# Sentinel's four capitals

## An integrated annual report is compiled primarily to explain how an organisation creates value over time, through various 'capitals' that include the traditional financial capital always reported on.

These capitals represent stores of value that can be built up, transformed or run down over time in the production of goods or services. Their availability, quality and affordability can affect the long-term viability of an organisation's business model and its ability to create value.

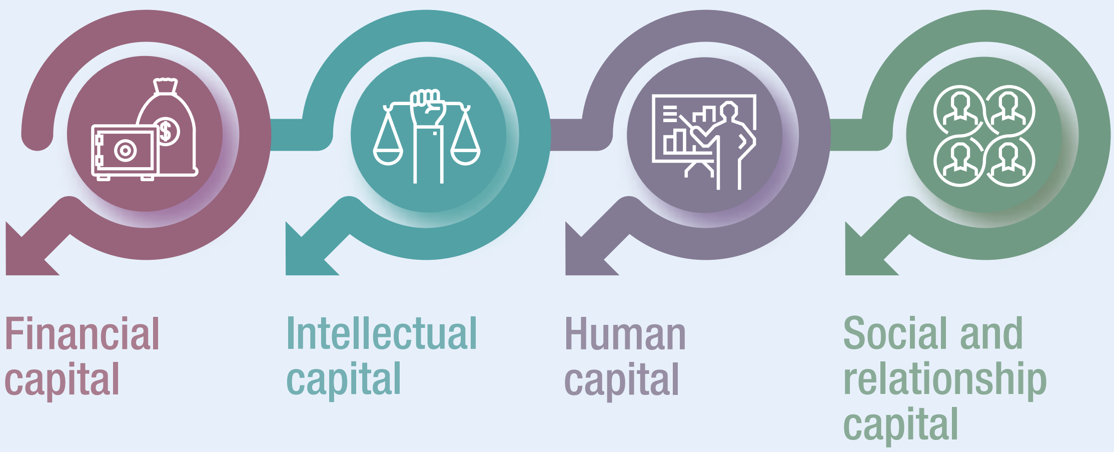
The IIRC reporting framework identifies six capitals, which are listed as:
– financial
– manufactured
– intellectual
– human
– social and relationship
– natural.

These six capitals are not equally relevant or applicable to all organisations. While most organisations interact with each capital to some extent, these interactions might be relatively minor, or so indirect that they need not be discussed in the integrated annual report.

Sentinel considered the uses or effects of all six capitals when preparing this integrated annual report. Given the nature of Sentinel's operations, only four of the six capitals are of sufficient impact to be reported. The four capitals reported on are the **financial, intellectual, human, social and relationship capitals**, while the manufactured and natural capitals are set aside. Sentinel's exposure to these two capitals is so limited that reporting on these areas is not material.

### Performance

Sentinel sets out specific key performance indicators (KPIs) for each of the capitals for which we measure progress against objectives. Shortfalls against objectives may be an early indicator of potential problems to be addressed.



# Financial capital

### What it is

**The pool of funds that is:**

– available to an organisation for use in the production of goods or the provision of services obtained through financing, such as debt, equity or grants, or generated through operations or investments.

# 1. Financial capital

- Monthly **contributions** from members and employers
- **Investment** capital and income
- **Reserves** for **pensions, risk benefits** and other reserves
- **Payment** of pensions and benefits.

## How Sentinel manages financial capital

Our purpose is to provide sustainable returns to our members and pensioners in a cost-effective manner, so that they can derive optimised benefits.

Sentinel shepherds its members seamlessly from employment to retirement, through a range of flexible options.

**Members (contributions)**

Each member of the Fund contributes an agreed upon percentage of their salaries towards retirement and risk benefit funding. Sentinel invests their contributions to generate returns through strategic investment decisions.

At the time of reporting Sentinel had 92 active participating employers contributing on behalf of 37 349 members. In the year of review, contributions increased by R105 million.

**Members (benefits)**

The Fund awards benefits upon a member's resignation, retirement, disability or death.

**Assets (investments)**

Sentinel actively pursues growth through astute market investing by sector specialists within an investment strategy based on patience, perspective and a focus on long-term income protection. Our asset allocation process is designed to achieve optimal yet sustainable long-term investment returns at risk levels set by the Board. We manage risk by diversifying investments across geographies, asset classes, within asset classes and through position sizing. As a major institutional investor, we have long adopted a responsible investment approach that incorporates sustainability considerations such as impact on the environment, society and governance. Investment management is outsourced to investment managers selected for their investment style, philosophy, track record, ability to add higher value than passive investing and the fit of their portfolios into the overall Fund investment structure. These investment managers are monitored constantly to ensure they remain within mandates and deliver on risk-adjusted performance objectives. The monitoring protocol includes a formal annual feedback session to the Investment Committee. Benchmarks are set for each portfolio, asset class and investment mandate.

**Pensioners (annuities paid)**

In the year of review, monthly pensions were being paid to 34 420 former members and beneficiaries.

## Performance

**KPI: Relative investment returns**

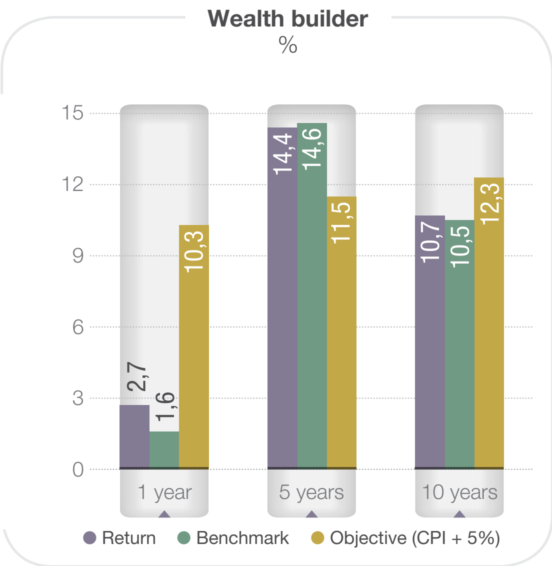
**Objective:** Meet or exceed real-return objectives and asset-based benchmarks over any five-year cycle.

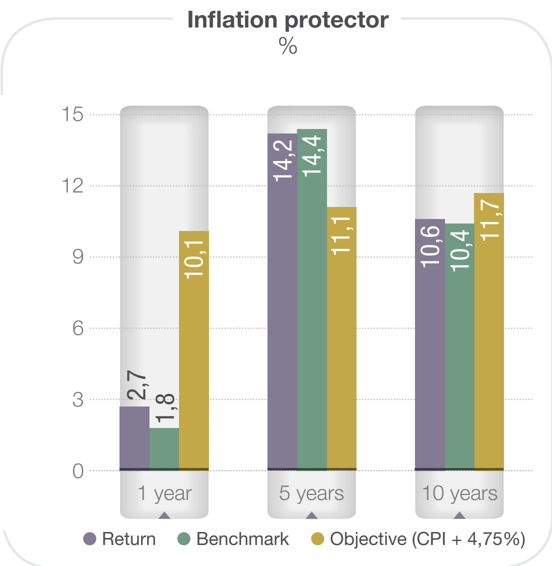
**Outcome – 2017**

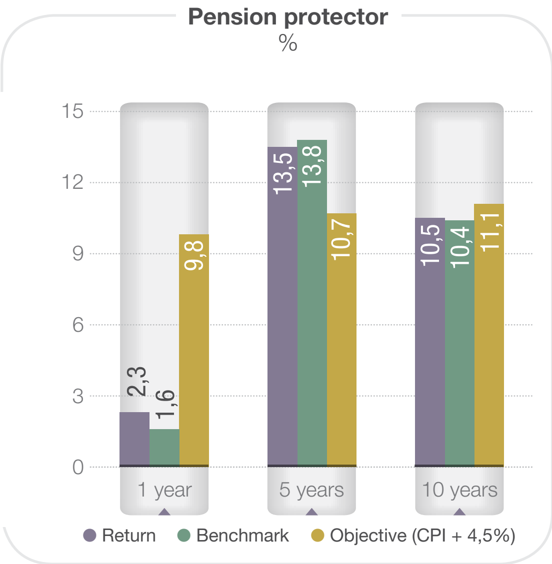
While Sentinel managed to meet its objective of exceeding the real-return objective over the five-year period, the devastating impact of lower or negative returns combined with higher levels of inflation can be seen over both the short-term (one year) and long-term (10 year) measurement periods. Sentinel continued to lag its asset-based benchmark over the five-year period, but as expected outperformed over the one year and 10 year measurement periods. This trend of outperformance of asset-based benchmarks and underperformance of real-return objectives is expected to continue in the short term.

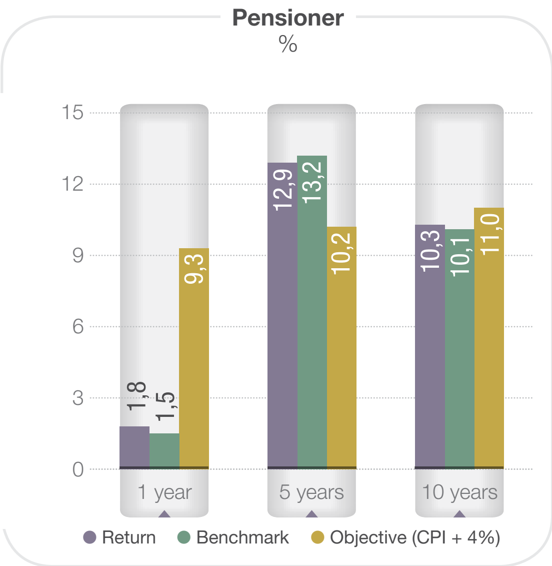
## Investment portfolio

Annualised portfolio investment returns (gross of direct costs) relative to real-return objectives and asset-based benchmarks for the financial year to 30 June 2017:

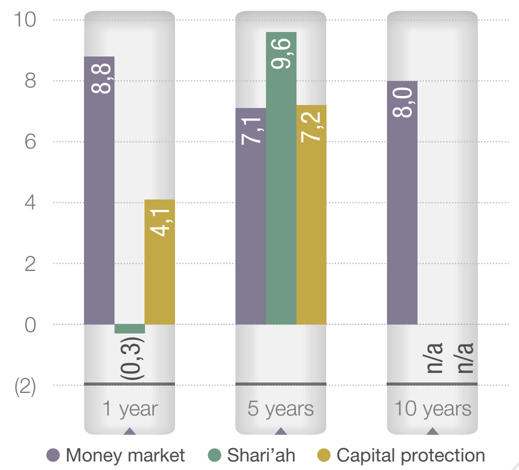


**Other**
%




**KPI: Pensioner pool funding level**
**Objective:** Maintain post-increase funding level within a range of 95% to 105% when measured at 100% of CPI level after the October increase and November bonus of that year.

**Outcome – 2017**
Sentinel maintained the post-increase pensioner pool funding level within the desired range, despite the challenging investment environment and rising inflation.

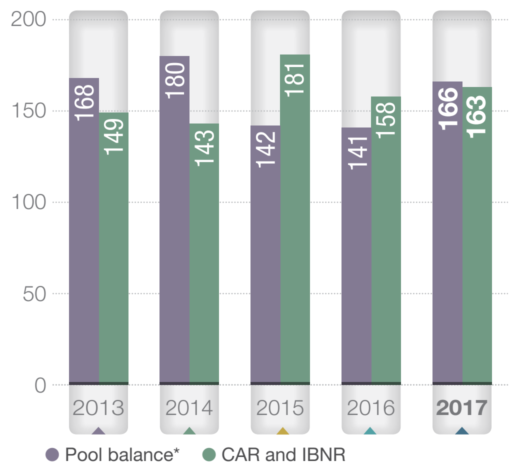
**Pensioner funding level at 100% of CPI level**
%


**KPI: Risk reserve pool balance**
**Objective:** Maintain pool balance at or above the recommended CAR/IBNR* ratio.

** CAR: Capital Adequacy Reserve/IBNR: Incurred But Not Reported.*

**Outcome – 2017**
While still early days, the adjustments made to contribution rates and benefit multiples in 2016, appears to be having the desired effect. As at the end of June 2017 the pool balance was marginally above the recommended CAR/IBNR ratio.

**Risk pool balance at 30 June**
Rm




** Includes unallocated contributions at financial year-end.*

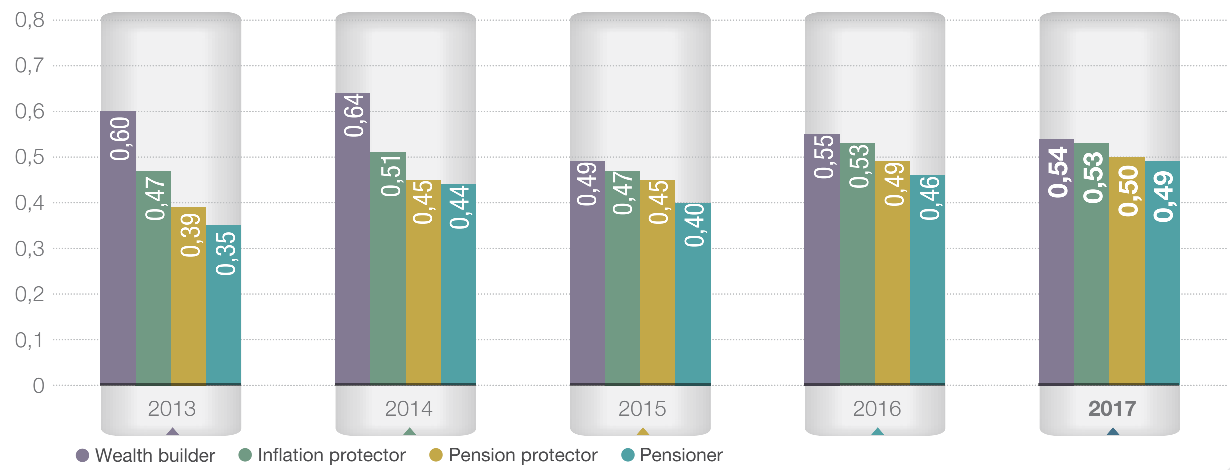
**KPI: Direct cost recovery ratios**
**Objective:** Maintain direct cost recovery ratios within budget.

**Outcomes – 2017**
A total direct cost basis point recovery methodology is used to show our commitment to transparency and fairness in recovering administration costs. This total cost consists of two components:
– a monthly investment management fee; and
– and a monthly administration fee.

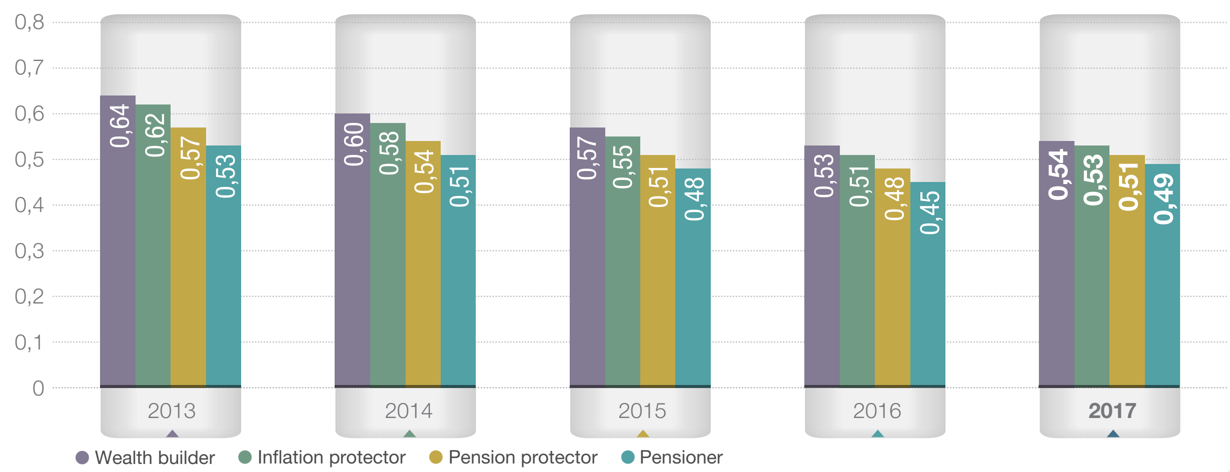
Recovery of these costs is based on a member's fund credit, while in the case of the pensioner pool and risk reserve it is levied against the total pool value.

Cost recovery ratios can fluctuate significantly from year to year as some investment managers are remunerated on performance relative to their benchmarks. Costs are expressed as a percentage of average asset value throughout the year. During the current financial year, actual recovery ratios were in line with budgeted recovery ratios. Higher than anticipated domestic investment management fees were offset by lower than anticipated international investment management fees. A slight uptick in direct cost recovery ratios is anticipated for the 2018 financial year.

**Direct cost recovery ratios – actual**
%




**Direct cost recovery ratios – budget**
%




### KPI: Pension increases awarded

**Objective:** To increase pensions on average annually by a minimum of 80% of the Consumer Price Index (CPI).

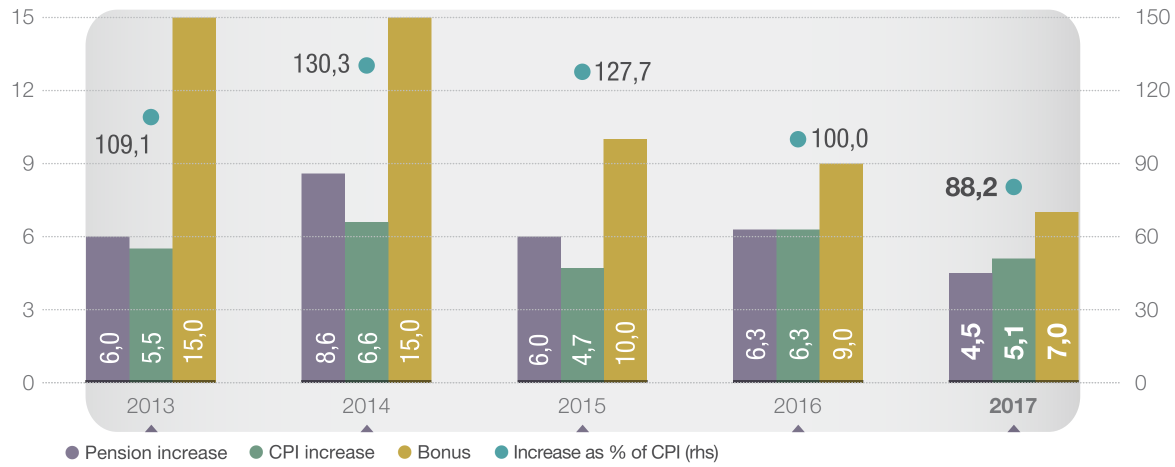
### Outcomes – 2017

Pension increases are considered, and are based, *inter alia*, on the investment return achieved on the underlying assets of the pensioner portfolio, funding level at financial year-end and the increase in CPI for the year to 30 June. The annual pension increase becomes effective on 16 October each year.

The Board needs to ensure that the long-term financial stability of the Fund is not jeopardised when attempting to counter the erosive effect of inflation on the purchasing power of pensions. Sentinel's pension increase methodology was implemented in terms of the Pension Fund Second Amendment Act (No 39 of 2001), which includes provisions requiring pension funds to pay a specific minimum pension increase to pensioners. The Board furthermore needs to ensure that the Fund meets the financial soundness requirements as published by the Registrar.

We have maintained our track record of pension increases on average exceeding 80% of CPI. Further to the 2017 increase granted, the Board was able to grant a once-off bonus of 7% of annual pension, which will be paid in November 2017.

**Pension increase and bonus**
%




**KPI: Increase in membership**
**Objective:** To increase the number of participating employers and diversify across industries, thereby diversifying the membership base and increasing assets under management.

**Outcomes – 2017**
The Fund has held promising discussions with a number of large potential new participating employers who currently participate in provident funds. Unfortunately progress has been delayed due to the postponement of retirement reform implementation until 1 March 2019.

We have also continued discussions with three employee benefit consulting firms to establish a working arrangement through which Sentinel is introduced to their client bases.

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| Participating employers | 122 | 110 | 109 | 107 | 102 |
| Net movement | 12 | 1 | 2 | 5 | |

**Objective:** To become cash flow positive from transactions with members to minimise the impact of negative cash flows on longer-term investment views.

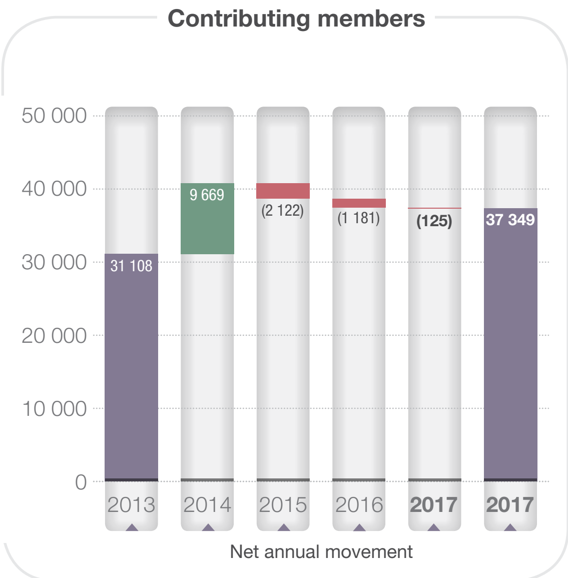
## Outcomes – 2017

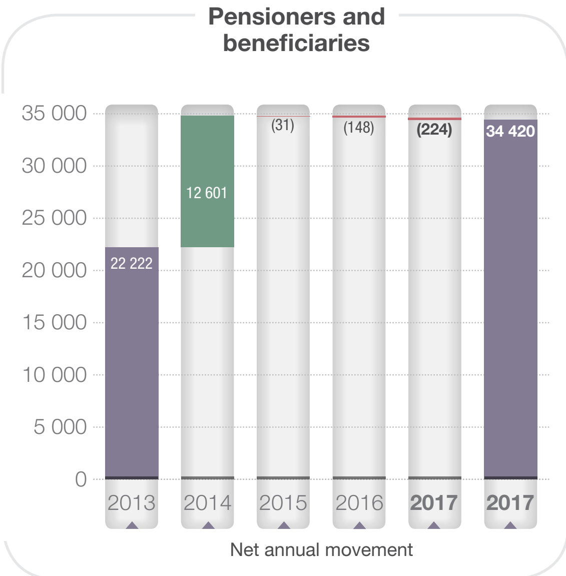
| | 2017 (Rm) | 2016 (Rm) | Net movement (Rm) |
|---|---|---|---|
| Contributions and transfers received | 3 230 | 2 808 | 422 |
| Benefits and transfers paid | (2 879) | (3 897) | 1 018 |
| Net inflow/(outflow) with members | 351 | (1 089) | 1 440 |

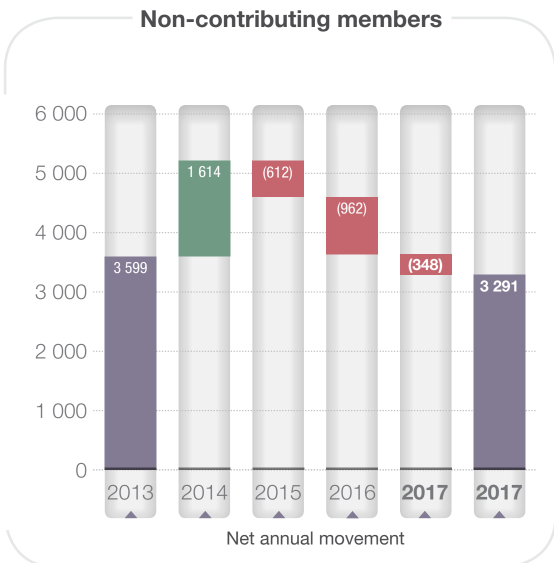
During the 2017 financial year the Fund managed to have a net inflow due to a decrease in benefits paid compared to the previous financial year and increased transfers in from other funds.

**Objective:** To ensure that Sentinel grows membership numbers and retains retiring members as pensioners.

## Outcomes – 2017




It should be noted that all non-contributory members have to retire in the Fund. Until recently, this had to be at normal retirement age.