that is willing to change its carbon dioxide (CO2) emissions will improve stakeholder relationships in the long term, for example, by creating better relationships with communities and protecting the reputation of the company.[49] If the company is listed on an exchange (e.g. the JSE Ltd) and the financial statements contain relevant reasons why the company has changed its business operations/activities/processes, such as to protect the environment, an investor may use this information to invest in that company.[50] For (some) investors, financial results are often not the most important factor when investing in companies, but rather good

47 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 3; D Bilchitz 'Privacy, surveillance and the duties of corporations' (2016) *Journal of South African Law* 601; See in general Human Rights Council, Protect, Respect and Remedy: A Framework for Business and Human Rights, A/HRC/8/5 (7 April 2008) para 54.

48 Air Quality Act 20 of 2014 s 30.

49 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 15; M Sebastien and P Guido 'Input and output legitimacy of multi-stakeholder initiatives' (2012) *Business Ethics Quarterly* 527.

50 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 16; See in general Human Rights Council, Protect, Respect and Remedy: A Framework for Business and Human Rights, A/HRC/8/5 (7 April 2008) para 54.

corporate behaviour pertaining to relevant disclosures on how the company is protecting the environment, for example.[51]

If a company refuses to implement due diligence to mitigate an identifiable risk, then there could be a violation of business human rights. In other words, although a company can argue why carbon emissions should not be measured by third persons (who are not state representatives, air quality representatives or officers) as a method of protecting its right to privacy, it is not a justifiable ground for preventing liability in the law based on a citizen's ill health – law of delict. On the other hand, if the company is in the process of adjusting its business activities to mitigate the risk, and reducing carbon emissions is a work in progress, then it would be difficult to argue delictual liability in future. The concept of due diligence includes the processes and analysis of the company's business operations, for example, an analysis of the company's supply chain.[52] Although each and every company in the supply chain can rely on a right to privacy as a method of protect themselves from private investigations, due diligence argues that when a risk has been identified by the board of directors, all the companies in that supply chain must cooperate in measuring their carbon-emitting activities, for example. Based on these measurements, all companies must mitigate their carbon emissions to promote a clean environment.[53] Besides the latter,

51 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 16.

52 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 17; JJ du Plessis 'A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia: Corporate governance and mergers and takeovers' (2010) *Acta Juridica* 263-289; N Bouwman 'Individual director due diligence: Company law' (2012) *Without Prejudice* 31-33.

53 R Luc and K Ans 'Global rule-setting for business: A critical analysis of multi-stakeholder standards' (2007) *Organisation* 667.

other common risks include corruption and poor social or business relations, and they should also be subjected to due diligence to avoid these practices in future.[54]

5.14 Other common risks include corruption, poor social or business relations and diligence: An example for South Africa

A practical example to explain the purpose of (due) diligence in avoiding or mitigating risk is the business activities of Norsk Gjenvinning,[55] a Norwegian recycling company. Today, Norsk Gjenvinning is the largest recycling company in Norway. In 2011, Altor Equity Partners, a company that specialised in equities, purchased the company. The newly appointed Norsk CEO had no experience in the recycling industry, so one of his objectives was to understand the business of recycling and try to make recycling a more sustainable business in future. The CEO worked alongside Norsk employees to understand the nature of their employment, for example, joining a truck driver to collect the material for recycling and understand the frustrations relevant to that position in the company. The CEO used this approach with all the employees in the different departments.

54 TM van der Merwe 'The carbon tax as a market-based enforcement mechanism to ensure compliance with environmental law and address pollution' Unpublished LLM thesis, University of South Africa, 2018 20; O Mulher 'South Africa ranked 218th in the global sustainability index' *Earth Org* https://bit.ly/3zr6OhS (accessed 1 February 2021).

55 G Serafeim and S Gombos 'Turnaround at Norsk Gjenvinning' (2015) *Harvard Business School Case Collection*; P Muchlinski 'Beyond the guiding principles: Examining new calls for a legally binding instrument on business and human rights' https://bit.ly/3UdonKi (accessed 1 July 2020); TY Shan 'What is sustainable development' https://bit.ly/3ffpnPb (accessed 15 December 2020).

After spending time with them, the CEO identified various risks and started to implement a due diligence programme to change corporate behaviour at Norsk. He found the employees to be very corrupt. For example, a theft syndicate was stealing steel manhole covers, which Norsk then bought and subsequently used for recycling purposes. The CEO implemented various methods to help root out corruption, for example, by not paying for stolen manhole covers. The CEO also implemented a strategy whereby only honest employees were employed. In addition, he made changes to the supply chain to recycle material more effectively, realising that the company generally did not recycle material sustainably simply because most of the material collected was sold to Africa at a profit. The CEO changed this business strategy by introducing more effective recycling methods instead of selling material to African countries.[56]

Most other recycling companies in Norway did not follow this lead this and continued with their corrupt practices and selling recycling material to African companies, which they saw as being part of a profitable recycling business. In response, Norsk approached the Government of Norway with a code of conduct for the recycling industry, thus changing the nature of the recycling industry in Norway. In this way, Norsk mitigated corruption successfully since each and every recycling company now has to measure its recycling practices and follow Norsk's example, implementing the code of conduct to mitigate corruption and to avoid the selling of unrecycled material to Africa. This led to a new business model that avoids corruption.

Consequently, 2.2 million tons of material is recycled more successfully, with 56% of recycled material collected being transformed into raw materials that can be used by other Norwegian companies. Norsk is twice as successful as most other recycling companies in Norway, which can produce only 33% raw materials. In addition, Norsk is able to recycle 2.2 million tons at a 95%

56 G Serafeim and S Gombos 'Turnaround at Norsk Gjenvinning' (2015) *Harvard Business School Case Collection*.

success rate per annum, so there is no point in selling unrecycled material to Africa. Globally, only 19% of all material collected can be successfully recycled.[57] Norsk also considers carbon emissions and how the factory can be operated more efficiently to reduce these emissions.

As a result of the code of conduct, other Norwegian recycling companies have followed suit by adopting a (similar) due diligence process. Although it can be argued that each and every company or factory has a right to privacy to prevent anyone from measuring its business practices, a mandatory industry code of conduct forces companies or factories to measure their business practices for future sustainability. The recycling industry in Norway is now generally corruption free and more efficient in producing raw materials.

5.15 South African Companies Act 2008 and diligence

Director duty of diligence is regulated by section 76 of the Companies Act 2008.[58] This section is relevant not only to directors who serve as members of the board but also to members of company audit committees. With regard to Norsk, the company discussed earlier, it is not expected of every CEO to work (temporarily) with each and every employee of the company to understand the company's activities or business activities, unless this could be reasonably expected. It must be remembered that the CEO of Norsk had never been part of the board of directors of a recycling company or served as an alternate director on such boards, as he had previously been part of a company specialising in equities or shares. However, the CEO realised that to understand the business of recycling and to take informed decisions, he had

57 Norsk Gjenvinning 'There is no such thing as waste' https://bit.ly/3U0XVTY (accessed 11 October 2020); Editorial 'Air pollution – crossing borders' https://bit.ly/3WhB7kU (accessed 5 January 2021).

58 S 76(1).

to gain relevant industry knowledge. Thus, any person who is appointed to serve as a director on the board of a company must understand the business activities of the company, especially if he has no previous experience in the company's business activities.[59] Once the director or CEO has the relevant knowledge,[60] then any business decision taken by that director or CEO would be based on the belief that such a decision has been made for the benefit of the company, for example, to avoid corrupt business activities/transactions.[61]

On the other hand, the 2008 Act makes provision for a director or CEO who has no knowledge of the company's industry to appoint professional persons to guide him or her. Therefore, a director that does not understand the industry may appoint professionals to assist him when making certain business decisions. This is regulated by section 76(5)(b). In our opinion, the two sections (section 76(5)(b) and section 76(3)(c)) should not be read separately – a director should try to understand the industry and in addition appoint professionals with relevant industry expertise to assist either the director or CEO to make better or more informed business decisions in future.[62]

5.16 South African King IV and diligence

King IV (in part 5.1) explains diligence which is relevant to leadership, ethics and corporate citizenship.[63] There is no definition for diligence in King IV or

59 S 76(3)(c)(ii). No significant difference should exist between diligence and due diligence. The former implies the latter.

60 S 76(4)(a)(i).

61 S 76(4)(a)(iii).

62 See above.

63 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 43.

the 2008 Act. However, board members are required to develop their skills or knowledge to lead effectively and ethically as good corporate citizens. This was illustrated earlier by the Norsk CEO example. This hands-on approach to learning the business activities of a company will allow any CEO and/or director to develop the necessary skills to understand the business practices of any company and to change those (corrupt) practices as part of the duty of care. King IV requires the board to assume collective responsibility for steering and setting the business in a particular corporate direction by executing and overseeing the necessary business plans or strategies, for example, on how to avoid corruption or to protect the environment in future.[64] King IV allows the board to take risks, in other words, to undertake new business risks to steer the company in a different corporate direction, but those risks must first be identified and then mitigated or avoided in the best interests of the company. King IV also requires the board to prepare adequately for board meetings. This follows that each and every director must be sufficiently informed to be able to make appropriate (business) decisions during board meetings – implying due diligence practices.[65] King IV also requires the board to draft relevant codes or rules of conduct so that they may operate the business activities of a company in an ethical manner.[66] These might relate to the training of employees on how to act with integrity, how employees or the company should be reporting on (or avoiding) corruption, how the employees of the company should understand human

64 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 43; T Legg 'Why is this relevant to South African companies' (No date) *The Carbon Report* https://bit.ly/3Nsbz0f (accessed 21 December 2020).

65 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 43.

66 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 44.

rights or business human rights, and how employees or the company could protect the environment (for example) more effectively in the long run.[67]

A possibility exists that should a third person (not an investigator approved by the Financial Services Conduct Authority (FSCA)) inspect or investigate the financial activities of a company, such investigations could violate the company's right to privacy – should the investigator exceeds his authority. Accordingly, the legislature has created regulatory bodies which can appoint investigators to investigate the business activities of companies lawfully. The relevant legislative guidelines are complex and necessary to protecting the business human rights (rights exist for companies and private individuals) to privacy, as an example.

The following points summarise how to conduct a lawful investigation:

- the statutory body must regulate the investigator's qualifications and/ or disqualifications as a way of acting objectively and fairly when investigating a specific company.
- the body must also ensure that the investigator will have no conflict of interest and have the appropriate skills and expertise to lead relevant investigations.[68]
- the body must issue a certificate to present to the board of the company being investigated, stating the name and surname of the investigator and the purpose for investigating the company.

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67 Financial Sector Regulation Act 9 of 2017 in ss 134-139, which relate to the powers to investigate a financial services company and ensuring that these investigations do not violate business human rights.

68 As an example, Financial Sector Regulation Act 2017 in ss 134-140; See in general Air Quality Act 39 of 2004 s 49; *The Trustees for the Time Being of Groundwork Trust v The Minister of Environmental Affairs* reported case number 39724/2019 concerning the quality of air.

- the body must generally investigate companies on the basis of a reasonable belief that the company has breached relevant legislation, participates in corrupt activities or is in breach of a specific code of conduct of the body. Or it may investigate a company based on the belief that such an investigation will disclose or achieve a specific outcome that will benefit all stakeholders of that company and/or the public.[69]
- the investigator must have the power to require any person to attend a meeting at a specific time, date and place and to present certain evidence to the investigator or to answer certain questions. In the event that it is not possible to confiscate the company's main computer, evidence may include any written document or software programme.
- the investigator must require the person to give such evidence under oath. If the document or other evidence presented has no value, it should be returned to the person in a reasonable time.[70]
- the person being questioned may be represented by a legal practitioner.
- the investigator must also have the authority to search the private residence of employees or board members of a company and/or any other premises used to conduct the business activities of the company – irrespective of whether the activities are lawful or unlawful.[71]
- since the investigation violates the business human rights of a company (and board members or employees), the investigator must make sure that he causes as little disturbance as possible to other employees of the company.
- no employee or any other person may hinder or interfere in the investigation. On the other hand, an employee and or board member being

69 S 135.

70 S 136(1-2).

71 S 137(1)(a)(ii).

questioned need not answer a question if the answer will incriminate himself, [72] and if the investigator forces the employee or board member to answer an incriminating question, the answer will not be permitted as evidence in any criminal proceedings. However, in the event of no answer being given, the investigator may inform the employee or board member that such a refusal to answer could be interpreted as (false or) misleading evidence.

5.17 OECD due diligence for banks as an example for South Africa

Banks play an important role in the economy by financing companies and helping them to restructure their capital requirements, among other things. If a bank is aware that a specific company produces excessive carbon emissions or is part of corrupt business practices, the OECD requires the bank to identify this as a risk and to complete its own (due) diligence processes to mitigate the risk on behalf of the company in future.[73] For example, if a bank refuses to implement the necessary due diligence approach, any form of financing may have an adverse effect on the economy, as it may create a culture that supports corruption or does not protect the environment. Although a bank is entitled to receive only financial information from the applicant company, in order that it may evaluate a request for a loan, for instance, the bank may implement a condition attached to the loan, for example, that

72 S 140(1)(a).

73 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 46; D Olivier 'Towards a new treaty on business and human rights' (2016) *Business and Human Rights Journal* 47–54; CSIR 'CSIR study finds annual standards for air pollutants in the Vaal Triangle exceeded' (No date) https://bit.ly/3Dn7OEJ (accessed 28 February 2021); TY Shan 'What is sustainable development?' https://bit.ly/3zuJAHp (accessed 15 December 2020).

the company has a duty to reduce its carbon emissions. However, asking for information that is not relevant to the financial value of the company may result in a possible violation of the company's right to privacy.[74] Therefore, to implement due diligence successfully requires creativity to ensure the desired end result for the bank. For example, if the applicant is a recycling company, the bank may request the company to provide a business plan explaining certain business practices relevant to its financial value, or to produce a licence which allows the company to produce excessive carbon emissions. Accordingly, the bank will be able to understand whether the applicant has effective internal mechanisms to comply with the law. On this basis, the bank can either grant the loan on the condition that the loan be reviewed annually or simply reject the loan application.[75] In addition, the bank could conduct annual investigations into the business activities of the company as a method of prevention or of mitigation – for example – of corruption and/or carbon emissions. If the bank can show evidence of an investigation, irrespective of whether the investigation was successful or not, it will be assumed that the bank complied with its OECD duty of (due) diligence.

Due diligence is, therefore, an ongoing process for banks and should be relevant during the loan repayment term. The bank should also consider changed business circumstances and their impact on the future activities of the company. It is possible, for example, to invite the board members of the company to participate in presentations made by the bank to educate the board on why it should act both proactively and reactively to prevent corruption. The bank may also recommend that the company appoint a compliance officer or make use of an auditor to monitor the company's

74 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 37.

75 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 37; Air Quality Act 39 of 2004 s 36 requires licensing for listed activities. A municipality must implement the licensing requirements.

compliance with its code of conduct and or the law in the long term.[76] The auditor can report on this compliance in the company's financial statements. A bank must do everything possible to teach the board to be aware of the consequences of wrongful business decisions and ensure that it knows the consequences of ignoring the law and or other relevant legislation (or the company's own code of conduct). These actions by the bank and the company are also recommended by the OECD Guidelines for Multinational Enterprises pertaining to due diligence.[77]

The OECD Guidelines for Multinational Enterprises uses the term 'leverage'. This is not the same as the leverage relevant to financial circumstances, i.e., knowing how much financial leverage a company has to obtain to repay a loan in future. Leverage in this regard illustrates the influence one company has on the business operations of another – it is generally relevant to supply-chain companies.[78] It is also explained as the ability to influence the business activities of another company to prevent adverse effects on the financial stability of the supply-chain companies. It is, therefore, expected that companies should at least be able to identify relevant risks in their business operations/activities, and if they are unable to do so, another company or enterprise (in our example, a bank as discussed above) should be able to do so

76 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 67; International Commission of Jurists Needs and Options for a New International Instrument in the Field of Business and Human Rights (2014) 9 https://bit.ly/3gY7PHO (accessed 12 October 2020).

77 OECD Annual Report on OECD Guidelines for Multinational Enterprises (2018) 52-59.

78 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 68; OECD Annual Report on OECD Guidelines for Multinational Enterprises (2018) 52-59; J Ruggie 'Closing plenary remarks, UN forum business and human rights' (No date) https://bit.ly/3NiMoNJ (accessed 10 October 2020).

to mitigate or avoid risks. Therefore, a company can either act individually or in 'partnership' (in a supply-chain relationship) to avoid or mitigate relevant risks.

In attempting to know or identify business practices that could harm the environment or the economy a bank should appoint a special committee. The bank employees on this committee should be specialists in the business practices relevant to the company applying for a loan. It is probably impossible to appoint employees from different sectors of the economy, for example, law, recycling, or manufacturing; nevertheless, the OECD requires that such committees conduct in-depth reviews of any applicant's business activities. The committee should focus on assessing corporate behaviour and business human rights and may also consider assessments received from third parties explaining the business activities of the applicant. For example, if the applicant is abusing its labour force, the bank may refuse to grant a loan, as the abuse of labour is directly linked to relevant human rights. In addition, if the company constantly ignores government regulations specifically designed for the economic sector in which the applicant is active, the bank may refuse to grant the loan. Such a situation may be more obvious if a company – such as a recycling company – is listed on the JSE Ltd and is audited by external auditors who know the business activities of the company and must report on those activities in the company's financial statements or sustainability reports. However, problems arise with small and medium-sized companies that cannot afford external auditors to audit their business activities. In this regard, it would be difficult for the bank to understand the operations of those companies. Nevertheless, the bank can teach the board how to mitigate the risks that are generally associated with a specific economic sector, for example, corruption or carbon emissions.[79]

79 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 37; G Erika 'Incorporate rights: Making the most of the meantime' (No date) http://jamesgstewart.co/ncorporating-rights-

Even if the applicant is subsequently unsuccessful in mitigating or rejecting such a risk, the bank will have complied with its duty of (due) diligence.

5.18 Small or medium-sized companies

If the applicant is a small or medium-sized company, the bank may focus on the company's cash flow statement. It can use this statement to assess the liquidity of the company and to ask relevant questions such as how the company uses the proceeds (extra cash) of the business. These questions will be asked if the income statement and balance sheet of the company do not reflect a 'liquid' financial position. The balance sheet is merely a snapshot of the company's business activities on a specific day – it does not reflect the flow of cash. If the cash flow is not disclosed to the bank, the bank may immediately assume that the company is using the cash for a different business endeavour. In this regard, the bank may also ask for the corporate structure of the applicant, that is, an organogram. The organogram could show a group of companies and the relevant board members, employees, departments or shareholders and the like to understand the flow of cash.[80] Subsequently, the bank may ask about

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making-the-most-of-the-meantime/ (accessed 10 October 2020); The bank can focus on whether the company or factory has breached ss 22, 25, 35(2), 51 of the Air Quality Act 2004. Violations of these sections produce penalties in the law. The bank can use a tick-box approach to understand s 51; LA Ferus 'Compliance notices – A new tool environmental enforcement' (2006) *PER* 53; AC Blackmore 'Public trust doctrine – research and responsible wildlife management in South Africa' (2017) *Bothalia – African Biodiversity and Conservation* https://bit.ly/3TSeLVs (accessed 16 December 2021) refers to the importance of the commercial management of wildlife.

80 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 38; M Taylor 'A business and human rights treaty: Why activists should be worried' (No date) https://bit.ly/3NktINu (accessed 1 December 2020).

the purposes for which the loan will be used, and the bank committee has to try to understand if the loan makes any sense. The bank may also request the company to move its accounts to the bank in question to allow the bank an opportunity to monitor the flow of money/cash on an ongoing basis. The loan can be reviewed more successfully in this way. The bank may also establish a dedicated fraud line as a method of receiving and investigating complaints from the company's clients or shareholders, among others. In addition, the bank may make use of artificial intelligence to 'print' a framework for the flow of cash. This would allow the bank to understand the possibly corrupt activities of the company or board of directors.[81]

It is possible for the applicant to approach a few banks to finance a specific transaction. In this regard, there will be a lead bank, which takes the most risk. Banks that take lesser risks are known as agent banks. In such circumstances, a golden opportunity is presented to implement a robust due diligence process, since each bank has a different process for understanding the applicant's business activities. Banks should share such relevant information; not information that breaches the right to privacy of the applicant, but general industry-related information. This gathering of information will eventually give rise to questions posed to the applicant for relevant answers. This approach is better than engaging in a mere tick-box exercise for understanding the business activities of the company. Such an approach could indicate whether the state or government is participating in any corrupt activities of the company.[82]

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81 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 39; OECD Annual Report on OECD Guidelines for Multinational Enterprises (2018) 81.

82 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 41; *Nova Property Group Holdings Ltd v Cobbett (MandG Centre for Investigative Journalism NPC as amicus curiae)* 2016 (4) SA 317 (SCA)

The bank may also ask the applicant company which director generally voted 'no' and in relation to which business decisions. The board must record the minutes of meetings and these will show the decisions that have been taken and who voted in favour of them. If the bank sees that a particular director was generally opposed to a decision, it can analyse the reason for this. It is possible to pose questions to the particular director or directors to understand the motivation for their decisions. If the bank realises that the director voted no to avoid possible corruption, it may reject the loan application.[83]

The bank must be creative. It should use the board minutes to gather relevant information to understand the board's appetite for corruption and/or desire to prevent corrupt activities. The bank may also request the minutes of the audit committee. These minutes must be stored by the company or applicant for a period of seven years.[84] This seven-year period applies to both director and board meeting minutes. The bank may also ask for the relevant employment contracts to see whether the applicant has appointed any previously convicted criminals. Section 26 of the Companies Act 2008 describes the persons who may request information from the company and the type of information that may be requested. Although the bank is not one of those persons, it may nevertheless approach the applicant for the relevant minutes if this complies with the South African Promotion of Access to Information Act 2 of 2000, for example.[85]

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para 22 pertaining to the company's right not to allow third persons to inspect its registers.

83 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 43. An example is presented relevant to the OECD's due diligence guidance for responsible business conduct.

84 Companies Act 71 of 2008 ss 24(f) – 26.

85 S 26(7)(b); *Nova Property Group Holdings Ltd v Cobbett (MandG Centre for Investigative Journalism NPC as amicus curiae)* 2016 (4) SA 317 (SCA) para 26.

5.19 Promotion of Access to Information Act 2000 in South Africa

The preamble to the Promotion of Access to Information Act 2000 (PAIA) clearly states that the Bill of Rights applies horizontally between individuals, for example, between two or more natural persons or between a natural person and a legal person/company.[86] Section 1 defines personal information and includes financial transactions. For this reason, if the applicant (company) approaches a different bank to apply for a loan, that bank must also obtain the permission of the applicant to view or analyse its cash flow. However, audited company financial statements are generally public information, and hence, an applicant may not refuse to answer any questions posed by the bank by relying on the business human right to privacy. The published financial statements are public and strictly speaking a bank would not breach the company's right to privacy when requesting information pertaining to the individual transactions used to calculate the cash flow statement by the auditor of that company.[87] The same applies to information pertaining to carbon emissions, which is also considered public information once the company has released the emissions into the atmosphere, and a third person (not a state representative) who monitors the emissions is not violating the company's right to privacy.[88]

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86 Constitution 1996 s 32(1)(b); *Nova Property Group Holdings Ltd v Cobbett (MandG Centre for Investigative Journalism NPC as amicus curiae)* 2016 (4) SA 317 (SCA) paras 29 and 47.

87 See in general Promotion of Access to Information Act 2 of 2000 s 36(2)(a).

88 See in general Promotion of Access to Information Act 2 of 2000 s 42(5)(c); *Nova Property Group Holdings Ltd v Cobbett (Centre for Investigative Journalism NPC as amicus curiae)* 2016 (4) SA 317 (SCA) paras 26 and 50.

5.20 Consequences for violating a (business) human right in South Africa

The amended Protection of Personal Information Act 2013 requires the Information Regulator to inform the bank of a complaint received as a result of a violation of a person's (natural or legal person's) privacy. The Regulator must send details of the complaint to the bank and request that any response to the complaint should be in writing only. Based on the written response, the Regulator may settle the complaint or it may decide to investigate the complaint further.[89] However, the Regulator will investigate the complaint only if the complainant or requester can show that he or she has exhausted the bank's internal complaints procedure. The complainant must also show that he was unsuccessful in this approach to resolving his dispute, for example, as dispute relating to privacy. In this regard, the complainant has 180 days to submit a complaint to the Regulator.

In relation to the disclosure of information or the non-disclosure of information, the Regulator has powers similar to those of a High Court of South Africa. The Regulator can, for example, hear *ex parte* applications, conduct hearings in camera and/or prohibit the publication of such information in relation to the proceedings, as well as the contents of orders made by the Regulator during the proceedings.[90] Generally the Regulator may refuse to assess/consider the complaint against a bank if it is frivolous or vexatious, as well as in the event that the complainant has no *locus standi*.[91] If the complaint is neither frivolous nor vexatious, the Regulator may request additional information. After hearing and considering the additional information, the Regulator may issue an enforcement notice with

89 Amended Protection of Personal Information Act 4 of 2013 s 77.

90 S 77 and Promotion of Access to Information Act 2 of 2000 s 80.

91 S 77.

instructions directing the bank how to avoid similar violations of privacy in future or to refrain from continuing with violation practices in the present.[92]

In the event that the enforcement notice is ignored, this is considered an offence. The penalty for the offence is either a fine or imprisonment for a maximum period of three years or both.[93] It is possible to appeal the Regulator's notice of enforcement. Accordingly, the requester is entitled to appeal the decision to the High Court and must show that he or she has exhausted the statutory process provided in the 2000 Act.[94]

The Regulator may either investigate the complaint in person or transfer the complaint to the Enforcement Committee. Generally during the investigation process the Regulator may also act as a conciliator to settle the dispute (breach of a business human right), but not as a mediator or arbitrator. In addition, the Regulator will inform the bank on the course of the process to be followed in settling the complaint, such as conciliation.[95]

Diligence or due diligence is important in the commercial world. A company should use due diligence to mitigate an identifiable risk ,such as, corruption or harm caused to an environment.[96] Although it is impossible to identify all risks, companies are expected to conduct their own due diligence to mitigate their risks in practice, for example to avoid corruption.[97] Since it is possible

92 S 77.

93 Amended Protection of Personal Information Act 4 of 2013 s 77.

94 Promotion of Access to Information Act 2 of 2000 s 78(1).

95 Amended Protection of Personal Information Act 4 of 2013 s 77.

96 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 3.

97 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 16.

for companies to participate in 'unlawful' business activities that are not subject to any form of legislation/legislative body, a company may rely on the right to privacy as a method of protecting its 'unlawful' activities. For this reason, it is important to understand when third persons can investigate or monitor the activities of a company in a manner that does not violate the right to privacy.[98] In this regard the Promotion of Access to Information Act is important, since public information is not subjected to any form of protection. Strictly speaking, carbon emissions are public information. As a result, a South African bank may take note of these emissions as a risk factor in whether to grant a loan to a company or not. If the bank refuses to grant a loan, it will force the company or factory to conduct its own due diligence to mitigate its carbon emissions in future.[99] Should a bank refuse to take note of such emissions when a company is applying for a loan, it will have breached its duty of (due) diligence.[100] In this regard, South African banks can use the relevant OECD documents to understand the international approach to due diligence and how it relates to domestic legislation.

98 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 67.

99 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 67.

100 OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (2019) 41.

CHAPTER 6

The 'environmental need' in environmental, social and corporate governance (ESG) and its applicability in the South African corporate governance setting

Caiphas Brewsters Soyapi

6.1 Introduction

In 2015, the world was shocked to find that Volkswagen, one of the largest vehicle manufacturers in the world, had falsified emissions of its diesel engine vehicles in what became known as the 'Volkswagen emissions scandal'.[1] In South Africa, a study by the Bench Marks Foundation revealed that ArcelorMittal (the world's largest steel manufacturing company) had been flaunting various environmental laws and had a poor record of resolving environmental grievances because of the desire to cut costs.[2] In the financial services sector, evidence from around December 2017 showed that Steinhoff International Holdings NV had crumbled under the weight of poor corporate

1 See discussion in JC Jung and E Sharon 'The Volkswagen emissions scandal and its aftermath' (2019) *GBOE* 6–15.

2 Bench Marks Foundation Steel at Any Cost (2013) https://bit.ly/3Wh3j7b (accessed 10 February 2020) 13.

leadership, which resulted in millions of rand being unaccounted for.[3] These are but a handful of the private sector corporate scandals that raise questions about the nature of corporations, those who run the corporations and the motives of such corporations.[4] They simply point to a failure in corporate governance, which is loosely conceived of as the 'system by which companies are directed and controlled.'[5] This system obviously relies in large part on strategic decisions that advance the core objectives for the existence of a corporation: the making and maximisation of profits.

Arguably, corporations and financial institutions are not charitable businesses. At the very least, for functionality there must be a stream of finances. Regardless, in the globalised world we now live in, where the world has gone through the Industrial Revolution, world wars, global environmental destruction and threatening global environmental catastrophes like climate change, there seems to be a turn in the thinking that accompanies development and business. Indeed, if corporations are to be sustainable, economic gains must not be the only outcome to be considered;[6] environmental and social considerations must form part of the matrix that informs and steers the work of corporations (either local or multinational) and financial institutions. This

3 See generally J Rossouw and J Styan 'Steinhoff collapse: A failure of corporate governance' (2019) *International Review of Applied Economics* 163-170.

4 For a listing of more scandals, see https://bit.ly/3Dn85Yh (access 1 February 2020).

5 *Cadbury: Report of the committee on the financial aspects of corporate governance* (London Gee 1992) para 2.5.

6 C Bernardi and A Stark 'Environmental, social and governance disclosure, integrated reporting, and the accuracy of analyst forecasts' (2018) *The British Accounting Review* 16-31; T Nelson 'Understanding environment, social and governance (ESG) analysis and the recent 'divestment' commentary' (2015) *Governance Directions* 87–89.

thinking has advanced the concept of environmental, social and corporate governance (ESG) into the realm of scholarship.[7]

ESG is emerging as a constituent part of corporate governance in broad terms and as a tool that could potentially lead to a long-term increase in corporate financial performance.

The idea of ESG can be linked to the obvious fact that in many instances corporations operate in spaces almost always composed of communities and the environment which they occupy. This is particularly true of African states, which rely hevily on natural resources and the extractive industry; one which has contributed to untold environmental degradation. It is also an industry that proves controversial (blood diamonds, for example) as some extractive corporations –often transnational corporations (TNCs) – operate in states with either weak human rights and rule of law records or weak governance practices, where regulation is poor and opportunities to avoid costly compliance measures are the order of the day. Such operating spaces are usually described as 'pollution havens'[8] and, in the African context, many states potentially fit this description. Consequently, ESG will be particularly important in many developing countries which are in need of development.

In view of the above, this chapter attempts to briefly provide a basic outline of ESG and its place in the governance of corporations. Given that the book

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7 Others prefer the term corporate environmental responsibility. See K Fisher-Vanden and K Thorburn 'Voluntary corporate environmental initiatives and shareholder wealth' (2011) *Journal of Environmental Economics and Management* 430-445.

8 G Dowell, S Hart and B Yeung 'Do corporate global environmental standards create or destroy market value?' (2000) *Management Science* 1060; See in general A Thompson 'A controversial JSE listed company plans a new city outside Windhoek and blames criticism on a 'cabal'' (2020) *Business Insider South Africa* https://bit.ly/3fokX8r (accessed 15 August 2020).

focuses on international corporate governance, this chapter will deliberately not deal with the corporate governance factor as it is covered elsewhere in the book.[9] It also does not focus much on the social aspects as these are largely part of corporate social responsibility (CSR).[10] Rather, this chapter focuses on mapping the salient characteristics of the two other aspects of ESG in generalised terms: the environmental and social aspects. Thereafter, the chapter narrows down its focus to the environmental need in ESG and how it could be addressed.

Central to the inquiry of this chapter is a two-pronged objective. First, to determine the contours and related aspects of ESG as an essential aspect of corporate governance and then to indicate the global frameworks that support ESG. Secondly, the chapter reviews some South African laws and policies which embody aspects that could advance ESG, before finalising the discussion with a judgment of the Supreme Court of Appeal of South Africa, which demonstrates some of the challenges related to ESG in practice and how the court dealt with the issues.

Two caveats apply to these objectives. First, scholarship on ESG has grown significantly, with the result that what is offered here is a basic, broad analytical framework within which to view a corporation's sustainability.[11] Secondly, in dealing with the way in which aspects of ESG feature in South Africa, the chapter does not engage in any empirical inquiry but rather specifically considers ESG aspects covered in the 2016 King IV Report on Corporate Governance in South Africa (King IV),[12] the National Environmental

9 See discussions in chapters 1,2,3,4 and 5.

10 Environmental aspects were included in part under CSR, but rarely as a substantive aspect on their own.

11 I do not offer a critique of ESG as a scholarly principle.

12 See in general the *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016).

Management Act,[13] and the Companies Act.[14] Where context fits, the terms 'company', 'TNC' and 'organisation' are used interchangeably to mean any form of private corporate entity.

6.2 Understanding ESG

ESG has its roots in corporate social responsibility. The European Union describes 'corporate social responsibility' as a 'concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.'[15] Though it is voluntary, one of the reasons why corporations engage in CSR is the need to keep in step with regulations or interventions by governments.[16] This implies that corporations could choose what 'social' aspects to engage in and how they could do so.

It seems, however, that the language of CSR proved inadequate to capture exactly what was at stake concerning corporate activity. It became apparent that profits and a few social activities, like building a clinic or school, are not all there is to companies. It has become obvious that corporations could do well financially while also actively serving other long-term human-centred interests like environmental and social interest. It is out of this insufficiency that ESG arose, as investors started to be more serious about longer-term investments and needed to actually determine whether projects are sustainable

13 National Environmental Management Act 107 of 1998.

14 Companies Act 71 of 2008.

15 EU Corporate Social Responsibility: A Business Contribution to Sustainable Development (Brussels 20021) https://bit.ly/3fk3KwZ (accessed 16 April 2020).

16 MA Camilleri 'Environmental, social and governance disclosures in Europe' (2015) *Sustainability Accounting, Management and Policy Journal* 224-242.

in the long run.[17] Questions were no longer about what corporations are, but rather what they should be. Two interrelated theories perhaps capture the essence and justification of the necessity of ESG in a corporation's activities: legitimacy theory and stakeholder theory.[18]

6.2.1 Two theories on the justification of ESG

The point of departure for legitimacy theory is the idea of a social contract between an organisation and the environment/society in which it operates.[19] In other words, there is an implied assumption that an organisation will not operate in ways that are detrimental to the society in which it operates. Corporate citizenship would require that corporations be sensitive to their surroundings and how they act and respond to stimuli from such surroundings. It is naturally the responsible thing to do, given that resources are finite. With the power of the media and the fast traffic of information, many parts of the globe can be instantly made aware of a company's negative environmental or social footprint at any given time. If this happens, then an organisation and its activities are illegitimate.[20]

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17 C Lokuwaduge and K de Silva 'Emerging corporate disclosure of environmental social and governance (ESG) risks: An Australian study' (2020) *Australasian Accounting, Business and Finance Journal* 35-50.

18 Weber gives another example of institutional theory which is characterised by evaluating how influences emerging from the corporation affect the behaviour of a corporation. See O Weber 'Environmental, social and governance reporting in China' (2014) *Bus. Strat. Env.* 303–317.

19 C Lokuwaduge and K de Silva 'Emerging corporate disclosure of environmental social and governance (ESG) risks: An Australian study' (2020) *Australasian Accounting, Business and Finance Journal* 41.

20 See 42 above.

On the other hand, stakeholder theory involves processes which factor in the stakeholders that can affect or be affected by the corporation's activities.[21] The effects of the stakeholders' actions in relation to the corporation could be direct or indirect and could make or break a corporation's business. For example, market (internal) stakeholders would be shareholders in the corporation who can directly affect the operations of the corporation, while those who could be affected indirectly would be non-market (external) stakeholders; those tied to the corporate through a social contract.[22] Ideally, ESG would require that these non-market stakeholders' considerations and needs be factored into the corporation's business operations. Put differently, this implies then that the social needs and concerns of non-market stakeholders have to be continuously addressed as part of the corporation's management process.[23]

Both theories acknowledge that corporations are responsible not only to their shareholders but also to the society in which they operate.[24] Consequently, social and environmental concerns are indispensable in the governance of a corporation, such that illegitimacy follows and stakeholders might revolt in their absence. A clear example of this occurred in the 1990s and involved involved the forming of a group of activists against Royal Dutch Petroleum Company and the Nigerian military's activities, which had resulted in untold suffering for people living in the Niger Delta area. In cahoots, the Nigerian

21 O Weber 'Environmental, social and governance reporting in China' (2014) *Bus. Strat. Env.* 304.

22 I Tarmuji, R Maelah and NH Tarmuji 'The impact of environmental, social and governance practices (ESG) on economic performance: evidence from ESG score' (2016) *International Journal of Trade, Economics and Finance* 67-74.

23 See 67 above.

24 C Bernardi and A Stark 'Environmental, social and governance disclosure, integrated reporting, and the accuracy of analyst forecasts' (2018) *The British Accounting Review* 16-31.

military and Shell raided these activists and ultimately executed a number of them, including well-known environmentalist, Ken Saro-Wiwa. The case *Wiwa v Royal Dutch Petroleum Co*[25] was brought against Royal Dutch Shell, which then opted to settle for $15.5 million in 2009.[26]

6.2.2 On the perceived benefits of ESG

There are many potential benefits to a corporation incorporating ESG as part of its core business. Among these, ESG could help with product sales by appealing to more customers.[27] For example, corporations could appeal to those who support sustainable business by engaging in 'green labelling'.[28] Indeed, in the face of climate change and other global environmental problems, some customers and suppliers are inclined to conduct business with those they believe have conducted their affairs in a manner that is sensitive to environmental concerns. For example, a study by Dos Santos[29]

25 96 Civ. 8386 (KMW) (HBP), 01 Civ. 1909 (KMW) (HBP), 02 Civ. 7618 (KMW) (HBP), (S.D.N.Y. Mar. 18, 2009).

26 For a discussion of the case and documentation, see https://earthrights.org/case/wiwa-v-royal-dutch-shell/ (accessed 15 August 2020).

27 K Fisher-Vanden and K Thorburn 'Voluntary corporate environmental initiatives and shareholder wealth' (2011) *Journal of Environmental Economics and Management* 430-445. Also see O Weber 'Environmental, social and governance reporting in China' (2014) *Bus. Strat. Env.* 303–317.

28 Also see I Tarmuji, R Maelah and NH Tarmuji 'The impact of environmental, social and governance practices (ESG) on economic performance: Evidence from ESG score' (2016) *International Journal of Trade, Economics and Finance* 67-74.

29 See discussion in MAO Dos Santos 'Minimizing the business impact on the natural environment: A case study of Woolworths South Africa' (2011) *European Business Review* 384-391.

a few years ago shows that Woolworths South Africa maintains a good clientele by engaging in sustainable practices like selling organic products independently certified for quality control purposes and labelling its fish according to standards of green,[30] orange[31] and red.[32]

In addition, ESG has been argued as helping to improve corporate performance.[33] The contention holds that instead of ESG engagements coming at a negative cost to the corporation, the environmental performance of a corporation can actually complement the financial reporting and result in better valuation and rewards for a corporation (through consumption, productivity and investments) from stakeholders.[34] In the same study, Dos Santos found that Woolworths South Africa had built a strong South African business brand through sustainable practices. Some of these practices also have a social and economic grounding in that the company often claims that it sources many of its products (like vegetables) from local farmers.

30 Indicates fish that are not under threat and are caught locally in a sustainable way.

31 Indicates concern over the sustainability of the fish species.

32 See above.

33 K Fisher-Vanden and K Thorburn 'Voluntary corporate environmental initiatives and shareholder wealth' (2011) *Journal of Environmental Economics and Management* 430-445. Also see O Weber 'Environmental, social and governance reporting in China' (2014) *Bus. Strat. Env.* 303–317.

34 D Baboukardos 'The valuation relevance of environmental performance revisited: The moderating role of environmental provisions' (2018) *The British Accounting Review* 32-47; Y Li, M Gong, XY Zhang and L Koh 'The impact of environmental, social, and governance disclosure on firm value: The role of CEO power' (2018) *The British Accounting Review* 60-75.

Even in 2019, Woolworths was considered the best supermarket brand in South Africa.[35]

Tied to the two points above is that ESG helps with transparency.[36] In other words, if a corporation like Woolworths seeks to retain its valuable brand, it is likely to ensure that its image is associated with transparency in the manner in which it builds its brand. The labelling and sustainability practices it prides itself on would have to be clear enough to be open to critique. Arguably, image and reputation with consumers and NGOs matter, and it is these stakeholders who could reward the corporation. In addition, transparency provides investors and financiers with information with which to determine the success and risk factors associated with the corporation.[37]

Overall, it seems that ESG can boost consumer and investor confidence. One could say that there is a correlation between a corporation's profitability and the relationship it has with its stakeholders and their needs. Most simply understood then, ESG is the language of sustainability in the corporate world. But what strategies could be employed to operationalise ESG?

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35 See https://bit.ly/3TQY9gK (accessed 4 November 2019); Author Unknown 'The best and worst supermarkets in South Africa' *Businesstech* https://bit.ly/3NrVYxS (accessed 4 November 2019).

36 Y Li, M Gong, XY Zhang and L Koh 'The impact of environmental, social, and governance disclosure on firm value: The role of CEO power' (2018) *The British Accounting Review* 61.

37 EU Corporate Social Responsibility: A Business Contribution to Sustainable Development (Brussels 2002) 6 https://bit.ly/3FuGIhz (accessed 16 April 2020).

6.3 Operationalising ESG

Like CSR, ESG reporting could be either voluntary or mandatory.[38] Where ESG is voluntary, it is often considered to be efforts beyond the legal requirements.[39] This is perhaps why there is value for corporations engaging in it, because it signifies at times a desire to go beyond the bare minimum legal requirements.[40] While there are potentially various ways through which corporations could employ ESG, I will refer to two interrelated ways: environmental policy statements and environmental management systems.

6.3.1 Environmental policy statement

In simple terms, an environmental policy statement (EPS) is a corporation's environmental policy vision or plan and outlines a corporation's environmental strategies and guidelines in relation to its business.[41] The contents of an EPS must be relevant and practical. Christiansen and Garcia believe that amongst other elements, an EPS must show the extent to which the corporation complies with the law, its commitment to exceeding legal requirements and/or its commitment to best practices in the industry in

38 GRI About Sustainability Reporting https://bit.ly/3Wh3GyB (accessed 15 April 2020).

39 V Lagasio and N Cucari 'Corporate governance and environmental social governance disclosure: A meta-analytical review' (2019) *Corp Soc Resp Env Ma* 701–711.

40 An interesting question is whether the satisfaction of mandatory legislative requirements by industries involved in air polluting industries, for instance, would count as ESG reporting. Probably not, because of their mandatory nature.

41 H Christiansen and E Garcia 'An overview of corporate environmental management practices: Joint study by the OECD Secretariat and EIRIS' https://bit.ly/3U0YMnE (accessed 10 March 2020).

which it is active.[42] The authors go on to indicate that while some corporations exceed legal requirements, such actions are not always the best indicator of a corporation's commitment to sustainability, as many jurisdictions operate under different legal regulatory requirements.[43] To be meaningful, then, an EPS must be open to public scrutiny and reportage.[44]

The result is that some corporations might have more ESG obligations than others, based on the operating space within which the corporations find themselves. In fact, research shows that corporations involved in industries that have high environmental risk or that are significantly reliant on environmental resources have a much greater obligation to have an EPS and to report such.[45] With economies that are largely reliant on natural resource bases, most corporations in Africa fall into the bracket of corporations needing a strong EPS.

Needless to say, having an EPS and managing it involve costs.[46] To be sure, there have to be initial studies that determine the likely and potential environmental impacts of a corporation's activities. Once these are in place, there have to be constant monitoring and collation of information related to the activities, their actual environmental impacts, the mitigation efforts

42 See above.

43 See above.

44 See the discussion on the *Company Secretary of Arcelormittal South Africa v Vaal Environmental Justice Alliance* (the VEJA case) (69/2014) [2014] ZASCA 184 (26 November 2014).

45 H Christiansen and E Garcia 'An overview of corporate environmental management practices: Joint study by the OECD Secretariat and EIRIS' https://bit.ly/3UbZrm6 (accessed 10 March 2020).

46 Y Li, M Gong, XY Zhang and L Koh 'The impact of environmental, social, and governance disclosure on firm value: The role of CEO power' (2018) *The British Accounting Review* 63.

made, and the like. All this information will then need to be prepared at some financial cost for the reportage. The unfortunate eventuality of this (including in instances where ESG is not mandatory) is that not every corporation may be able to do enough to fulfil its ESG obligations.

6.3.2 Environmental management system

An Environmental management system (EMS) works perfectly with an EPS in that it could serve as the vehicle through which a corporation's EPS is applied. Consequently, it goes without saying that any corporation needs an EMS of sorts. This is because many (if not all) corporations have a form of environmental imprint, and EMSs could assist corporations in identifying, managing, monitoring and controlling environmental issues in a holistic manner.[47] For this reason an EMS is expected to be comprehensive, and should include aspects related to 'an environmental policy statement; an initial review; environmental objectives and targets; implementation procedures; internal monitoring and auditing; and internal reporting.'[48]

An example of such an EMS is the ISO 14001 standard, which is a leading EMS certification scheme which 'requires that an organisation considers all environmental issues relevant to its operations, such as air pollution, water and sewage issues, waste management, soil contamination, climate change mitigation and adaptation, and resource use and efficiency.'[49] In other words,

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47 International Organization for Standardization Introduction to ISO 14001:2015 https://bit.ly/3TQGqpL (accessed 12 March 2010).

48 H Christiansen and E Garcia 'An overview of corporate environmental management practices: Joint study by the OECD secretariat and EIRIS' https://bit.ly/3DLOlir (accessed 10 March 2020).

49 International Organization for Standardization Introduction to ISO 14001:2015 https://bit.ly/3gLyJCs (accessed 12 March 2010).

when a corporation receives ISO certification, this implies that a series of environment-related criteria has been met.

Perhaps the biggest case for an EMS is that it usually considers a project's complete life cycle and is continuously monitored. For example, in the beginning of a project, a company might need to embark on an environmental impact assessment (EIA) to try to understand a potential project's environmental impact. Once the likely impacts are identified, an EIA would require that mechanisms for the mitigation of such impacts be put in place. Further, in view of any potential impacts, environmental accounting and auditing and life cycle assessments may be employed to ensure that a corporation is in touch with its impact on the environment. Such impacts, efforts to mitigate them and successes and failures then need to be reported through environmental performance reporting.[50] We thus see circular effect in the manner in which the environmental footprint of a corporation is monitored, loosely described and in no special order:

- A corporation determines the likely impacts it will have on the environment.
- The corporation then subscribes to an EMS and has a comprehensive EPS along with targets and mitigation measures.
- The corporation then regularly checks these targets and intervention measures.
- The corporation engages in environmental accounting and auditing.
- The corporation reports and publicly publishes its environmental performance report, which is measured against the EMS and the EPS.

When all is said and done, these processes mean nothing to the stakeholder and investor if they are not publicised. Because of globalisation, one of many other reasons, the world as we know it today is knowledge-driven.

50 Discussed below.

Information is key to decision making on almost every level of human existence. Given that 'how companies manage their ESG reporting and which indicators to use to disclose ESG information is a corporate decision', it is necessary to briefly show how information reporting on ESG is conceived of globally.[51]

6.4 Making it all stick together: ESG reporting

Having undertaken empirical research on ESG reporting in China, Weber concluded that '[t]he combination of high ESG performance and transparent reporting leads to higher market returns for sustainable corporations and therefore creates a win–win situation for both shareholders and sustainable development.'[52] This is a clear affirmation of the link between a move towards adequate ESG reporting and financial performance. However, logic dictates that the nature of an industry will invariably determine the nature of the disclosures to be made.[53]

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51 The need to disclose environmental information related to a corporation's activities was not always acknowledged. It took catastrophic incidents to bring to the fore concerns about the environment. Examples such as the Bhopal tragedy in India and the Ogoniland environmental destruction in Nigeria often come to mind.

52 O Weber 'Environmental, social and governance reporting in China' (2014) *Bus. Strat. Env.* 311. Also see findings by C Bernardi and A Stark 'Environmental, social and governance disclosure, integrated reporting, and the accuracy of analyst forecasts' (2018) *The British Accounting Review* 16-31; K Fisher-Vanden and K Thorburn 'Voluntary corporate environmental initiatives and shareholder wealth' (2011) *Journal of Environmental Economics and Management* 430-445.

53 CSD Lokuwaduge and K Heenetigala 'Integrating environmental, social and governance (ESG) disclosure for a sustainable development: An Australian study' (2017) *Bus. Strat. Env.* 439.

Corporations operating in industries with a high social or environmental impact have a greater responsibility in reporting their actions for mitigation.[54] For example, an extractive corporation would report differently from a financial institution. More could be expected of its reporting of its activities because most extractive corporations have immense impacts on both an environmental and a social level.[55] Christiansen and Garcia observe that such corporations usually see the need to subscribe to voluntary environmental initiatives in addition to their own EPS and EMS.[56] This potentially adds another layer of accountability in that a corporation could be compelled to report accurate information on its environment-related activities, knowing that under-reporting could result in reputational risk.

While there are no universally agreed-upon ESG disclosure and reporting standards, there seems to be consensus that whichever standard is used, the information reported must be accurate, traceable and perhaps even bankable. So far as examples of standards are concerned, corporations could use sustainability reporting or integrated reporting (IR).

The Global Reporting Initiative (GRI) describes 'sustainability reporting' (otherwise also known as 'sustainable development reports' or 'corporate social responsibility reports') as requiring of:

> organizations to measure, understand and communicate their economic, environmental, social and governance performance, and then set goals

54 H Christiansen and E Garcia 'An overview of corporate environmental management practices: Joint study by the OECD secretariat and EIRIS' https://bit.ly/3No5aDu (accessed 10 March 2020).

55 See the discussion of *Company Secretary of Arcelormittal South Africa v Vaal Environmental Justice Alliance* (69/2014) [2014] ZASCA 184 below.

56 H Christiansen and E Garcia 'An overview of corporate environmental management practices: Joint study by the OECD secretariat and EIRIS' https://bit.ly/3Dpwbl6 (accessed 10 March 2020).

> and manage change more effectively. A sustainability report is the key platform for communicating sustainability performance and impacts – whether positive or negative.[57]

Elsewhere, sustainability reporting is described as a process which 'combines the profitability of a company with corporate social responsibility towards its stakeholders. It is a more forward-looking business approach, which creates long-term shareholder value by embracing opportunities and managing risks derived from economic, environmental and social development.'[58] The main concern with sustainability reporting as a stand-alone report is that at times it is difficult to properly link the report with the performance of the corporation. Needless to say, an environmental performance report which cannot be linked to the actual performance of the corporation is unhelpful.

What is needed is to measure the performance of the corporation against its actual imprint on the environment and society. This is what determines if a business is actually sustainable. This is also why some scholars argue that corporations are better off having an integrated report (IR) rather than a stand-alone environmental performance report.[59] An IR is increasingly being seen as the gold standard in terms of company reports. Pioneered by the International Integrated Reporting Council (IIRC), 'IR' is described as 'a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead

57 GRI About Sustainability Reporting https://bit.ly/3TOUbFf (accessed 15 April 2020).

58 CSD Lokuwaduge 'Emerging corporate disclosure of environmental social and governance (ESG) risks: An Australian Study' (2020) *Australasian Accounting, Business and Finance Journal* 37.

59 C Bernardi and A Stark 'Environmental, social and governance disclosure, integrated reporting, and the accuracy of analyst forecasts' (2018) *The British Accounting Review* 16.

to the creation of value in the short, medium and long term.'[60] Put differently, IR combines or factors ESG into the actual financial reports by means of quantification. When the IR is made in this way, it quantifies and integrates the social and environmental aspects related to non-market stakeholders by appending a monetary value to them. This is essential because reporting is how a corporation communicates with its stakeholders, and depending on the level of detail and the worth of the reportage, stakeholders communicate back by either rewarding or punishing a corporation.

Let us consider an example: Bernardi and Stark conducted a study that considered the extent to which IR involving ESG had an impact on the ground on the users of financial reports for forecasting the performance of corporations in South African listed companies.[61] Their results indicate that IR improves the links between ESG and financial performance. In other words, it is possible to tie the financial performance of a corporation to its environmental and social impacts.[62] This could prove crucial for investors as well as the overall reputation of a company. It also makes clear that attending to the environmental and social aspects of governing a corporation does not necessarily result in diminishing profits, improves governance in general, and could potentially advance the longevity of a corporation.

It stands to reason that through comprehensive IR and being responsive to social and environmental matters is related to a corporation's business, long-term viability. But given this need to be transparent, or at least to be seen as transparent, is there a possibility that corporations could undervalue their imprint on the environment and society? Could there be a possibility

60 See https://integratedreporting.org/the-iirc-2/ (accessed 15 April 2020).

61 C Bernardi and A Stark 'Environmental, social and governance disclosure integrated reporting, and the accuracy of analyst forecasts' (2018) *The British Accounting Review* 16-31.

62 See 28 above.

that corporations could overpromise and exaggerate their environmental and social plans while falling short when it comes to actual performance? Yes indeed, and this is labelled as 'greenwashing'.[63] As noted earlier, this is because there are no globally available set guidelines on the nature of reports and most of the reports are never audited, especially when they are done on a voluntary basis and in a number of separate reports. It can also become a particular problem if corporations deliberately withhold information from parties/stakeholders that might seek to verify such information. As we shall see further on, this has happened in South Africa.

Some scholars list the following as examples of how corporations could go about greenwashing:[64]

- exaggerating the actual environmental performance of the corporation;
- selective disclosure where favourable environmental information is presented while negative information is never released; and
- product-level greenwashing, where corporations append eco-labelling to attract more customers.

This is why an active civil society is important as a stakeholder, because it can take corporations to task through campaigns and even litigation. A clear example is how the NGO Social and Economic Rights Action Center (SERAC) was active in campaigning against the activities of Royal Dutch Shell PLC and the Nigerian government in their oil activities in the Niger Delta region.[65]

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63 EP Yua, BV Lu and CH Chen 'Greenwashing in environmental, social and governance disclosures' (2020) *Research in International Business and Finance* 101192 https://bit.ly/3Nm0IVE (accessed 15 May 2019).

64 See above.

65 SERAC eventually took the case to the African Commission, *The Social and Economic Rights Action Center and the Center for Economic and Social Rights v*

To conclude: at its core, ESG requires corporations to be responsible to their stakeholders, which can also include people and environmental resources. Regarding people, ESG requires accountability not only to the investors and shareholders of companies, but also to the societies in which corporate businesses operate. Concerning the environment, there must be a realisation that the environment itself is a resource that is worthy of protection. That is why corporations are required first to measure the potential environmental impacts of their projects and business through an EIA, regardless of whether they intend to operate in spaces surrounded by people or far removed from society. Unbridled profiteering (a practice that was the order of the day in most colonial societies and countries suffering from poor governance) at the expense of society and the environment is unacceptable and a clear sign of poor corporate governance in broad terms. In the end, corporations must – as a matter of necessity – delve into reviewing the cost at which financial performance is attained.

6.5 Global initiatives supporting ESG

There are potentially many global initiatives[66] that are relevant for establishing the need for ESG in corporations.[67] Many of these are voluntary, and this brief section highlights only two: the OECD Guidelines for Multinational Enterprises and the United Nations Principles for Responsible Investment.

Nigeria (Communication No. 155/96).

66 This section is intended merely to describe some of the global initiatives that support ESG. Further discussion of the initiatives described here (and even more) can be found in chapter 7.

67 Some of those not discussed here include the Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) framework and the UN Global Compact.

6.5.1 OECD Guidelines for Multinational Enterprises

One of the foremost global initiatives dealing with corporations is the 2011 OECD Guidelines for Multinational Enterprises.[68] These guidelines are unique in that they are supported by world governments, who are required to operationalise the guidelines in their legal systems. So far as ESG is concerned, Part A requires TNCs to '[c]ontribute to economic, environmental and social progress with a view to achieving sustainable development.'[69] Further, Part III on disclosure requires TNCs to disclose relevant information, including governance practices, stakeholder relations and any codes of conduct to which the corporation subscribes. Paragraph 33 of the commentary on disclosure emphasises that the 'Guidelines also encourage a second set of disclosure or communication practices in areas where reporting standards are still evolving such as, for example, social, environmental and risk reporting.' In addition, the G20/OECD Principles of Corporate Governance[70] encourage corporates to 'disclose policies and performance relating to business ethics, the environment and, where material to the company, social issues, human rights and other public policy commitments.'[71] This clearly supports the idea of sustaining and respecting stakeholder interest in the running of the business. Since these Guidelines have government support, they could end up by making it a legal requirement for states to operationalise them.

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68 OECD Guidelines for Multinational Enterprises (2011); See foreword and part A(1).

69 See part A(1) above.

70 OECD Principles of Corporate Governance (2015) 36-38.

71 See 38 above.

6.5.2 United Nations Principles for Responsible Investment

The UN Principles for Responsible Investment were made by investors and, unlike the OECD Guidelines,[72] the UN Principles explicitly refer to ESG: '[a]s institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios.'[73] The first three of the six principles require members to include ESG in 'investment analysis and decision-making'[74] and 'ownership policies and practices'[75] and to disclose ESG issues in their investments.[76] The importance of these principles being advocated by investors cannot be underestimated. These are primarily the stakeholders who could make or break a business by advancing or even withholding finances at times. Though voluntary, the UN Principles are a clear affirmation of the necessity of ESG in corporate governance issues.

6.6 ESG in the South African context

The discussion thus far has sought to characterise ESG in scholarship and in global initiatives. In what is left of the chapter, I draw on some of the South African frameworks that embody aspects of ESG either in voluntary or binding terms.

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72 PRI 'What are the principles for responsible investment?' https://bit.ly/3NlHpLZ (accessed 12 April 2020).

73 See above.

74 See above principle 1.

75 See above principle 2.

76 See above principle 3.

6.6.1 King IV: Report on Corporate Governance for South Africa, 2016

King IV represents the ideology underpinning the full package of what good corporate governance should be in South Africa. A voluminous document with apt explanations, it encapsulates many of the ESG-related aspects discussed previously. To start with, King IV acknowledges the interrelationship between the corporation and its stakeholders; it specifically notes that it adopts IR, which could be either in the form of a standalone report or combined with and integrated into other financial reports; and it mandates the incorporation of ESG. These are in turn summarised below.

Principle 3 of King IV states as follows: 'the governing body should ensure that the organisation is and is seen to be a responsible corporate citizen.' It will be recalled from the earlier discussion that what justifies a corporation also pertains to stakeholder theory in terms of whose perceptions of the corporation matter. King IV acknowledges that corporate citizenship comes with duties and responsibilities. ESG factors in here through the recommended practices to principle 3 of King IV, which asks of a corporation's governing body to 'oversee and monitor, on an ongoing basis, how the consequences of the organisation's activities and outputs affect its status as a responsible corporate citizen.'[77] The explanatory recommended practices then further note that management must agree to measures and targets related amongst other matters to society (including public health and the protection of human rights etc.)[78] and the environment (including pollution prevention, waste disposal and biodiversity protection).[79] Principle 3 should also be read together with the 2011 Code for Responsible Investing

77 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 45 and principle 3.

78 See above.

79 See above.

in South Africa, which was devised in line with the UN Principles mentioned earlier. The Code composed is composed of five principles; the first one reads as follows: '[a]n institutional investor should incorporate sustainability considerations, including ESG, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.'[80]

ESG is also firmly embedded in King IV through principles 4 and 5 (for example, social and ethics committees of companies). The former notes that corporations must appreciate the inseparability of an organisation's 'core purpose, its risks and opportunities, strategy, business model, performance and sustainable development.'[81] Reference to sustainable development is particularly noteworthy because South African courts have spoken much on the aspect. For example, in *BP Southern Africa (Pty) Ltd v MEC for Agriculture, Conservation and Land Affairs* (*BP Southern Africa*)[82] the High Court observed that:

> [P]ure economic principles will no longer determine in an unbridled fashion whether a development is acceptable. Development, which may be regarded as economically and financially sound, will in future be balanced by its environmental impact, taking coherent cognisance of the principle of intergenerational equity and sustainable use of resources in order to arrive at an integrated management of the environment, sustainable development and socioeconomic concerns.[83]

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80 IODSA Code for Responsible Investing in South Africa (2011); See in general principle 1.

81 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 47 and principle 4.

82 2004 (5) SA 124 (W).

83 See 125 above.

More than anything, King IV's reference to sustainable development and its inseparability from other aspects of a corporation's activities symbolises an approach to governance that is sensitive to the changing times – as sustainability is the language of the future.

Principle 5 crystallises IR in that it requires of the governing body to issue reports which 'enable stakeholders to make informed assessments of the organisation's performance, and its short-, medium- and long-term prospects.'[84] As noted earlier, investment decisions and the rewards that could be obtained from stakeholders are primarily reliant on reportage that is well-informed and comprehensive. The recommended practices for such comprehensive reporting include that a corporation must publish an IR at least once annually.[85] South Africa also has the Integrated Reporting Committee (IRC) of South Africa which promotes IR.[86]

These are just a few of the principles that speak to ESG and its related aspects. It stands to reason that King IV crystallises ESG as it appears in global initiatives. Whether corporations actually apply King IV is another enquiry beyond this discussion.

6.6.2 The National Environmental Management Act and ESG

The National Environmental Management Act 1998 (NEMA) is South Africa's environmental framework law. While it does not speak directly to ESG in corporate language, it does have some relevant provisions. Section 2 of NEMA includes a list of environmental management principles. One

84 *King IV: Report on corporate governance for South Africa* (Johannesburg: Institute of Directors in Southern Africa 2016) 48 and principle 5.

85 See above.

86 https://integratedreportingsa.org/ (accessed 15 August 2020).

of these is 'sustainable development', which is defined as 'the integration of social, economic and environmental factors into planning, implementation and decision-making so as to ensure that development serves present and future generations';[87] planning, implementation and decision-making are all aspects that are central to the functioning of a corporation. Also, as was shown earlier, sustainability is the language of ESG and is embedded in global initiatives and King IV. NEMA further holds that sustainable development requires the consideration of relevant factors, including the factor that '[r]esponsibility for the environmental health and safety consequences of a policy, programme, project, product, process, service or activity exists throughout its life cycle.'[88] Further, NEMA holds that the costs of remedying pollution must be paid by the polluters.[89] Arguably, those aspects related to the avoidance of pollution can have a direct impact on corporate activity in that activities that are likely to cause environmental harm may be considered risky for investment. Stakeholder considerations thus come into play.

Where a 'listed' or 'specified' activity will be undertaken, NEMA requires the application of an environmental authorisation.[90] This applies mostly to mining corporations. Along with the application for the authorisation, the applicant must develop an environmental management programme if the activity to be done had to employ the use of an EIA first.[91] Once the programme is approved, NEMA holds that it is an offence to fail to comply

87 National Environment Management Act 1998 s1; *The Trustees for the Time Being of Groundwork Trust v The Minister of Environmental Affairs* Reported case number 39724/2019 concerning the quality of air.

88 S 2(4)(e).

89 S 2(4)(p) and 28(1).

90 S 24(1) and 24(N).

91 S 24(N)(1)(A).

with such an environmental management programme.[92] If, as noted earlier, a corporation has an EMS, and an environmental management programme is approved as part of that EMS, then compliance becomes mandatory and information on such compliance is required for IR purposes.

6.6.3 The Companies Act 2008

One of the objectives of the Companies Act 2008 is to encourage 'transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation.'[93] No mention is made of the environment under the purpose of the Act, but a reasonable assumption could bemade that transparency in the role of corporations in the 'social' life of the nation could include environmental concerns. Such transparency could be linked to the requirement for corporations to provide IR that covers the entirety of a corporation's activities.

Section 76 of the Act deals with the standard of conduct expected of directors of companies. In this section a duty of diligence is expected of the directors, such that when the directors act, they do so to promote the best interests of the company.[94] But what if the best interests of the company result in environmental harm or the violation of human rights? What if a situation like that of Ken Saro-Wiwa arises? Any action that might save the company yet result in human rights violations or environmental degradation is sure to result in liability. This would be consistent with sections 24(F)(2)(e) and 24(N)(7) of NEMA, for example. In any case, the Companies Act itself requires a director to act 'with the degree of care, skill and diligence that may

92 Ss 24(F)(2)(e) and 24(N)(7).

93 S 7(b)(iii).

94 S 76(3)(b) and (c).

reasonably be expected of a person … having the general knowledge, skill and experience of that director."[95]

In the event that a stakeholder believes a corporation or anyone associated with it to have breached the Companies Act, the Act provides a remedy: '[a]ny person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention."[96] Stakeholders with sustainability concerns or social concerns could possibly use this provision to obtain a remedy or to force compliance.

Ultimately, while the Companies Act does not say much about ESG aspects, it stands to reason that the King IV Report complements the Act. To be sure, the Companies Act mentions corporate governance only once in the whole Act: '[t]he purposes of this Act are to … promote the development of the South African economy by … encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation."[97] The only other governing document on corporate governance in South Africa is King IV, and this could be how ESG matters filter into the governance of corporations.

95 S 76(3)(c) (ii).

96 S 218(2).

97 S 7(b)(iii).

6.7 Aspects of ESG in a judicial context: *Company Secretary of Arcelormittal South Africa v Vaal Environmental Justice Alliance*

This chapter has so far described the aspects of ESG as they are understood broadly on a global scale and then demonstrated how some of those aspects are accommodated in the South African corporate governance setting. The last part of this chapter appraises the way some ESG aspects played out in practice in a case.

The *Company Secretary of ArcelorMittal South Africa v Vaal Environmental Justice Alliance* (VEJA case) [98] concerned ArcelorMittal South Africa Limited's refusal to release information related to its past and present activities and its past documented strategic and operational approaches to environmental protection in the area in which it operated.[99] For contextual purposes, ArcelorMittal (the applicant) was at the time South Africa's largest steel manufacturer, accounting for over 90% of the country's steel products. The respondent, VEJA, was a non-profit voluntary association which described itself as advocates for environmental justice. The judge characterised the issues before the court as follows:

> [T]he present litigation represents, in juxtaposition, two competing interests, namely industrial activity and its concomitant significance for the country's development and economy, as against concerns about the preservation of the environment for the benefit of present and future generations.[100]

98 (69/2014) [2014] ZASCA 184 (26 November 2014).

99 Para 2.

100 Para 3.

This clearly showed the contrast between the corporation and non-market stakeholders who stood to be potentially affected by the activities of the corporation.

Relying on the provisions in the Promotion of Access to Information Act (PAIA),[101] the respondent sent two requests, specifically asking for ArcelorMittal's Environmental Master Plan and the progress reports in relation to the plan. For the respondent, ArcelorMittal had developed the Environmental Master Plan (which could be considered the equivalent of an EPS) for the purposes of rehabilitating the environment in which it operated in Vanderbijlpark. The respondent's justification for these requests was that they sought to enforce the constitutional right to a clean and healthy environment, as well as to ensure that ArcelorMittal fulfilled its environmental obligations in terms of NEMA.[102] The second request concerned information relating to the rehabilitation of a disposal site where hazardous waste was reported to have been dumped at some point.

ArcelorMittal's attorneys responded to the requests by asking for more clarity on some of the requests; asking how they knew of the existence of the documents they were requesting; and requesting proof which would confirm VEJA's mandate to act in this regard as, for the applicant, VEJA was usurping a regulatory authority's duty to monitor environmental compliance.[103] After further correspondence between the lawyers of the parties, ArcelorMittal declined to provide the information, arguing that the respondent had not demonstrated a right which they sought to protect in terms of PAIA. This led to the case going before the High Court of South Africa.

101 Para 3; Promotion of Access to Information Act 2 of 2000.

102 Para 8.

103 Para 12.

In its affidavits VEJA produced evidence of past executive reports which made reference to the Environmental Master Plan and the strategies to be used to mitigate environmental damage over a period of many years. Further evidence was submitted to prove that the Environmental Master Plan had been included in annual reports as ArcelorMittal's environmental strategy.[104] ArcelorMittal, however, showed that in 2010 the corporation had not released the Environmental Master Plan with its annual reports because it had been outdated. In a series of explanations ArcelorMittal demonstrated how the Environmental Master Plan had been developed under inappropriate standards reliant on worst case scenario tests, when in fact ArcelorMittal's actual performance was above board.[105] This, for ArcelorMittal, meant that the Environmental Master Plan was outdated.

VEJA objected, arguing that at the very least the Environmental Master Plan provided a baseline which could be relied on and that even though it might have been outdated ArcelorMittal's actions even to its shareholders did not indicate such. In any case, VEJA argued that ArcelorMittal had relied on this seemingly flawed plan to get environmental authorisations for its activities. ArcelorMittal again insisted that VEJA 'was setting itself up as a parallel regulating authority in relation to the environment, which the legislation does not sanction'[106] and that some of the information sought was confidential.

The High Court decided against ArcelorMittal, finding that VEJA needed the information if it were to successfully assert its right to a clean and healthy environment: 'a refusal of VEJA's application would hamper the organisation in championing the preservation and protection of the environment'[107]

104 Para 19.

105 Paras 22-29.

106 Para 38.

107 Para 42.

and that although ArcelorMittal argued the Environmental Master Plan was outdated, it had been consistently submitted to authorities and could legitimately be scrutinised by entities like VEJA. ArcelorMittal was ordered to release the documents to VEJA.[108]

In deciding the appeal from the High Court, the Supreme Court of Appeal emphatically noted the following:

> AM's acknowledged history of operational impact on the environment is important. This is not an aspect touched on by the high court. AM's industrial activities, impacting as they do on the environment, including on air quality and water resources, has an effect on persons and communities in the immediate vicinity and is ultimately of importance to the country as a whole. Translated, this means that the public is affected and that AM's activities and the effects thereof are matters of public importance and interest. Put differently, the nature and effect of AM's activities are crucially important. AM is a major, if not the major, polluter in the areas in which it conducts operations.[109]

The Supreme Court of Appeal also noted that ArcelorMittal had also committed in its 2010 annual report to engaging with stakeholders on environmental issues, including with VEJA.[110] Again, this confirms the importance of the information presented in annual reports and the necessity for these reports to be made public as part of the ESG processes. In fact, the Supreme Court of Appeal castigated ArcelorMittal for its actions in refusing to release the information, arguing that the corporation should have been worried about the potential for its image to be tainted by such refusal. The Court added that '[t]he disclosure of the information will enable either a

108 Para 48.

109 Para 52.

110 Para 53.

verification of AM's stance or might cause us to have even greater concerns about environmental degradation.'[111]

The Supreme Court of Appeal ended its castigation by noting:

> Corporations operating within our borders, whether local or international, must be left in no doubt that in relation to the environment in circumstances such as those under discussion, there is no room for secrecy and that constitutional values will be enforced.[112]

This was a clear affirmation of the importance of ESG and stakeholder relations. The Supreme Court of Appeal essentially confirmed that it matters to non-market stakeholders how a corporation handles its business, especially if it is engaged in an activity that affects the environment and communities. This is why IR matters, because information presented is what the public has go on in understanding a corporation's activities.

6.8 Unbridled profit

The levels of environmental awareness enveloping the world are remarkable. For corporate governance, this means that corporations will not only face pressure from their investors, but also from their consumers and non-market stakeholders. It is in corporations' best interests to adopt EMSs that integrate ESG into their governance.[113] This is because a company's image will increasingly be determined not only by its financial reports to the exclusion of the social and environmental trail that accompanies success or failure.

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111 Para 81.

112 Para 82.

113 AE Jeffers, S Romero and F Aquilino 'The increased demand for transparency on ESG roles in sustainability investing strategies' (2018) *Proceedings of the North-East Business and Economic Association* 143–145.

Ultimately, unbridled profit is no longer the order of the day for corporations in the global space. With globalisation and the increase in TNC operations, it has now become much easier for corporations to suffer because of negative coverage related to their activities. There is thus a global reputational incentive for corporations to ensure that wherever they operate, they factor in ESG as part of their corporate governance efforts.[114] One could almost state that ESG matters should and must form part of a corporation's anticipated and actual costs, such that the environmental and social risks could assist in determining whether an investment is viable or not.

For its part, South Africa seems to be on the right path as far as policy and law are concerned, but the levels of corporate governance failures across the board that have rocked the country the last couple of years are astounding. However, if VEJA is anything to go by, then one could also argue that courts will always be there to ensure that failures of corporate governance are addressed and that threatened rights are protected.[115]

114 K Neel and O Voorhis 'Executive compensation in an era of stakeholder primacy: Integrating ESG metrics into pay plans' (2020) *Directors and Board*s 5–52.

115 See in general AE Jeffers, S Romero and F Aquilino 'The increased demand for transparency on ESG roles in sustainability investing strategies' (2018) *Proceedings of the North-East Business and Economic Association* 143–145; D Monsma 'Equal rights, governance and the environment: Integrating environmental justice principles in corporate social responsibility' (2006) *Ecology Law Quarterly* 443–498.

CHAPTER 7

Corporate governance and principles of international environmental law in Africa

Caiphas Brewsters Soyapi

7.1 Introduction

There are many terms for the interplay between the environment and corporate governance. Some of these include corporate environmental governance, corporate social responsibility, corporate sustainability, environmental, social and corporate governance (ESG). For ease of reference this discussion will use the term corporate environmentalism to refer to the integration of environmental considerations in corporate governance settings.[1] 'Corporate environmentalism' can be understood to mean a corporation's 'commitment [to] and adoption of responsible actions targeting environmental protection and improvement while achieving economic performance.'[2] This commitment is geared to the minimisation of environmental damage and can be used to determine a corporation's environmental performance.[3]

1 M Phillips 'Daring to care: Challenging corporate environmentalism' (2019) *Journal of Business Ethics* 1151.

2 D Li et al. 'Effects of corporate environmental responsibility on financial performance: The moderating role of government regulation and organizational slack' (2017) *Journal of Cleaner Production* 1324.

3 S Manrique and CP Martí-Ballester 'Analyzing the effect of corporate environmental performance on corporate financial performance in

As noted earlier in Chapter 6, considerations of what kind of environmental duties a corporation should have are in part dependent on the kind of activities which a corporation undertakes. This is important to the extent that once we acknowledge that corporations are private entities serving a specific purpose, over-regulation and overburdening them with environmental responsibilities which might be unnecessary in relation to their activities could actually end up pushing corporations away. Yet scholars also realise that if governmental regulatory measures are not sufficient, 'firms may not value much about their environmental performance.'[4] Consequently, as they are situated in a developing continent, African states will certainly embark on and are exploiting their natural resources for development, but caution must be exercised in relation to how their corporations function and consideration must also be given to environmental issues in such activities.

The imperative for corporations to engage in corporate environmentalism is necessitated in that that many states in Africa now acknowledge the right to a clean and healthy environment.[5] Most of the provisions pertaining to environmental rights come with the imperative to protect the environment for the benefit of present and future generations. If ensuring a healthy environment is not only a state responsibility but also an individual and juristic one, then perhaps as a matter of public interest corporations should engage in corporate environmentalism. In fact, it is now settled that corporations are role players in environmental governance: '[t]he private sector, and in particular global corporations, are becoming increasingly important

developed and developing countries' (2017) *Sustainability* 9 https://bit.ly/3NmPMXD (accessed 15 December 2020).

4 D Li et al. 'Effects of corporate environmental responsibility on financial performance: The moderating role of government regulation and organizational slack' (2017) *Journal of Cleaner Production* 1326.

5 See in general DR Boyd *The environmental rights revolution: A global study of constitutions, human rights, and the environment* (UBC Press Vancouver 2011).

to the future prevention of global environmental problems.'[6] Writing on the perceived obligations stemming from international environmental agreements, Kock and Min state:

> [W]e suggest that by signing these accords governments make rather visible commitments to stricter environmental targets and thus essentially impose a (environmental) stakeholder-centric view on their local firms. By endorsing environmental targets as legitimate, governments, as powerful actors, send a strong signal of the importance of the environment to stakeholders, thereby likely causing isomorphic effects.[7]

In other words, by becoming party to international instruments that incorporate principles of international environmental law, states commit themselves to furthering environmental protection through regulatory efforts which apply to citizens as well as juristic persons like corporations.

How corporations set out to engage in corporate environmentalism matters. As Saleem *et al.* have recently said, cooperate environmentalism is composed of the environmental strategies of a corporation as well as the environmental orientation of a corporation.[8] The former includes aspects like environmental management systems which corporations employ as avenues for realising their environmental responsibilities. As noted in Chapter 6, ISO 14001 is an

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6 J Salo 'Corporate governance and environmental performance: Industry and country effects' (2008) *Competition and Change* 328-354.

7 CJ Kock and BS Min 'Legal origins, corporate governance, and environmental outcomes' (2016) *Journal of Business Ethics* 512.

8 F Saleem et al. 'Corporate environmentalism: An emerging economy perspective' (2020) *Sustainability* https://bit.ly/3NlRqJp (accessed 30 November 2020); B Luppi, F Parisi and S Rajagopalan 'The rise and fall of the polluter-pays principle in developing countries' (2012) *International Review of Law and Economics* 135.

example which is often integrated into a corporation's overall governance strategy. The latter, however, deals with how a corporation generally recognises the importance of environmental issues in its activities,[9] for example by abiding by laws requiring environmental impact assessments to be undertaken or appropriately remedying the environment as the polluter-pays principle would dictate. As aspects of environmental management systems as corporate environmental strategies were briefly referred to in Chapter 6, it is the latter conceptualisation of corporate environmentalism that informs this chapter.

In crafting the discussion, and in addition to this introduction, the chapter is divided into five further parts. By employing the example of corporations in the extractive sector generally, the second part demonstrates the urgent need for good environmental governance. This discussion then sets the groundwork for a brief analysis of the growing global recognition of corporate environmentalism. Having determined good environmental governance and corporate environmentalism as necessities for the pursuit of the overall goal of sustainability, the fourth part of the chapter explores jurisprudence from South Africa, Uganda and Kenya, wherein principles of international environmental law are at play, demonstrating the interplay between state environmental governance and corporate environmentalism. The fifth and penultimate part then explores the possibilities of corporations looking to African-led initiatives in the pursuit of corporate environmentalism, as well as enhancing environmental governance so far as it relates to the activities of corporations (on the part of the state). The last part offers some final thoughts.

9 See above.

7.2 The urgent need for good environmental governance in Africa

The reality of our present times is that the world requires corporations to sustain its neoliberal consumer-driven socioeconomic development agenda.[10] Considering that corporations are generally not in business for altruistic purposes, it is reasonable to assume that many of them function for maximising profit.[11] This creates obvious challenges related to the sustainability of this socioeconomic development agenda. To illustrate some of these potential challenges, let us reflect on the example of extractive industries in the African context where natural resources are significant contributors to the gross domestic product of states and where there are many mineral extraction-purposed corporations.[12] To start with, for natural resource extraction to generate sufficient revenues to contribute meaningfully to an economy, it is usually done on a large scale, which often results in acute socio-ecological impacts.[13]

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10 M MacLennan 'Locating the policy space for inclusive green growth within the SADC extractive sector' (2012) *International Policy Centre for Inclusive Growth* 1.

11 S Manrique and CP Martí-Ballester 'Analyzing the effect of corporate environmental performance on corporate financial performance in developed and developing countries' (2017) *Sustainability* 9 https://bit.ly/3sGMp4q (accessed 20 October 2020).

12 Besada and Martin also find that between 2000 and 2011 natural resource extraction made a major contribution to the GDPs of over 15 countries; H Besada and P Martin 'Mining codes in Africa: Emergence of a 'fourth' generation?' (2015) *Cambridge Review of International Affairs* 264.

13 A Du Plessis and L Kotze 'Absolving historical polluters from liability through restrictive judicial interpretation: Some thoughts on *Bareki NO v Gencor Ltd'* (2007) *SLR* 173.

Worse still, if an extractive corporation operates in a state with weak human rights protection, dubious rule of law safeguards and weak governance practices where regulation is poor and opportunities to avoid costly compliance measures are the order of the day, then environmental protection is potentially an afterthought. In fact, there is a term for such states – 'pollution havens'[14] – and in the African context some states potentially fit this description. For example, I have previously noted that in Zimbabwe there are several instances where mining has been undertaken without legally required environmental impact assessments or where companies deliberately engage in extractive activities only to start with licensing processes after judicial proceedings have been instituted.[15]

The challenge is more complex, however, as while mining corporations are mostly to blame for environmental transgressions, it is often governments which, as the primary responsible regulators, fail dismally at enforcing the law. Shari and Hofmann correctly note that governments face a difficult challenge. In this respect, they maintain that governments must create an environment attractive to private investment in the extractive industry *and* they must address policy issues such as limiting the environmental impacts associated with the extractive industry.[16] In an ideal setting these two goals should be perfectly balanced, but in some African states the nature and quality of governance is decidedly weak. Accordingly, where good environmental

14 G Dowell, S Hart and B Yeung 'Do corporate global environmental standards create or destroy market value?' (2000) *Management Science* 1060.

15 See comments in B Soyapi 'Zimbabwe's 'look east' policy: A sociolegal perspective' (2017) *Southern African Public Law* 176-92;B Soyapi 'The judiciary and environmental protection in Zimbabwe' in M Addaney and J Oluborode (eds) *Human rights and the environment under African Union law* (Palgrave 2020).

16 S Bryan and B Hofmann (eds) *Transparency and accountability in Africa's extractive industries: The role of the legislature* (2007) 19.

governance on the part of the state and its institutional regulatory mechanisms is weak, then corporations could operate with impunity, as is the case in Zimbabwe.

Levy and Newell provide a useful generic description of environmental governance, a term which they describe as implying a broad, general system of order and structure. In their view, environmental governance is:

> [T]he broad range of political, economic, and social structures and processes that shape and constrain actors' behaviour towards the environment. Environmental governance thus refers to the multiple channels through which human impacts on the natural environment are ordered and regulated. It implies rule creation, institution-building, and monitoring and enforcement. But it also implies a soft infrastructure of norms, expectations, and social understandings of acceptable behaviour towards the environment, in processes that engage the participation of a broad range of stakeholders.[17]

This definition suggests that environmental governance is an institutionalised social construct that provides for state and non-state means to influence and direct (human and juristic) behaviour vis-à-vis the environment. It is an institutional response (juridical, political, economic and social) that orders and regulates human and juristic behaviour to the extent that such behaviour and its effects conform to what society perceives to be acceptable vis-à-vis the environment. The main functions of environmental governance are rule creation (e.g. in the form of environmental laws), which includes the revision, improvement and/or repeal of rules; the interpretation of these rules; and the establishment of institutions that must oversee and conduct rule creation and ensure the monitoring and enforcement of these rules.[18]

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17 D Levy and PJ Newell (eds) *The business of global environmental governance* (MIT Press Cambridge Massachusetts 2005) 2-3.

18 See the discussion below in which these issues can be seen to be at play in the jurisprudence of some African states.

Collectively considered, the foregoing descriptions suggest that environmental governance is a normative institutional regulatory intervention and social construct that aims to influence how people interact with the environment. It entails a pluralistic, dynamic, multilevel, multi-actor process of change, which idealistically aims to sustainably optimise environmental benefits and use, while at the same time seeking to equally protect environmental capital for the sustainable benefit and use of present and future generations. As such, achieving sustainability through environmental governance is arguably more likely to happen when it is done through the good governance paradigm. This is especially true when we accept that if governance is a reaction to existing or expected future regulatory problems such as environmental degradation, environmental policies and laws will not function in the face of weak governance and it will be impossible to achieve sustainability.[19]

It follows then that good environmental governance is an ideal that demands effort and deliberate action on the part of the state, especially if corporations are to be expected to play their part; for although investors usually prefer stable and predictable environments, extractive corporations have been known to go wherever lucrative resources are to be found.[20] Hilson and Maconachie confirm that not even the mismanagement of revenue flows, rampant corruption, prolonged autocracy and civil violence, in other words poor governance, could discourage investment by investors (as is evident from countries like the Democratic Republic of the Congo and Sierra

19 UN GA Res 66/288 The Future We Want A/RES/66/288 (11 September 2012).

20 UN Expert Group Meeting on Natural Resources and Conflict in Africa: Transforming a Peace Liability into a Peace Asset, Conference Report 17-19 June (Cairo Egypt 2006) 17.

Leone).[21] In addition, situations where corporations yearning for big profits deal with inefficient governments could result in a lack of transparency and accountability, corruption and weak law enforcement.[22] As I noted earlier, Zimbabwe is one such example and to this day the status quo has not changed at all. Ultimately, in the face of poor environmental governance it remains up to corporations to take responsibility for the pursuit of sustainability through corporate environmentalism.

7.3 Corporate environmentalism in a global context

Writing on corporate governance in general, Claessens observes that discussions on corporate governance have gained traction around the globe because of the scandals associated with the governance of corporations.[23] These have been proliferating around the world and in Africa; perhaps the most infamous being the Shell case in Nigeria.[24] As can be seen from this case, one of the biggest challenges for corporate environmental governance at the international level is that corporate law is both engendered and enforced in national jurisdictions, as opposed to internationally. This is precisely why there are so many soft law and voluntary initiatives at the international level. On this level, the 'environment' is now considered a stakeholder in corporate

21 G Hilson and R Maconachie "Good governance' and the extractive industries in Sub-Saharan Africa' (2008) *Mineral Processing and Extractive Metallurgy Review: An International Journal* 57.

22 P Chisanga 'Environmental degradation in the extractive and other industries in Africa' (2013) *Action Aid* http://goo.gl/Idte13 (accessed 28 January 2021).

23 S Claessens 'Corporate governance and development' (2006) *The World Bank Research Observer* 95.

24 https://bit.ly/3h06yja (accessed 15 November 2020).

governance discussions,[25] such that its protection must be the subject of corporate governance. The problem, as Ong rightly notes, is in relation to the legal subjectivity of the environment:[26] i.e., unlike other stakeholders the environment is not anthropocentric and cannot readily litigate for its own interests. However, if one views the effects of the damage to the environment as a consequence of anthropocentric actions, as is the case with climate change, and that industrialisation has been at the centre of this damage, then it stands to reason that the environment is in fact an identifiable stakeholder with interests to be protected. Needless to say, Africa is a vulnerable continent that stands to suffer from the effects of climate change, because although the causes of such changes in climate might not be located within Africa, the consequences are spreading to the continent.[27] This is why discussions about the trans-nationalisation of corporate environmentalism have gained traction outside of the general discussions on corporate social responsibility.

In addition, while they set principles for environmental governance, international environmental agreements are yet to settle the issue of where international environmental liability lies, as practice is that state laws apply.[28] This failure to have an international framework that regulates

25 DM Ong 'The impact of environmental law on corporate governance: International and comparative perspectives' (2001) *European Journal of International Law* 685 and 689.

26 See above.

27 For a general discussion of the impacts of climate change and how industry has played a significant role in climate change, see the discussion in T Clarke 'The widening scope of directors' duties: The increasing impact of corporate social and environmental responsibility' (2016) *Seattle University Law Review* 531-578.

28 DM Ong 'The impact of environmental law on corporate governance: International and comparative perspectives' (2001) *European Journal of International Law* 697. The exceptions are those instances where corporations

environmental liability for corporations mirrors the status quo in the general human rights system, where piercing the corporate veil is seemingly impossible as companies have their subsidiaries registered/incorporated where they operate. That is not to say national systems cannot play a role in at least regulating or punishing corporations that violate environmental laws or renege on environmental responsibilities. As the discussion that follow will show, principles of international environmental law have been used to impute liability on corporations and even their directors.

One can also see the principles of international environmental law at play in the United Nations Global Compact. The Global Compact, which is a voluntary initiative constituted by CEOs and representing business commitments to implementing sustainability initiatives, has a set of principles which corporations are expected to strive for.[29] In terms of these principles, businesses are required to 'support a precautionary approach to environmental challenges';[30] 'promote greater environmental responsibility'[31] and 'encourage the development and diffusion of environmentally friendly technologies.'[32] The obvious method through which these principles could be measured against corporate performance is through reportage. To this end, some corporations now adopt environmental management systems that would require the corporations to report on their environmental

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engage in activities which involve hazardous substances like nuclear waste, which would be covered by the Paris Convention on Third Party Liability in the Field of Nuclear Energy 1960, for example.

29 The principles can be found at United Nations Global Compact: The Ten Principles of the UN Global Compact https://www.unglobalcompact.org/about (accessed 25 January 2021).

30 Principle 7.

31 Principle 8.

32 Principle 9.

performance. Consequently Clarke observes that the widespread adoption of annual environmental reports by Anglo-American corporations is an indication that the consideration of environmental aspects in corporate governance is no longer rhetoric but is a practical change.[33]

The significance of corporate environmentalism is also evident from the recent Sustainable Development Goals which call for sustainable practices in development processes. Sustainable Development Goal 12 seeks to 'ensure sustainable consumption and production patterns.'[34] Bolstered by a set of targets for its fulfilment, Sustainable Development Goal 12 strives for the encouragement of 'companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle.'[35] There is thus a clear mandate from soft law initiatives for corporations to engage in environmentalism. As Clarke notes, 'the goal of a sustainable enterprise that exists integrally with the natural environment is both possible and necessary: business strategies can be redirected to serve the natural environment rather than to destroy it.'[36] To this end, through the principles of sustainable development, for example, the polluter pays and the preventative principle, corporations could organise their activities in a way that considers their overall impact on the environment.

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33 T Clarke 'The continuing diversity of corporate governance: Theories of convergence and variety' (2016) *Ephemera: Theory and Politics in Organization* 43.

34 Sustainable Development Goals https://bit.ly/2KGgDgC (accessed 25 January 2021).

35 See above.

36 T Clarke 'The widening scope of directors' duties: The increasing impact of corporate social and environmental responsibility' (2016) *Seattle University Law Review* 549.

We are now living in a highly globalised world. The internet of things has facilitated a wave of consciousness unseen before. The younger generation is believed to be now more environmentally conscious than ever before, such that they are likely to spend their money on corporations providing services in environmentally friendly ways.[37] With this consciousness comes an enhanced need for due diligence in the actions of both individuals and juristic persons. As far as the latter is concerned, this globalisation of corporate governance has resulted in what Ong terms a 'corporate environmental reality'[38] where it is increasingly becoming not only necessary but perhaps even mandatory for corporations to subscribe to well-known and internationally agreed standards of corporate environmental governance. As the discussion will show through case law, gone are the times when companies could operate with impunity and as they pleased.

37 JC Jung and E Sharon 'The Volkswagen emissions scandal and its aftermath' (2019) *GBOE* 6–15. As noted earlier, the level of environmental consciousness of its clientele could help a corporation build its brand and sustain its activities.

38 DM Ong 'The impact of environmental law on corporate governance: International and comparative perspectives' (2001) *European Journal of International Law* 685.

7.4 At the intersection of corporate governance and principles of international environmental law in Africa

Some courts in Africa have been willing to castigate corporations and governments for not honouring principles of international environmental law like public participation[39] or the precautionary principle.[40] Such failures on the part of corporations were related to the violation of external existing state laws. Thus, when environmental considerations are externalised, outside methods of enforcement or regulation like fines and civil liability are used to address corporate environmental damage or failure. In the South African context, for example, the National Environmental Management Act subscribes to the polluter pays principle.[41] What this implies is that where appropriate, even directors of a company could indeed be held liable for environmental degradation. This is, however, only when there are specific and clear laws or directives to which companies are expected to adhere.

7.4.1 Polluter pays principle

A classic example of the 'polluter pays principle' is the South African case, *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Limited and Others (Stilfontein)*.[42] Operating in the Klerksdorp, Orkney,

39 See for example the findings in the Kenyan case of *Mui Coal Basin Local Community and 15 Others v Permanent Secretary Ministry of Energy and 17 Others* [2015] eKLR (Constitutional Petition No 305 of 2012).

40 See for example the findings in South Africa's *Earthlife Africa Johannesburg v Minister of Environmental Affairs and Others* (*Earthlife*) 2017 (2) All SA 519 (GP).

41 National Environmental Management Act 107 of 1998 s 2(4)(p).

42 [2006] ZAGPHC 47 (15 May 2006). For examples of directors being held liable in other jurisdictions, see discussion in DM Ong 'Effects of corporate

Stilfontein and Hartebeesfontein areas of South Africa, Stilfontein Gold Mining Company's activities (along with those of other mining companies) had resulted in a situation where (among other consequences) untreated underground water had become polluted to the point where other connected 'valuable water resources' could also subsequently become polluted.[43] In addition, the pumping of underground water through a shaft operated by Stilfontein Gold Mining Company was also necessary for the operations of other mining companies, such that the company's failure to sustain the shaft would result in the connected shafts of the other companies being flooded and their property damaged. When, for various reasons, Stilfontein Gold Mining Company failed to maintain this pump, the responsible water authorities issued directives of a legal nature which required the company to honour its commitments, which included refraining from activities that would result in environmental (water pollution in this case) damage.[44] When these directives were not adhered to, the Minister of Water Affairs and Forestry instituted legal proceedings against the company.

Interestingly, between the time that the directives were issued and the legal proceedings instituted, four directors of Stilfontein Gold Mining Company resigned from their positions. Having considered why the directives had to be adhered to, the court went on to address the aspect of the *en masse* resignation of the directors, finding that such an occurrence had not previously been experienced in South Africa, or even in English case law.[45] The directors were found to have flouted the very basic foundations of corporate governance in

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environmental responsibility on financial performance: The moderating role of government regulation and organizational slack' (2001) *European Journal of International Law* 685-726.

43 Para 2.

44 Para 6.

45 Para 16.1.

the light of their fiduciary duties towards the company, such that they could not be 'allowed to merely walk away because it is convenient for themselves to do so.'[46] Having cited the Companies Act, as well as the King Report, the court found the following:

> The object of the directives is to prevent pollution of valuable water resources. To permit mining companies and their directors to flout environmental obligations is contrary to the Constitution, the Mineral Petroleum Development Act and to the National Environmental Management Act. Unless courts are prepared to assist the State by providing suitable mechanisms for the enforcement of statutory obligations an impression will be created that mining companies are free to exploit the mineral resources of the country for profit over the lifetime of the mine, thereafter they may simply walk away from their environmental obligations. This simply cannot be permitted in a constitutional democracy which recognises the right of all of its citizens to be protected from the effects of pollution and degradation … I am persuaded that the second to fifth respondents, notwithstanding their sudden resignation, must be held responsible for the first respondent's failure to comply with an order of court.[47]

This was a clear affirmation of the roles that directors have in their organisations in relation to external regulatory interventions, such that one cannot separate the corporation's environmental responsibilities from the duties of its directors, especially because it is through the directors

46 Para 16.6. Clarke has recently noted that risk, strategy and investments, as they pertain to a director's fiduciary duties, are now calibrated alongside environmental and social responsibilities; See T Clarke 'The widening scope of directors' duties: The increasing impact of corporate social and environmental responsibility' (2016) *Seattle University Law Review* 532.

47 Para 16.9.

that a corporation acts.[48] The situation might, however, be different in circumstances where there are no directives or specific laws on how corporations should protect the environment, or where there is weak state governance. What is clear, though, is that the externality of environmental regulation in the context of the polluter pays principle, as it played out in *Stilfontein,* is in that liability ensues after the pollution has happened (or when it is about to happen) whereas, if environmental protection considerations are internalised, practice would dictate that the planning and strategies for a corporation's development are undertaken with the price of their potential impacts on the environment taken into account.

7.4.2 The preventative principle

According to Sands, the 'preventative principle' aims at the avoidance of environmental harm, or preventing environmental harm from occurring.[49] In other words, corporate environmentalism in such circumstances would dictate that corporations must in fact prevent environmental damage from occurring, even when there are no laws in place. This much is clear from Uganda's *Asiimwe v Leaf Tobacco and Commodities (U) Ltd and NEMA* (*Asiimwe*).[50] In this case, the applicants argued that the respondents were violating their right to a healthy environment as protected under Article 39 of Uganda's Constitution. The respondent, a tobacco processing company, had

48 The question of whether the resignation was a direct result of the directors trying to evade their environmental responsibilities was addressed in an appeal, and the Supreme Court of Appeal absolved the directors. For comments on the appeal see L Kotzé and H Lubbe 'How (not) to silence a spring: The Stilfontein saga in three parts?' (2009) *South African Journal of Environmental Law and Policy* 49-77.

49 P Sands *Principles of international environmental law* (CUP 2003) 247.

50 (Misc. Cause No. 43 of 2013) [2014] UGHCCD 179 (21 October 2014) https://ulii.org/node/25145 (accessed 14 November 2020).

been operating its business and indiscriminately polluting the environment through unregulated air emissions. However, it turned out that Uganda's National Environmental Management Authority had not set/established air quality standards through which the emissions of Leaf Tobacco and Commodities could be regulated/reviewed.

Leaf Tobacco and Commodities argued that it could not have been violating the right to a healthy environment since there were no standards with which to evaluate its emissions, to which the court disagreed:

> [T]o say that one cannot gauge the totality of the right to a clean and healthy environment in the absence of standards and yet such right is provided for under the Constitution and National Environment Act is unacceptable by this Court, it is unrealistic and too theoretical. And if one may ask, is it the Applicants to set the standards or NEMA? If NEMA has failed to do its work, and yet Applicants are suffering or claim to be suffering as a result of the actions of both NEMA and another, how long should they continue to suffer as they wait for standards to be set?[51]

During the course of the proceedings, it became clear too that Leaf Tobacco and Commodities was operating its activities within a residential area, which worsened the plight of those affected by the smell and pollution from the tobacco-processing activities. In this regard the court ruled against the company, finding that the location was in fact a violation of laws on impact assessments, in addition to a direct violation of the right to a clean environment.[52] Having quoted the idiom 'prevention is better than cure' the court further found that:

> [T]here is no other opportune time than now to apply precautionary measures to avoid irreversible dangers to public health associated with

51 At 2.

52 At 2.

> tobacco processing. In this regard, I reject the 1st Respondent's alleged contribution to the economy of this country because that is not helpful to people who are living in [*sic*] unhealthy environment and people who cannot benefit when they are sick or threatened with highly potential sickness and even death.[53]

It should have been obvious to Leaf Tobacco and Commodities, even in the absence of air quality standards, that the indiscriminate discharge of emissions would damage the environment such that corporate environmentalism would come into play. In other words, governance failures on the part of the state do not absolve the responsibility of a corporation to prevent environmental harm. Corporations must operate within a 'beyond-compliance' framework in that apart from the expressly stated and legally founded environmental requirements, they must also embark on reasonable, responsible and perhaps even ethical actions.[54]

7.4.3 Sustainable development and public participation

Popularised through the 1987 Brundtland Report, the principle of sustainable development requires that the development and use of natural resources be holistic and ultimately sustainable by meeting the needs of the present generation without compromising those of the next generation.[55] While many courts have pronounced on this concept, it is the Kenyan case *Moffat Kamau and 9 Others v Aelous Kenya Limited and 9 Others (Moffat Kamau)*

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53 At 9.

54 D Li et al. 'Effects of corporate environmental responsibility on financial performance: The moderating role of government regulation and organizational slack' (2017) *Journal of Cleaner Production* 1324.

55 P Sands *Principles of international environmental law* (CUP 2003) 252.

that will be discussed.[56] The case is interesting because the project being undertaken was a 'green project' concerning the generation of electricity through harnessing wind in line with Kenya's development policy agenda, Vision 2030, which was envisioned to facilitate the pursuit of sustainable development. One of the respondents in the case, Kinangop Wind Park Ltd, was a special purpose vehicle with equity investors from Mauritius, Norway and South Africa, with Standard Bank of South Africa providing debt for the project.[57]

The facts relevant to this discussion are that the petitioners approached the Environment and Land Court of Kenya, challenging the upscaling of the wind project from an initial 30 megawatts to 60 megawatts.[58] Part of their argument was that as residents situated in or around the area where the wind farm was to be constructed they had never been consulted in relation to the issuance of a licence for the project, especially considering that in terms of the established environmental impact assessment processes, those potentially affected by the project must be heard.[59] It followed that whatever environmental impact assessment licence had been obtained could not have been given as a result of 'informed consent' on the part of those to be affected.[60]

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56 Constitutional Petition No. 13 of 2015 [2016] eKLR http://kenyalaw.org/caselaw/cases/view/125995 (accessed 14 November 2020).

57 Para 22.

58 Para 3.

59 See in this regard another Kenyan case, *Mui Coal Basin Local Community and 15 Others v Permanent Secretary Ministry of Energy and 17 Others*, [2015] eKLR (Constitutional Petition No 305 of 2012) para 97.

60 *Moffat Kamau* case para 11.

From the court's analysis, it appeard that Standard Bank South Africa had commissioned an environmental impact assessment gap analysis, which did find 'some gaps between the existing project documentation and the relevant international environmental and social standards.'[61] This gap analysis was never presented in court and the court expressed dismay at this lapse. Further, the court deliberated on whether the upscaling of the project by more than 100% from 30 megawatts to over 60 megawatts demanded that an altogether new environmental impact assessment be conducted, or if a variation was sufficient.[62] In its finding the court castigated the authority, noting that the National Environmental Management Authority had to exercise its discretion in whether to vary a licence in a reasonable manner, in which in this case it had failed.[63] Also, in responding to the fact that the company argued in justification that they were supported by the government of Kenya in engaging in a project presumed to be green and not destructive of the environment, the court emphasised the need for environmental processes to be followed by both the company and the responsible authority if sustainable development were to be achieved. In a lengthy yet poignant finding the court found the following:

> [A]ll projects, whether 'Green' or not, and however beneficial, must be implemented in accordance with the environmental laws of the country. There should be no shortcuts taken. Where an EIA is required, let that be done, and let the same be done properly. This court is not going to overlook the importance of such a process, on the arguments that the project at hand is of immense economic benefit to the country. True, we need to develop, and we need to take strides towards achieving our development goals. But this needs to be done within the proper legal framework, so that we do not commit the same mistakes that have

61 Para 75.

62 Para 78.

63 Para 84.

> been committed by our predecessors, which mistakes have led to the degradation of the environment, not to mention climate change. The world is now struggling to mitigate such aftershocks and it falls upon this generation to do things right in so far as the protection of the environment is concerned. The starting point is of course following all proper procedures as outlined in the law relating to environmental protection. This court is not going to be shy to point out mistakes where they have occurred and to require proper procedure to be followed, the importance of the project notwithstanding, for we have a higher mandate to ensure that the environment is protected for this and the future generations.[64]

The court finally required of the company to go back to the drawing board and ensure that they followed the correct environmental procedures: '[i]t behoves upon the proponents of the project to get their act together, follow the law and see whether their project will be given the go ahead.'[65] This required them to restart the whole process of public participation and to ensure that they obtained the required input from those who could be affected by the project. Ultimately, as these cases demonstrate, a thriving space for investment and corporations which could prove beneficial to the pursuit of sustainable development has to have an elaborate framework on environmental governance, while corporations themselves (especially those involved in activities that impact on the environment) would do well to internalise corporate environmentalism.[66]

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64 Para 95.

65 Para 96.

66 As Clarke aptly notes: '…government, business, and the wider community have to engage in the immediate and urgent stewardship and recovery of the environment. Business corporations will respond-or shareholders, stakeholders, and governments will make them respond to the demand that they act with greater responsibility in their use of resources and impact on

7.5 African solutions?

While it might seem that the outlook on corporate environmentalism is gloomy, there are more than enough frameworks on an international scale which corporations could adopt in attempting to integrate environmental considerations in their activities. Chapter 6 briefly alluded to the OECD Guidelines for Multinational Enterprises and the United Nations Principles for Responsible Investment.[67] In addition, there is a myriad of other international initiatives, including the FTSE4 Good Index Series;[68] the Equator Principles;[69] and the S&P Dow Jones Sustainability Index.[70] It should be noted, though, that none of these initiatives are failproof. They could, for example, be biased towards some corporations and the consequence could be that smaller corporations might not see the need to subscribe to them. Perhaps the most glaring criticism against some of these initiatives is that they cannot be relied on with absolute certainty. For example, before Volkswagen was implicated in the massive emissions scandal, the S&P Dow Jones Sustainability

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the community and environment.' T Clarke 'The widening scope of directors' duties: The increasing impact of corporate social and environmental responsibility' (2016) *Seattle University Law Review* 540.

67 See Chapter 6.

68 https://bit.ly/3U7oU04 (accessed 1 December 2020). The FTSE4Good Index Series is designed for the measurement of the performance of corporations engaged in strong environmental, social, and governance (ESG) practices.

69 https://equator-principles.com (accessed 1 December 2020). These were established by international financial institutions as a way of addressing the environmental and social risks that are associated with the financing of projects.

70 https://www.spglobal.com/esg/csa/indices/index (accessed 1 December 2020). It also assists investors to track which companies to invest in according to ESG performance.

Index had rated Volkswagen as a top corporate environmental performer. After the scandal, the S&P Dow Jones Sustainability Index quickly moved to remove VW from its indexes.[71] Suffice it to say that the initiatives work with what corporations present, which information could at times be greenwash.

7.5.1 The Draft Pan-African Investment Code

In the final instance, and in addition to the existing global voluntary initiatives, could there be some African inspiration for corporate environmentalism? A survey of the African Union website shows that the level of commitment to addressing the sometimes debilitating results of the effects of corporate environmental degradation has been low. Even after incidents like the Ogoni disaster, progress is not sufficiently measurable, at least in terms of legal developments. There have, however, been efforts on the continental scale which could be directly related to the activities of corporations and the need for them to consider environmental protection. In December of 2016 the Economic Affairs Department of the African Union published the Draft Pan-African Investment Code (the Code).[72] Although not yet in force, the Code is 'a legal instrument – shaped in the form of a model investment treaty – which has been drafted from the perspective of developing countries and least developed countries focusing on sustainable development goals.'[73] At the very start, the Code recognises the need for sustainable development, noting

71 See P Serafino 'VW stock to be removed from Dow Jones' *Bloomberg* https://bloom.bg/3Fvi6p9 (accessed 1 December 2020); Author Unknown 'Volkswagen AG to be removed from the Dow Jones sustainability indices' https://bit.ly/3SKi5k9 (accessed 1 December 2020).

72 https://bit.ly/3NsgApB (accessed 12 November 2020).

73 MM Mbengue and S Schacherer 'The 'Africanization' of international investment law: The Pan-African investment code and the reform of the international investment regime' (2017) *The Journal of World Investment and Trade* 414-448.

that its main objective is to 'promote, facilitate and protect investments that foster the sustainable development of each Member State, and in particular, the Member State where the investment is located."[74] Arguably, the main goal of including environmental protection within the realm of corporate governance is the pursuit of sustainable development. One could thus argue that this objective is a statement of intent by Africa's member states, possibly embodying a bold commitment to sustainable development, at least on paper. However, the Code is also clear in that it guides not only states, but also investors and their investments.[75] In an effort to clearly single out what the term 'investor' would mean, the Code defines such as 'any national, company or enterprise of a Member State or a national, company or enterprise from any other country that has invested or has made investments in a Member State."[76]

Chapter 4 dedicated a section of the Code to the obligations of investors wherein corporate governance and some of its associated practices are specifically addressed. For instance, Article 19 requires investments to be in line with nationally and internationally accepted standards of corporate governance. In this regard investors are required to disclose in a timely fashion accurate information 'on all material matters regarding a corporation, including the financial situation, performance, ownership, and governance of the company, risks related to environmental liabilities, and any other matters in accordance with the relevant regulations and requirements."[77] Here one can observe an overt reference to the growing significance of environmental issues to the whole governance process of a corporation.

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74 Art 1 of the Code.

75 Art 2(1) of the Code.

76 Art 4(5) of the Code.

77 Art 3(c) of the Code.

Green technologies have indeed been reported to increase a corporation's environmental performance and even its reputation in the long run.[78] In view of this, Article 30 of the Code lays significant foundations for the structuring and pursuit of 'environmentally sound technologies.'[79] The article does so by requiring states and investors to 'take all practicable steps to promote, facilitate, and finance, as appropriate, the transfer of, or access to, environmentally sound technologies and know-how', especially as developing countries are vulnerable to climate change and will need financial and technological resources to meet the costs of adaptation and the mitigation of climate change effects.[80] To this end, and especially considering that Africa is replete with mineral resources which contribute to the economies of some states, Article 30 stands perhaps as a clarion call for states to be vigilant both in their concessions to corporations (in relation to environmental obligations) and in their enforcement of environmental laws applicable to corporate activities.

Article 37 is more direct in the manner in how it deals with the environment, requiring state laws and regulations to provide mechanisms for environmental protection. States are specifically required not to lower their environmental standards in an effort to lure investments, even if other countries are doing so.[81] This dictum brings gives rise to an interesting discussion of neo-colonialism, as some argue that with the increased involvement of corporations, neo-colonialism becomes a possible reality, as donors and corporations could

78 D Li et al. 'Effects of corporate environmental responsibility on financial performance: The moderating role of government regulation and organizational slack' (2017) *Journal of Cleaner Production* 1325.

79 Art 30(1) of the Code.

80 Art 30(2) of the Code.

81 Art 37(2) of the Code.

dictate to governments needing funds.[82] The Zimbabwean example I discuss elsewhere is one instance. Specifically, as a result of the sanctions imposed on Zimbabwe because of the human rights violations instigated by the state, the government turned to the East, especially China.[83] This resulted (and is still resulting) in various agreements (between Chinese corporations and the state) wherein mineral resources have been looted out of the country and where aid has been extended against the ceding of mineral concessions which have all but resulted in extensive environmental degradation and human rights violations which are never prosecuted.[84]

One scholar has also observed that in Ghana and Malawi the New Alliance for Food Security and Nutrition has been used to facilitate land-grabbing under the guise of enhancing food security, while at the same time dispossessing subsistence farmers of their lands.[85] Government needs in these instances to allow for practices that would otherwise be frowned upon but for the need. A consequence of this is that necessary and essential corporate governance practices, like ensuring environmental protection, could be glossed over as affected countries would not want to dry up the avenues to aid.

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82 Afronomics Law African Union and Public–Private Partnership: The Potential and Limitations of Corporate Social Responsibility in Context 18 June 2020 https://bit.ly/3DJlxqW (accessed 10 January 2020).

83 The interesting aspect of all this is that China itself is known to struggle with environmental regulation in general; See discussion in D Li et al. 'Effects of corporate environmental responsibility on financial performance: The moderating role of government regulation and organizational slack' (2017) *Journal of Cleaner Production* 1323-1334.

84 B Soyapi 'Zimbabwe's 'look east' policy: A sociolegal perspective' (2017) *Southern African Public Law* 176-92; B Soyapi 'The judiciary and environmental protection in Zimbabwe' in MO Addaney and A Jegede (eds) *Human rights and the environment under African Union law* (Palgrave 2020).

85 M Langan 'Let's talk about neo-colonialism in Africa' (2017) https://bit.ly/3Nm4cHI (accessed 12 October 2020).

The above notwithstanding, Article 37 requires investors to protect the environment in the course of their activities: '[i]nvestors shall, in performing their activities, protect the environment and where such activities cause damages to the environment, take reasonable steps to restore it as far as possible.'[86] The Code also requires that environmental impact assessments be completed before any investments are undertaken. This is a particularly important provision, as it has been indicated that corporations in some African states often start their operations without having undertaken environmental impact assessments.[87] The requirement for environmental impact assessments would thus capture the essence of corporate environmentalism right from the start of a corporation's activities.

7.5.2 The SADC Protocol on Finance and Investment

Moving from the continental to the regional, in 2006 the countries in the Southern African Development Community (SADC) ratified the SADC Protocol on Finance and Investment.[88] Perhaps owing to the time when it was ratified, it does not address environmental considerations as comrehensively as is done in the Code. The two relevant provisions are Articles 12 and 13. The former requires states to promote the sustainable and environmentally friendly use of natural resources while the latter requires that environmental standards, among others, should not be lowered for the sake of accessing investments:

State parties recognise that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures and agree

86 Art 37(3) of the Code.

87 See the general discussion in B Soyapi 'Principles of international environmental law in the African courts: South African and Kenyan courts in context' (2021) *Journal of Environmental Law* [forthcoming].

88 https://www.sadc.int/documents (accessed 15 December 2020).

not to waive or otherwise derogate from international treaties they have ratified, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in their territories, of an investment.

It would seem that at both a regional and a sub-regional level there are frameworks which could be consulted in the furtherance of sustainability and the betterment of environmental governance in relation to the activities of corporations.

7.6 Some final words – engaging corporate environmentalism

This chapter has sought to demonstrate that the pursuit of sustainable development requires corporate contributions in addition to state-led efforts. Such corporate contributions could be achieved through corporate environmentalism, which can be enhanced by corporations' internalisation of environmental issues and taking heed of the principles of international environmental law as guidelines for how they can undertake their activities. In the end, the pursuit of sustainability could be achieved through concerted efforts among corporations, the state and citizens. Corporations in Africa and those international ones looking to do business in Africa could be guided by African-inspired frameworks, in addition to those existing globally, in achieving the dual goal of making a profit yet also protecting the environment.

Finally, it should be clear that engaging in corporate environmentalism involves obvious costs.[89] However, if sustainability is pursued as part of the obvious corporate strategy, the costs involved therein could become operational costs, such that such investments in corporate environmentalism

89 D Li et al. 'Effects of corporate environmental responsibility on financial performance: The moderating role of government regulation and organizational slack' (2017) *Journal of Cleaner Production* 1323.

are not viewed as additional and unnecessary costs cutting into profit margins, but as necessary costs borne out of a corporation's commitment to behaving reasonably and responsibly in its affairs.[90] There is, however, a need for empirical research on African countries and environmental performance across industries in order to determine the actual performance of corporations that do engage in corporate environmentalism.

90 TK Cheruiyot and P Onsando 'Corporate social responsibility in Africa: Context, paradoxes, stakeholder orientations, contestations and reflections' in A Stachowicz-Stanusch (ed.) *Corporate social performance in the age of irresponsibility: Cross national perspective* (Information Age Publishing 2016) 93.

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NEW PERSPECTIVES ON CORPORATE GOVERNANCE

This book discusses new perspectives on good corporate governance principles. It focuses on ESG, the history of good corporate practices and aspects of business human rights, as well as international developments in the way business human rights should be protected by domestic companies, using as an example the duty of corporate vigilance issued by France.

The book also discusses relevant Organisation for Economic Co-operation and Development (OECD) documents or instruments, including those pertaining to international good corporate governance practices for pension funds, cross-border exchange listings, investments, cell captives and administrative decisions relevant to investment treaties. In addition, recent international developments emanating from the United Nations and relevant to companies or enterprises are also examined. In general, the book is written from a South African perspective, explaining what amounts to current good corporate governance practices.

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