

Investing for Impact

Pension funds' portfolio
strategies 2020

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Preface

Objectives

Conventionally, only two things matter in investing: risk and return. But a growing number of investors are also concerned about the sustainability of their investments, which is increasingly assessed from environmental, social and governance perspectives. Various concepts have been developed to reflect these considerations such as “sustainable investing”, “socially responsible investment” and “impact investing”. While the details of these additional concerns differ depending on the framework being used, the general concern is that an investor should also be concerned with the impact of the investment and not just its financial returns. In this report we have grouped these different terms and concepts under the term “investing for impact”.

In this report we aim to bring to light the attitudes of South African institutional investors, particularly pension funds, to investing for impact. The key part of the report is the output of a survey we undertook of some of the largest pension funds in the market, but we contextualise the research goals and results within wider debates regarding investing and how social impact should be considered.

This presupposes that investing for impact is desirable. Not all investors, including some we surveyed in this study, agree. Many argue that their sole responsibility to their clients is to maximise returns while managing risk. We are sympathetic to their concerns but also recognise that financial markets are fundamentally a social institution, created to serve society broadly. The public interest has an important role to play in setting out what kind of investor behaviour is desirable. The goals that financial markets are put to are not value neutral. As the anti-apartheid divestment campaign proved, investors’ decisions can have important moral dimensions.

For long-term investors, of which pension funds are the quintessential example, sustainability is an important concern. A corporate sector that consumes resources to deliver only short-term profits does not serve investors who have a multi-decade investment horizon and are also concerned about the livelihoods of the next generation and beyond. Environmental sustainability has therefore become an important non-financial goal for many investors. Additionally, investments can have social consequences, such as the

working conditions of staff and wider economic impact such as job creation or the social impact of the goods and services produced, which collectively improve social stability by enhancing broader social welfare. To these can be added governance concerns about how the business is managed. This framing of the issues still casts them as being in the financial interest of the investor: sustainable investments with positive social consequences are likely to provide stable long-term returns. But from a public policy perspective, we should also promote investing for impact that provides a positive public good, even when it is not obviously in the interests of investors. Interestingly, studies¹ are showing investors increasingly agree that their investments should “do good” and not just meet their financial objectives. For example, “impact first” investors are willing to sacrifice returns if the positive social impact of an investment is significant, blurring the line between investment and philanthropy.

Attitudes to this line of thinking are clearly evolving. The goal of this research was to gain insight and understanding into the views of South African pension fund decision makers.

This study took place after the Financial Sector Conduct Authority published Guidance Notice 1 of 2019², “Sustainability of investments and assets in the context of a retirement fund’s investment policy statement”. This guidance note, issued in June 2019, was the first regulator-level intervention with institutional investors to promote thinking about ESG objectives. It therefore provided a departure point for our goal of assessing attitudes by surveying respondents on their response to the guidance note. Clearly, however, there are many other regulator-led options available that would affect institutional investors’ decision-making regarding investing for impact. Regulation 28 of the Pension Funds Act is the key prudential standard for asset allocation by pension funds and could also be used to guide investing for impact. This possibility is considered in the context of the feedback from such investors.

We hope this report will be of interest to all stakeholders in the South African investment sector and beyond, including journalists, investors, policymakers, industry professionals, issuers, banks, researchers and academics.

¹ See survey reports by Morrow Sodali, “Institutional Investor Survey 2020” available at <https://www.morrowsodali.com/uploads/insights/attachments/83713c2789adc52b596dda1ae1a79fc2.pdf>; The Global Sustainable Investment Alliance “Global Sustainable Investment Review 2018”, available at http://www.gsi-alliance.org/wp-content/uploads/2019/06/GSIR_Review2018F.pdf

² Access a copy of the notice here: [https://www.fsca.co.za/Regulatory Frameworks/Guidance Notes/Sustainability of investments and assets \(retirement fund\).zip](https://www.fsca.co.za/Regulatory%20Frameworks/Guidance%20Notes/Sustainability%20of%20investments%20and%20assets%20(retirement%20fund).zip)

Methodology

This report includes a survey of 49 South African pension funds registered with the FSCA. Research was carried out through an online survey between September and November 2019. Participation in the survey was voluntary. While there are more than 5,000 funds in existence, many of these have insignificant assets. Our focus was on the larger funds. In addition, we engaged with asset consultants to obtain feedback on preliminary results, which we will include in the final report.

The 49 funds that participated in this study have combined assets under management of R2,6-trillion, which is equivalent to 65% of the total R4.3-trillion AUM in the pension fund industry.³ The sample included most of the largest funds in the industry.

We report both weighted and unweighted results, with weightings calculated according to the relative AUM of each respondent.

Graphics include both weighted and unweighted data. For the unweighted data, the results from the survey were added or aggregated (depending on the context) with no further adjustment. For the weighted results, each firm was weighted by the proportion of total assets out of the respondent base. The weight was capped so no fund was weighted by more than 25%. The weights were then applied to each response, then totalled or aggregated (depending on the context). Further notes are provided with some of the specific results to provide further insight.

With the results analysed, we invited four industry experts to share their views on the results and to validate the outcomes of the survey. Their views are presented alongside some of the survey findings in the report.

They were:

1. **Anne-Marie D'Alton**, CEO: Batseta (Council of SA Retirement Funds)
2. **Malcolm Fair**, Managing Director: Riscura
3. **Jolly Mokorosi**, Professional principal officer and independent retirement fund trustee.
4. **Mabatho Seeiso**, Independent Trustee: Post Office Retirement Fund and independent investment committee member of the National Treasury Jobs Fund.

Key findings

1. Terminology and definitions of different investing for impact approaches vary widely across the pension fund industry. Guidance Notice 1 of 2019 appears only to connect sustainable investments with ESG integration. This narrow conception limits the potential for pension funds to support a much wider array of sustainable investments. Respondents to our survey call for greater clarity on classifications and measurement. Some argue that investing for impact should become compulsory.
2. Socially responsible investments (SRI) globally have been increasing across the major pension markets. South Africa and the rest of Africa show similar growth trends. There are notable regional differences in specific approaches.
3. Researchers and industry experts offer differing views on whether pension funds should pursue impact-driven investments and concur that more research and regulatory alignment will be key to enable better approaches and measurement.
4. South Africa's Regulation 28 of the Pension Funds Act is lauded globally as an exemplary piece of regulation giving clear guidance that ESG factors are considered, and responsible investment is linked to the fiduciary duty of pension fund trustees.
5. Pension fund regulators globally are bringing alignment to the industry while taking into account local conditions. In particular, regulations are seeking to address the main risks and challenges of investing for impact in their domestic contexts to create an enabling environment for institutional investors to increase their investments for impact.
6. Respondents in our survey attempt to balance sustainability, diversification and high risk-adjusted returns. Larger funds place a greater priority on improving the sustainability of portfolios than smaller funds.
7. The primary issue for asset managers to engage pension fund clients on is diversity, which should be taken in the broad sense to include workforce diversity, board diversity and diversification in the value chain (especially in terms of suppliers such as black asset consultants).
8. Almost 80% of respondents say their funds get portfolio construction expertise from asset consultants or third-party advisers, while less than 10% make use of specialist ESG advisors.
9. Investors report that they actively engage investee companies through shareholder resolutions. Larger funds are more concerned than smaller funds with environmental and social practices of their investments as well as remuneration policies.
10. Almost all respondents expect sustainable investing to become more important in the next five years.

... continues on page 6

³ The FSCA annual report (2018) indicates that the aggregate value of assets of retirement fund is R4.26tn, of which, R1.94tn are held by privately administered funds. The report is available here: <https://www.masthead.co.za/wp-content/uploads/2019/01/Registrar-of-Pension-Funds-Annual-Report-2017.pdf>

11. Survey results indicate that greater transparency as well as more evidence that investing for impact delivers better returns would help investors to incorporate ESG issues into investment decision-making.
12. Pension funds consider the major challenges to increased sustainable investments to be difficulty in measurement and lack of transparency. Smaller funds emphasise that financial performance is their primary concern.
13. After black economic empowerment, thematic investing emerged as the primary strategy for investing for impact in South African pension funds.
14. Funds report that they have increased their focus on impact investment in the past five years.
15. While pension funds vary in implementing directives of Guidance Notice 1 of 2019, only 4% expressed no interest in pursuing the recommendations.
16. 83% of pension funds do expect ESG issues to become mandatory in their investment decisions.
17. In terms of specific concerns for pension funds when applying ESG criteria to investments, water use was the top environmental concern, employment creation was the top social concern and bribery/corruption was the primary concern in governance.
18. The United Nations-supported Principles for Responsible Investment, launched in 2006, has the most influence on funds' investment approach out of several global codes.
19. Pension funds place a low priority on publishing investment and sustainability policies on their websites, but 60% of respondents say they make them available in other forms.

Recommendations

The study found that there is already great deal of compliance with Regulation 28 and Guidance Notice 1 of 2019. This lays the foundation to expand and entrench SRI strategies further through enhanced regulations. We draw on insights from our review of the global state of SRI and the findings of our survey and make the following recommendations:

1. A critical step to enabling SRI in South Africa is to have a single, universal set of definitions of terms and a taxonomy of the different strategies within the field.
2. Regulation 28 needs to be expanded to include all seven activities and strategies for investing for impact as defined by the Global Sustainable Investment Alliance outlined on page 8 in this report. This will enable pension funds to participate in a much wider array of opportunities.
3. Larger funds tend to be more aligned to SRI in their portfolios. They have access to more resources and can pay for the best advice. A possible solution is to bring about greater coordination and cooperation between smaller funds to enable them to advance their SRI strategies.
4. Regulations that guide the industry specifically on measurement and metrics and bring greater transparency to SRI initiatives will give investors more comfort in making decisions.
5. In the same way that Regulation 28(2)(c)(ix) guides pension funds to consider ESG criteria⁴, a further update of Regulation 28 that encourages pension funds to include impact investments as defined by the GSIA into their investment policy statements is needed.
6. Respondents included comments that Regulation 28 should do more than encourage consideration of ESG factors and become "instructive". The same would hold true for impact investments in the future.

⁴ See the final version of the 2011 amended regulations here: <http://www.treasury.gov.za/publications/other/Reg28/Reg%2028%20-%20for%20Budget%202011.pdf>

1. Introduction: Review of key issues in sustainable investments

Background and context

Institutional investors include retirement funds (defined benefit or defined contribution plans), grant-making organisations, endowments, insurance companies, banks and sovereign wealth funds, among others. This study focuses on retirement funds.

The global pension fund industry manages in excess of \$40.2-trillion across 22 markets, including South Africa. The US is the largest market (61.5%), followed by Japan (7.7%) and the UK (7.1%).⁵

The South African pension fund market is relatively large by global standards. According to the 2017 annual report of the Pension Funds Registrar,⁶ it manages assets of R4.26-trillion through more than 5,000 funds consisting of 16-million members. These assets represent 95.6% of GDP, which positions South Africa as the ninth largest pension fund market in the world as a percentage of GDP, just behind the UK and ahead of Sweden.⁷

South Africa's Regulation 28 is cited in the Social Impact Investment Task Force Report (2014) as an exemplary piece of regulation that aims to overcome one of the main challenges in enabling allocations to impact investments by pension funds. According to the report:

"The revised Regulation 28 in South Africa sets well-defined, prudential asset-allocation guidelines for pension funds. South African pension funds are therefore required to take ESG factors into account and responsible investment is linked to the fiduciary duty of pension funds' trustees." - G8 Social Impact Investment T.F.-

The Principles for Responsible Investment (PRI) have become the globally recognised catalyst for responsible investments (and, as we report, is the most influential code for South African funds). As an independent organisation, UNPRI "encourages investors to use responsible investment to enhance returns and better manage risks".⁸

Over time, the general domain of non-financial investment objectives has had a variety of labels including ethical, green, mission-based, social impact value-driven, sustainable and responsible investments, environmental, social and governance (ESG).⁹ The emerging consensus is that the overall category should be called sustainable and responsible investments or SRI (GSIA, 2018).¹⁰

Global Sustainable Investment Alliance (GSIA) data on five key markets show that over \$30-trillion of assets were professionally managed under sustainable and responsible investment (SRI) strategies in 2018, up from \$22.9-trillion in 2016 and \$13.3-trillion in 2012. This fast growth signals that all institutional investors are starting to incorporate, or at least consider, SRI factors in their investment decisions. This growth is motivated both by underlying fund members and other end-clients, as well as wider public policy concerns looking at ways that direct investment can better serve the public good. Evidence of this support for pension funds' allocating more investments to sustainable assets was found in a DFID study¹¹ of pension fund contributors in the UK. According to the study, "over 70% of the people say they want their investments to avoid harm and achieve good for people and the planet".

Table 1: Snapshot of Global Sustainable Investing Assets, 2016 - 2018

Region	2016	2018	% Change
Europe	12,040	14,075	17
United States	8,723	11,995	38
Japan	474	2,180	360
Canada	1,086	1,699	56
Australia / New Zealand	516	734	42
Total	22,838	30,683	34

NOTE: Asset are expressed in Billions of US dollars. All 2016 assets are converted to US dollars at the exchange rates as of year-end 2015. All 2018 assets are converted to US dollars at the exchange rates at the time reporting.

Source: GSIA Global Sustainable Investment Review 2018

This trend aligns with the findings from the most recent institutional investor survey by Schroders.¹² Globally, 75% of institutional investors said sustainable investment was becoming more important.

As we report below, our findings on the South African pension fund market show an even greater view that sustainable investing is becoming more important, with 93% (unweighted) of respondents saying that sustainable investing will become more important over the next five years.¹³

⁵ See the report by Willis Towers Watson here: <https://www.willistowerswatson.com/en-CZ/News/2019/02/global-dc-pension-assets-exceed-db-assets-for-the-first-time>

⁶ It can be accessed here: <https://www.masthead.co.za/wp-content/uploads/2019/01/Registrar-of-Pension-Funds-Annual-Report-2017.pdf>. Note that the 2017 report was the last issued before the registrar was incorporated into the FSCA and is the latest available.

⁷ The figures come from the OECD's Pension Markets in Focus 2019, which can be accessed at <http://www.oecd.org/daf/fin/private-pensions/globalpensionstatistics.htm>

⁸ The UN PRI site can be found here: <https://www.unpri.org/about-the-pri>

⁹ www.nuveen.com/en-us/thinking/responsible-investing/the-story-of-responsible-investing

¹⁰ See the Global Sustainable Investment Alliance 2018 trends report here: <http://www.gsi-alliance.org/trends-report-2018/>

¹¹ See the report for DFID here: <https://www.gov.uk/government/publications/investing-in-a-better-world-results-of-uk-survey-on-financing-the-sdgs>

¹² See the Schroders Institutional Investor Study 2019 report here: https://www.schroders.com/en/sysglobalassets/digital/institutional-investor-study/sustainability/pdf/Schroder2019_SIIS_Sustainability2.pdf

¹³ See the Global Sustainable Investment Alliance 2018 trends report here: <http://www.gsi-alliance.org/trends-report-2018/>

What is sustainable investment?

The lack of aligned and coherent definitions is one of the challenges of research into any emerging field. Terminology, definitions and standards of measurement are not widely adopted, or are defined and used differently by the myriad stakeholders spread across the globe. South Africa also has a terminology that somewhat differs from usage elsewhere. Efforts are under way to bring a level of coherence to the field of sustainable investments. The Global Sustainable Investment Alliance (GSIA) is a newly formed body that includes national bodies from Europe, the US, Canada, Japan, Australia and New Zealand. Sustainable investing assets in these five major markets stood at \$30.7-trillion at the start of 2018, a 34% increase in two years (GSIA, 2018).

GSIA proposes that sustainable investments are those that consider environmental, social and governance (ESG) factors in portfolio selection and management. Sustainable investment encompasses the following activities and strategies:

1. **Negative/exclusionary screening:** the exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria;
2. **Positive/best-in-class screening:** investment in sectors, companies or projects selected for positive ESG performance relative to industry peers;
3. **Norms-based screening:** screening of investments against minimum standards of business practice based on international norms, such as those issued by the OECD, ILO, UN and UNICEF;
4. **ESG integration:** the systematic and explicit inclusion by investment managers of environmental, social and governance factors into financial analysis;
5. **Sustainability themed investing:** investment in themes or assets specifically related to sustainability (for example clean energy, green technology or sustainable agriculture);
6. **Impact/community investing:** targeted investments aimed at solving social or environmental problems. This category includes community investing where capital is specifically directed to traditionally underserved individuals or communities and finance that is provided to businesses with an explicit social or environmental purpose (also called social enterprises).

7. **Corporate engagement and shareholder action:** the use of shareholder power to influence corporate behaviour, including through direct corporate engagement (ie, communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals and proxy voting that is guided by comprehensive ESG guidelines.

The seven categories of sustainable and responsible investments as outlined by the GSIA align somewhat with the terminology and definition proposed for South Africa in the Guidance Notice 1 of 2019. In that document, we find the following definitions:

ESG means environmental, social and governance factors. In the South African context, and specifically in reference to assets located in South Africa, this includes but is not limited to the manner in which broad-based black economic empowerment is advanced.

Sustainability refers to “the ability of an entity to conduct its business in a manner that primarily meets existing needs without compromising the ability of future generations to meet their needs”. The note seeks to further clarify the link between sustainability and ESG as follows: “Conducting business sustainably includes managing the interaction of business with the environment, the society and the economy in which it operates towards better long-term outcomes.”

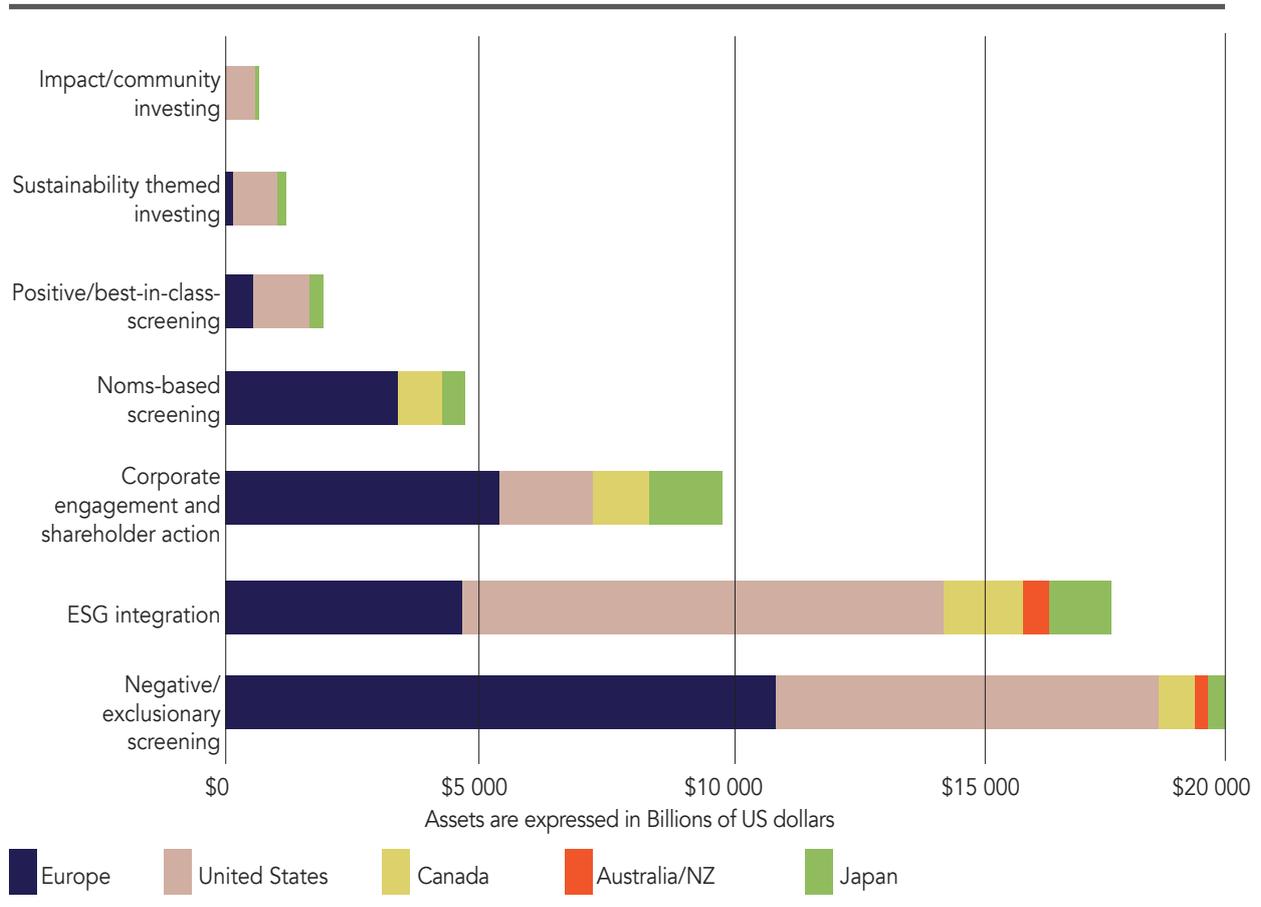
In our view, this definition aligns most closely with the fourth type of sustainable investment strategies from the GSIA list above. This comparison makes it clear that even though Guidance Notice 1 of 2019 is a step in the right direction, it is very narrow in its consideration of the full set of strategies and opportunities available for investors interested in investing for impact. On the other hand, the UCT Bertha Centre’s African Investment for Impact Barometer already measures SRI investments on the continent according to the same criteria as the GSIA global taxonomy.

The international investment community is moving towards accepting the taxonomy as collated by GSIA. It would be in the best interests of the institutional investment community in South Africa to align with this framework. Less fragmentation and greater cooperation in the industry will enable investors domestically to integrate with global opportunities while also enabling investors outside South Africa to participate in domestic opportunities.

Global growth of sustainable investments

Globally, the most prominent sustainable investment strategy is negative/exclusionary screening (\$19.8-trillion) followed by ESG integration (\$17.5-trillion) and corporate engagement/shareholder action (\$9.8-trillion). Regional differences are noteworthy with negative screening dominating in Europe while ESG integration is most prevalent in the US, Canada, Australia and New Zealand in asset-weighted terms. In Japan, corporate engagement and shareholder action is the primary strategy.¹⁴

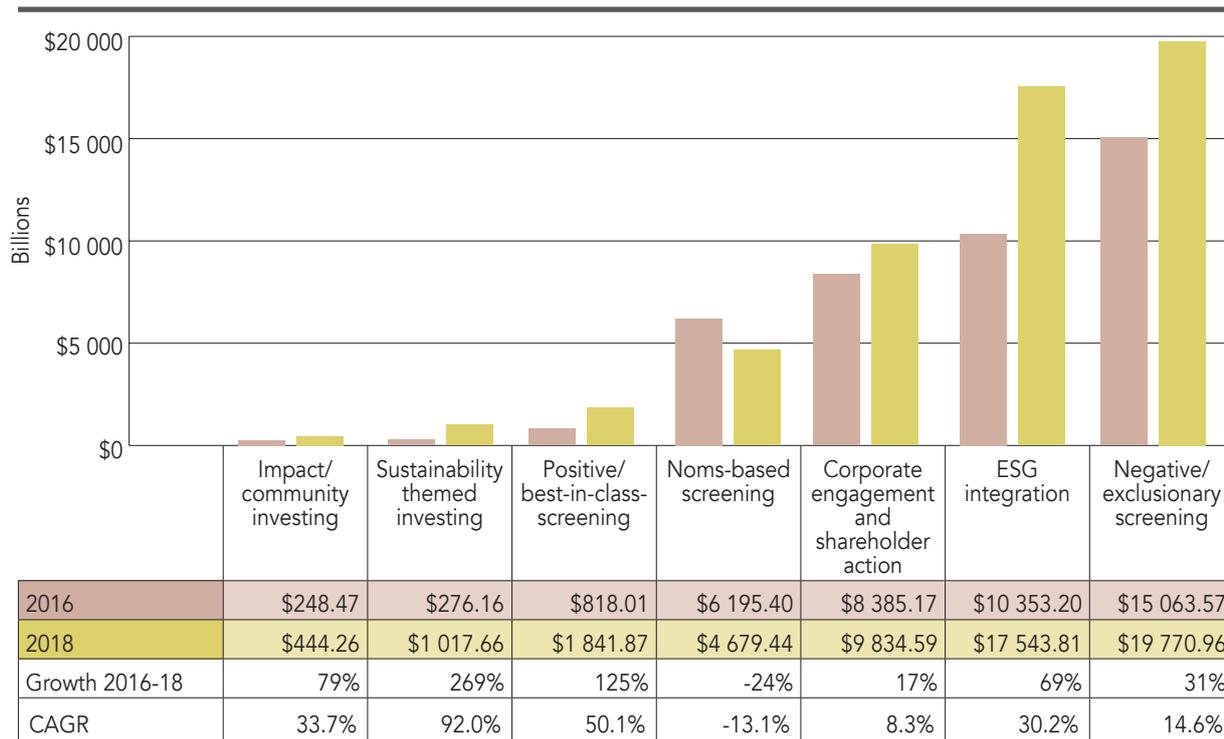
Figure 1 Sustainable investing assets by strategy and region 2018



Source: GSIA Global Sustainable Investment Review 2018

⁵ See the Global Sustainable Investment Alliance 2018 trends report here: <http://www.gsi-alliance.org/trends-report-2018/>

Figure 2: Global growth of sustainable investing strategies 2016 - 2018

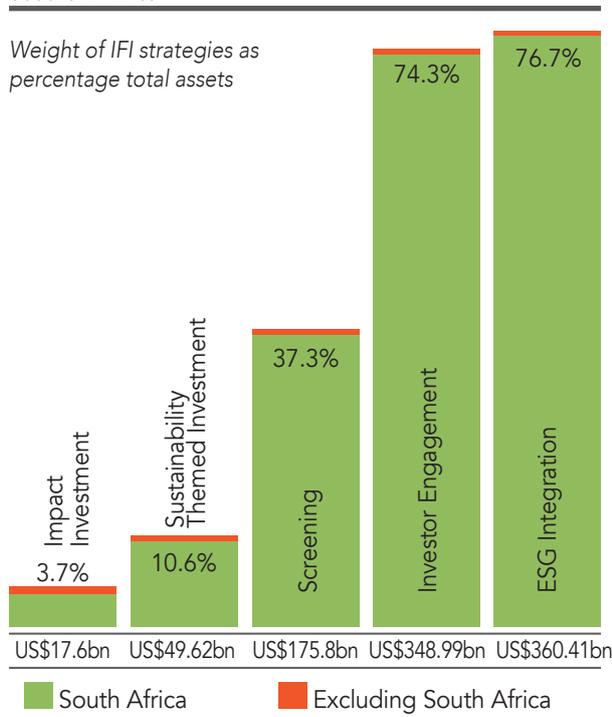


Assets are expressed in billions of US dollars
Some corrections to the 2016 strategies have been made.

Source: GSIA Global Sustainable Investment Review 2018

Figure 3: Weight of strategies as percentage of total assets in Southern Africa

Weight of IFI strategies as percentage total assets



The African Investing for Impact Barometer (2017)¹⁵ collates data from East Africa (Ghana and Nigeria), West Africa (Kenya, Rwanda, Kenya and Uganda) and Southern Africa (Botswana, Eswatini, Mauritius, Namibia, South Africa, Zambia and Zimbabwe). Looking specifically at Southern Africa, the report indicates that the most common strategy is ESG integration, accounting for 77% of the total asset strategy or \$360.41bn.

Source: UCT Bertha Centre African Investing for Impact Barometer 2017

¹⁵ The UCT Bertha Centre African Investing for Impact Barometer (2017) and earlier versions of the report are available here: <https://www.gsb.uct.ac.za/impact-barometer>

The debate over sustainable and responsible investments

Active pension funds inherently have long-term goals as they perform their fiduciary duty to act in the best interest of their members. Funds must achieve the highest long-term portfolio returns within a given risk level while meeting cash flow requirements. One side of the argument is that funds should retain a pure focus on financial returns, while the counter argument is that it is in members' interests to take environmental, social and governance concerns into account.¹⁶

The debate has additional nuances. Research on pension funds in the public and private sectors show contradictory findings. One study in the *Journal of Applied Corporate Finance*¹⁷ found that investment managers that integrated ESG metrics into investment strategies have, on average, seen higher return and lower risk, so therefore the debate over ESG is reduced to a debate over risk and return. For public sector pension funds, the findings are less positive. Another study found¹⁸ that public pension funds with ESG strategies underperformed those without similar restrictions. Researchers argue that each additional restriction lowers the fund's ability to diversify its portfolio sufficiently.

Carlos Ramirez Fuentes, president of the International Organisation of Pension Supervisors (IOPS) and the Mexican Commission of the Retirement Savings System (CONSAR), writes¹⁹ that pension funds should consider SRI in their strategies because "pension funds should be focused on long-term goals, according to a lifecycle approach [and] it is essential that pension fund providers or managers start considering structural long-term factors in their investment decisions".

Citing a wide-ranging review of 2,200 studies on the relationship between financial performance and the consideration of ESG factors, Fuentes asserts that the empirical evidence shows that a positive, or neutral, relationship exists between financial performance and the consideration of ESG factors. This finding, Fuentes reasons, aligns with the expectation that firms that are well governed and manage internal issues such as gender equality, diversity and water and environmental issues are also firms that are well-managed overall and thus demonstrate robust performance.

“ Pension funds should be focused on long-term goals, according to a lifecycle approach [and] it is essential that pension fund providers or managers start considering structural long-term factors in their investment decisions. ”

Not all researchers are in favour of pension funds adopting SRI. Swiss economist Rabener²⁰ lists a range of challenges that SRI presents for investors including:

1. Additional costs
2. Data issues
3. Higher fees
4. ESG-focused companies consider the interests of other stakeholders and not just shareholders
5. Reduced investment universe
6. Certain sectors are over-represented in ESG portfolios, for example technology, while the energy sector is under-represented

The US Institute for Pension Fund Integrity (IFPI)²¹ writes that ESG investments should be made when they add value to a fund. "When such investments will not improve the financial performance of the fund, or the decision to invest in them is based on political motives, they should be forgone." This position implies that ESG investments should not be undertaken even if the extent of social impact is significant while the cost in financial return is small, and even when the social impact is directly on fund members. The literature has not yet come to a consensus view on how to think about value-neutral, socially positive investments of this sort in terms of financial trade-offs.

Regulators in many countries, however, are beginning to find solutions to measurement challenges and ensuring funds are aligned with members' broader interests. We review some of these in the next sections.

¹⁶ The report by Social Finance "Microfinance, impact investing, and pension fund investment policy survey" is available here: <https://www.socialfinance.org.uk/resources/publications/microfinance-impact-investing-and-pension-fund-investment-policy-survey>

¹⁷ The paper is by Kotsantonis, S., Pinney, C. and Serafeim, G., 2016. ESG integration in investment management: Myths and realities. *Journal of Applied Corporate Finance*, 28(2), pp.10-16, and is available here: <https://onlinelibrary.wiley.com/doi/pdf/10.1111/jacf.12169>.

¹⁸ Munnell, A.H. and Chen, A., 2016. New developments in social investing by public pensions (No. ibslp53).

¹⁹ See the article by Fuentes called "Pension funds want ESG guidelines" here: <https://www.top1000funds.com/2018/08/pension-funds-want-esg-guidelines/>

²⁰ See the article by Rabener called "Why pension funds & millennials should avoid ESG" here: <https://www.factorresearch.com/research-why-pension-funds-millennials-should-avoid-esg>

²¹ The IFPI report is available here: <https://ipfiusa.org/wp-content/uploads/2018/09/IPFI-ESG-Paper.pdf>

Current regulatory framework for sustainable investment in South Africa

South Africa's pension funds are mostly regulated by the Pension Funds Act (24 of 1956) though certain funds are exempt, particularly the Government Employees Pension Fund, which is by far the largest. The act is given force through regulations, and Regulation 28 specifies constraints on funds with, among other things, ceilings for maximum exposures to certain asset classes. The act and Regulation 28 are overseen by the Financial Sector Conduct Authority which has powers to investigate and discipline funds that violate the act or its regulations.

Regulation 28 was last overhauled in 2011 under then finance minister Pravin Gordhan.²² This made a significant change in that instead of simply specifying prudential limits, it introduced general investment principles. These created some positive responsibilities for investment managers to adhere to certain principles, rather than simply maintaining their portfolios within asset allocation limits. These principles range from promoting the education of trustees to performing appropriate due diligence on investments. Among those principles is Regulation 28(2)(c)(ix):

“ Before making an investment in and while invested in an asset, consider any factor which may materially affect the sustainable long-term performance of the asset including, but not limited to, those of environmental, social and governance character. ”

Since the establishment of this principle in 2011, the next major document from the FSCA was the Guidance Notice 1 of 2019 in June 2019: “Sustainability of investments and assets in the context of a retirement fund’s investment policy statement”. The notice clarifies that the FSCA expects funds, in their investment objectives and philosophy, to comply with Regulation 28(2)(b) (that funds have an investment policy statement) and should be read with Regulation 28(2)(c)(ix) quoted above.

Three core expectations are outlined in the guidance notice. First, funds should stipulate how they intend to

“ Give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social or governance character. This concept applies across all assets and categories of assets and should promote the interests of a fund in a stable and transparent environment. ”

Survey respondent



monitor and evaluate the ongoing sustainability of their assets and the extent to which ESG factors had been considered by the fund. Furthermore, funds are required to make explicit the advantage of owning any assets that limit the application of ESG factors or sustainability criteria.

Second, funds must make copies of their investment policies (even in abridged format) available to members. Third, funds are expected to report their compliance with the guidance notice to enable the FSCA to monitor compliance with Regulation 28(2)(b) and Regulation 28(2)(c)(ix).

The notice recognises that the field is still developing and commits to ongoing refinements of the regulations, ensuring further alignment across different parts of the investment industry and the financial services sector generally. Its primary impact is likely to be to draw out from funds their thinking and approach to ESG, making this visible to members. Further regulatory momentum can then be initiated by members in demanding that their pension funds do more to deliver on ESG concerns.

²² The full notice in the Government Gazette can be downloaded here: <http://www.treasury.gov.za/publications/other/Reg28/Reg%2028%20-%20for%20Budget%202011.pdf>

Regulation 28 and the spectrum of capital

The Guidance Notice seeks to illuminate the investment practices of pension funds by augmenting investment objectives of finance-only or finance-first by adding ESG considerations to investment strategies. The diagram below is an adaptation of the “spectrum of capital” first created by the G8 Social Impact Investment Taskforce.²³ This is a useful way to understand the intervention that the guidance note is trying to make into how capital is allocated by pension funds.

Figure 4: Spectrum of capital

	Traditional investing	Investing for impact				Philanthropy	
		Socially responsible investing	Sustainable investing	Thematic investing	Impact investing		Impact first investing
	Max returns, min risk	ESG risk management	ESG opportunities	Measurable strategy with high-impact solution			
Objective	Seeks financial return regardless of ESG factors	Investments are screened out based on ESG risk in order to protect value	Financial returns and sustainability factors that may enhance value drive investment selection	Targeted themes and financial returns drive investment selection	Seek to generate competitive financial return, may deliver below market returns for investors	ESG factors take precedence over financial returns, will deliver below market return for investors	Seeks ESG solutions that cannot generate financial returns
Approach	Mainstream investment analysis and due diligence	Negative screens for tobacco, alcohol, weapons, gambling, pornography, nuclear energy	Considers carbon footprint, resource use, waste reduction, compensation product safety, gender equality	Seeks solutions for climate change, population growth, urbanisation, water scarcity, food systems	Augment and expand proven commercial models that deliver ESG outcomes	Aims to support innovation and risk taking, proof of concept/pilots, enabling environments, commercial capital leverage	

Source: Adopted from G8 Social Impact Investment Task Force.

Starting on the far left, pension funds had traditionally been looking for competitive returns based purely on financial outcomes. Regulation 28 introduced ESG considerations for pension funds moving them to the right, by suggesting they add ESG risk management and opportunities to their considerations. The Guidance Notice clarifies the expectations of the

FSCA for pension funds in terms of transparency of their investment policy statements and the inclusion of ESG elements into their strategies. The objective of this study is to explore ways in which further regulatory developments could move pension funds even further along the path to towards impact investments.

²³ The G8 Task Force 2014 report on impact investments is available here: <https://gsgii.org/reports/allocating-for-impact/>

International regulatory review

In this section, we outline a framework of 10 barriers to greater investing for impact, adapted from the G8 Global Task Force.²⁴ “We have selected the barriers, remedies and examples from the G8 report that are relevant to pension funds.”

We have also added examples from the Global Sustainable Investing Alliance (GSIA) 2018 report²⁵, which examines how each country or region has dealt with the challenges through regulatory reform, the Global Impact Investment Network (GIIN) report on catalytic capital and other sources as indicated.

Table 2: Investing for impact - barriers and remedies

Barrier	Description	Recommendations	Examples of application by country/region
Fiduciary duty	<p>Perception that impact investing cannot deliver appropriate risk-adjusted financial returns</p> <p>Societal duty to maximise people’s future pensions creates a fear of any additional investment criteria that may inhibit maximising financial value</p>	<p>Clarification of fiduciary duty</p> <p>Permit (and consider requiring) investors to factor social and environmental impacts into investment decisions</p> <p>Require reporting on ESG factors</p>	<p>South Africa: Regulation 28 now clearly links trustees’ fiduciary duty with consideration of ESG factors</p> <p>US: The IFPI position is that ESG considerations should only apply when clear financial returns are evident²⁶</p>
Compliance	Perceived conflict with internal/external rules and regulations	<p>“Do or explain” rule</p> <p>Require all regulated financial and foundation endowments to articulate their contribution to impact investment</p>	UK: Since October 2019, the UK’s department for work and pensions requires trustees to justify long-term investment decisions that do not consider ESG factors ²⁷
Lack of specialism	<p>Traditional asset allocation frameworks, team structures and skill sets are not designed to incorporate impact investment strategies.</p> <p>Where someone may be leading on impact investments, they tend not to have any specific budget for allocation</p>	<p>“Opt-out” as standard package</p> <p>Require all pension fund offerings to include an allocation to impact investment, unless a pensioner chooses to “opt out”</p>	France: Since 2010, all medium and large businesses that give employees savings plans have to include at least one communal solidarity fund (“Fonds Commun de Placement d’Entreprise Solidaires (FCPES)”). These FCPES are required to contribute within the range of 5% and 10% of their capital in associated social enterprises

²⁴ The G8 Task Force 2014 report on impact investments is available here: <https://gsgii.org/reports/allocating-for-impact/>

²⁵ See the Global Sustainable Investment Alliance 2018 trends report here: <http://www.gsi-alliance.org/trends-report-2018/>

²⁶ The IFPI report is available here: <https://ipfiusa.org/wp-content/uploads/2018/09/IPFI-ESG-Paper.pdf>

²⁷ The Financial Times article “ESG wake-up call for pension fund laggards” is available here: <https://www.ft.com/content/a681b422-91a3-11e8-9609-3d3b945e78cf>

Barrier	Description	Recommendations	Examples of application by country/region
Lack of appropriate opportunities	<p>Lack of suitable investment options in terms of sector (target outcome/ beneficiary), geography, size or asset class, as well as lack of intermediaries to support origination</p> <p>Lack of suitable investment options in terms of sector (target outcome/ beneficiary), geography, size or asset class, as well as lack of intermediaries to support</p>	<p>Request for proposals</p> <p>Challenge product developers to bring forward opportunities with profiles that asset owners seek</p>	<p>UK: Five local government pension funds share the Investing4Growth initiative which invests to achieve financial returns and positive social and environmental outcomes. Asset managers are obliged to propose opportunities that fit the risk and return expectations of the fund while ensuring benefits to the local communities that have contributed to the funds</p>
Disproportionate transaction costs	<p>Transaction costs out of proportion with potential financial returns</p> <p>Can have strict rules about investment size, % of holding and management fees</p>	<p>Bundling</p> <p>Stimulate the intermediary market (through co-investment or fund-of-funds) to create more bundled/ multi-asset products at scale</p>	<p>UK: Big Society Capital (BSC) was established in 2012 to strengthen social-investment markets. BSC serves as a “wholesaler” of capital to social investment intermediaries. Its goal is to enable access to new sources of finance for social-sector organisations</p>
Capital risks	<p>Loss of some or all of the original investment amount.</p> <p>Role as conscientious ‘steward’ of people’s pensions makes protection against losses a priority</p>	<p>Catalytic Capital</p> <p>Provide matching capital, first-loss layers positions, guarantees, tax schemes and/ or insurance</p> <p>Support enterprises/ products to become investment-ready</p>	<p>Australia: The Community Finance Fund for Social Entrepreneurs was supported by a pension fund, but it needed protections due to its fiduciary duty. A first-loss structure enabled the pension fund to participate²⁸</p> <p>Africa: USAID has provided a 50% loan guarantee, in addition to subordinated equity investments, through its Development Credit Authority to boost the African Agriculture Capital Fund (AACF). The AACF is a private-equity fund that aims to boost productivity and profitability of the continent’s undercapitalised agricultural sector</p>

²⁸ The GIIN report on Catalytic-first loss capital is available here: <https://thegiin.org/assets/documents/pub/CatalyticFirstLossCapital.pdf>

Barrier	Description	Recommendations	Examples of application by country/region
Unquantifiable risk	Lack of track record: While all investments carry risk, unquantifiable risk applies to situations in which the investment profile is not well known. Since impact investment is not yet a mainstream strategy – in terms of its investment products and investment teams – asset owners can find quantifying the level and type of risk involved particularly challenging	<p>Placement and distribution platforms</p> <p>Support platforms that showcase a wide range of social impact investment products, allowing investors to compare, benchmark and even trade</p>	Ghana: In 2013, the government's Venture Capital Trust Fund (VCTF) funded the Ghana Alternative Market exchange (GAX) aimed at enabling easier access to finance for SMEs. This overcame the high cost challenges for SMEs in accessing the primary market exchange
Exit risk	Investments not sufficiently liquid to meet uncertain cash flow demands; liquidity not a top priority, although exit path must be clearly defined	(As above)	Canada: SVX is a private investment platform to connect impact ventures, funds and investors. The initiative is led by the MaRS Centre for Impact Investing in Toronto and supported by the Government of Ontario
Impact risk	<p>Misaligned language and taxonomy of SRI and how to measure them</p> <p>Impact evidence not sufficiently robust to justify diversion of funds from other impact-creating opportunities.</p> <p>Protecting against (the reputational risk of) poor impact performance often viewed as priority</p>	<p>Establish an impact rating system</p> <p>Support the development of an impact investment rating system, including a formal alliance with a credible global rating agency</p>	<p>Europe: In 2018 the European Commission developed a taxonomy for sustainable investment and a definition of a green bond standard</p> <p>Europe: The rating Initiative, launched in 2010, promotes the use of financial and social ratings in the microfinance industry. The government of Luxembourg and the Swiss Development Corporation funded the project. The initiative creates a rating market in underserved regions and overcomes the lack of transparent data in microfinance</p>

2. Survey of South African pension funds

About the Respondents

In total, 49 respondents completed an online survey that was conducted from 28 August 2019 to end-December 2019. The respondents were solicited through e-mails, text messages and phone calls using two principal databases: the membership of the council of retirement funds for South Africa, Batseta, and a trustees' database of Today's Trustee, a specialist publication servicing fund trustees.

Assets under management

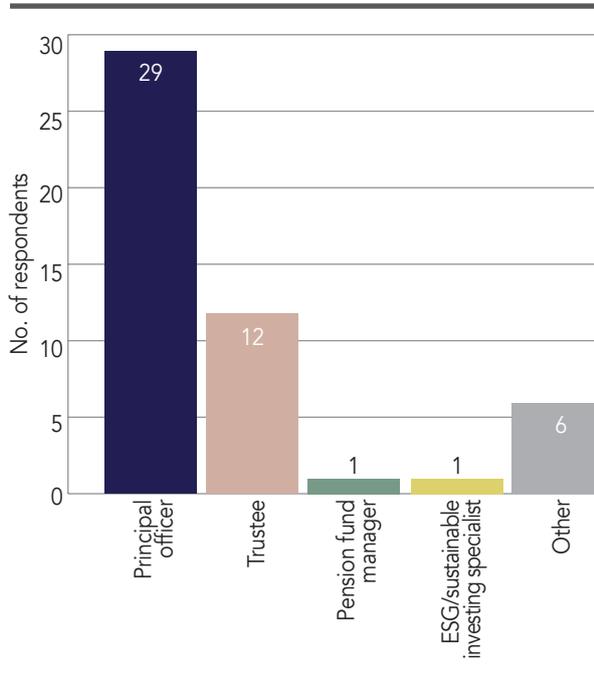
The 47 funds that answered this question manage a combined AUM of R2.6-trillion, which represents 65% of the total AUM of all South African pension funds of approximately R4.3-trillion.

Members and member types

Contributing / active members	3,381,271
Pensioners in receipt of regular payments	534,690
Persons entitled to unclaimed benefits	24,616
Dependents and nominees	20,398
Deferred benefit members/pensioners	17,132
TOTAL	3,960,975

Q5: How many active members does your fund have? n=45

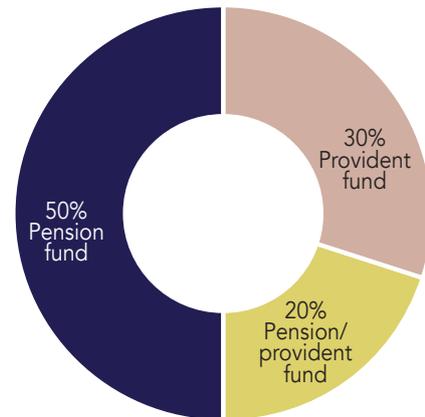
Main function of survey respondents



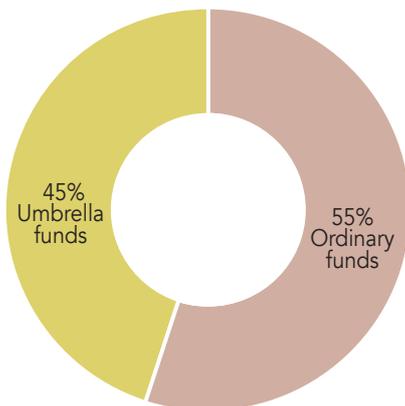
Q2: What is your role or designation at the pension fund? n=49

Fund types represented by the respondents

The funds that the respondents are involved in are of three different types: pension funds, provident funds and funds that have both elements. The main difference between a pension fund and a provident fund is that upon retirement, a pension fund member gets one third of the total benefit in a cash lump sum and the other two thirds is paid out in the form of a pension over the rest of the member's life. A provident fund member can get the full benefit paid in a cash lump sum.



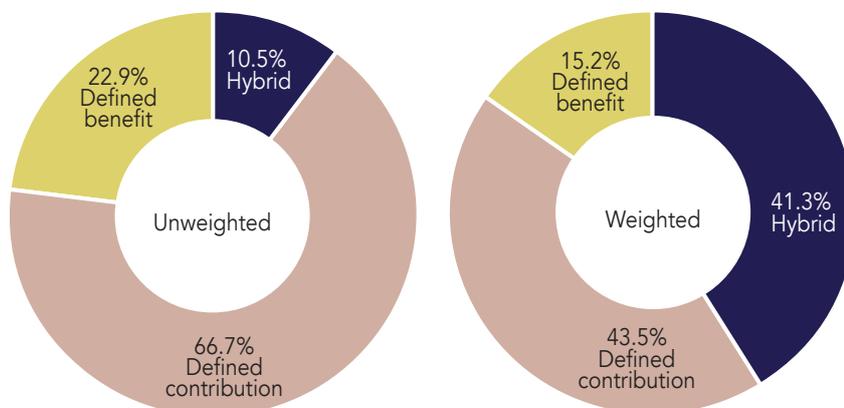
Split between umbrella and ordinary funds



These funds consisted of both "ordinary" funds established for one specific employer, and umbrella funds that service several unrelated employers. Umbrella funds are a response to a need from smaller employers for affordable retirement fund solutions. Umbrella funds are normally established by a service provider who appoints the initial trustees.

Split between defined benefit and defined contribution respondents

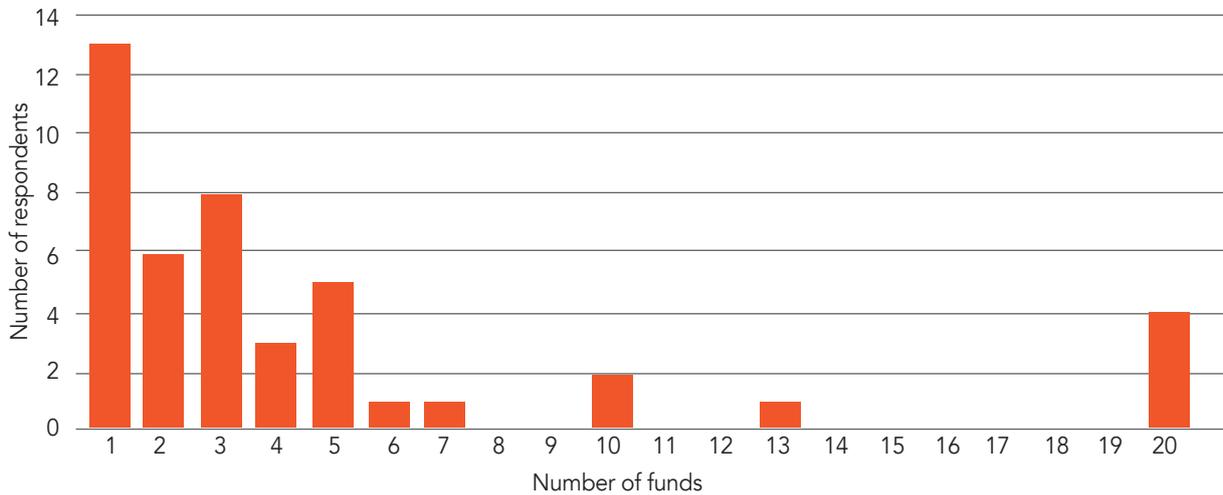
Both defined benefit and defined contribution funds participated. On an unweighted basis, the majority of the funds were defined contribution funds, but on a weighted basis the split was more even between types of funds. This indicates that more large funds were defined benefit funds compared to smaller funds.



Q3. What type of fund structure do you manage? n=49

Number of funds in portfolio

Most respondents indicate that there is only one fund in their portfolio. Four respondents say there are 20 funds in their portfolio.



Q6: How many funds do you have in your portfolio? n=44



“
The typical trustee needs asset managers to lead the ESG debate in terms of creating standards and protocol.
 ”
 Survey respondent

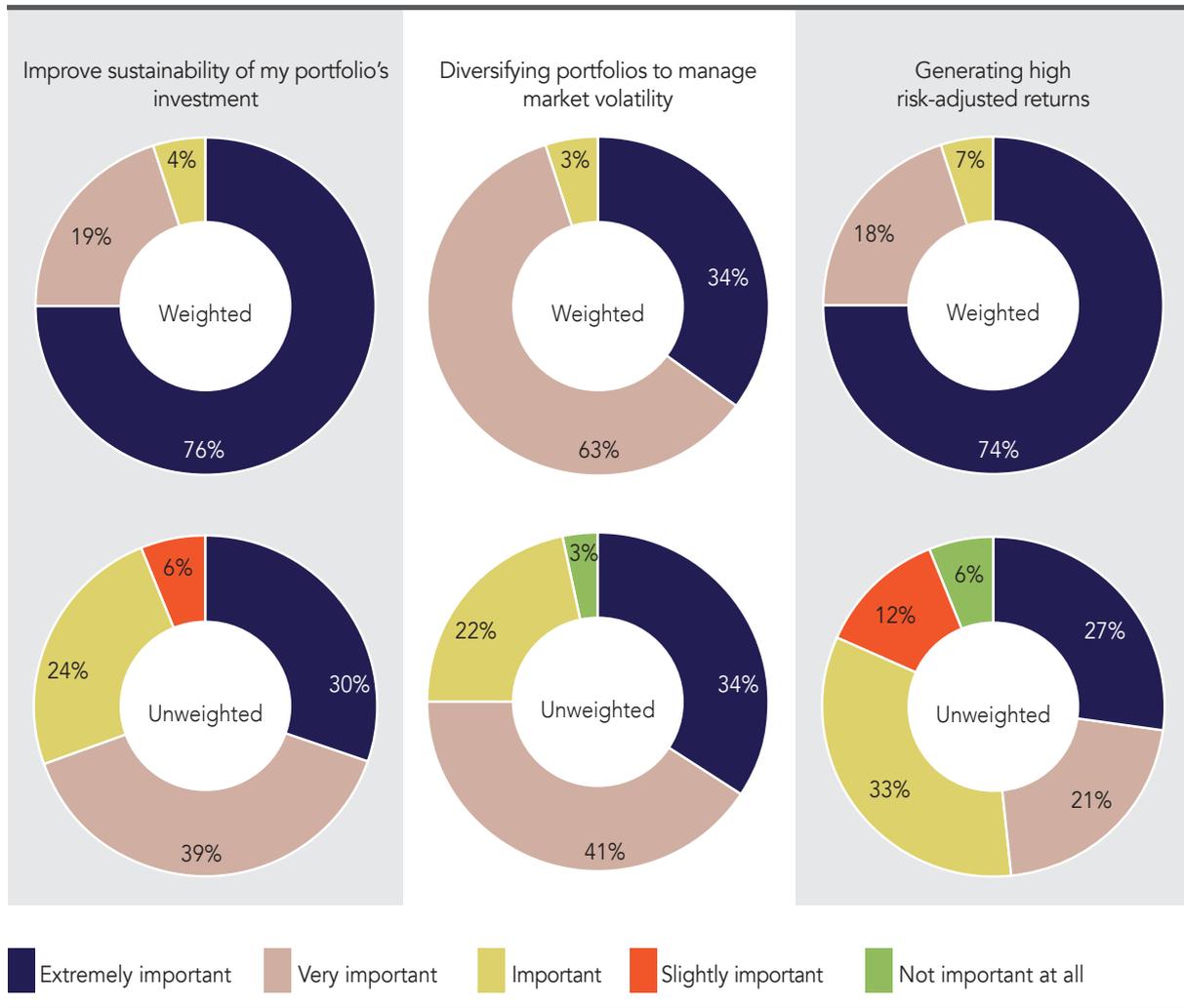
Survey results

In this section we provide the results on a weighted and unweighted basis to the questions asked in the survey.

Respondents have several clear investment objectives for their funds. Sustainability, diversification and high risk-adjusted returns were all considered important with sustainability clearly considered very

important. Interestingly, the weighted results showed sustainability was considered to be as important as risk-adjusted returns, with 73% of respondents (on a weighted basis) saying it was "extremely important". This indicates that larger funds place a greater priority on improving the sustainability of portfolios compared to smaller funds.

Investment objectives



Q7: How important are the following investment objectives for your organisation over the next 12 months?

n=33

Note: Unweighted results are based on the absolute number of funds giving each response. For weighted results, a formula has been applied based on relative AUM.

Important issues for investment managers and asset owner engagement

Rank	Unweighted result	Weighted result
1	Corporate strategy	Diversity
2	Accounting quality	Corporate strategy
3	Diversity	Remuneration
4	Remuneration	Bribery and corruption
5	Bribery and corruption	Climate change
6	Climate change	Labour rights
7	Cyber security	Accounting quality
8	Labour rights	Supply chain management
9	Supply chain management	Cyber security

Q11. Please rank in order of importance the areas that you believe it is important for investment managers and asset owners to engage on.

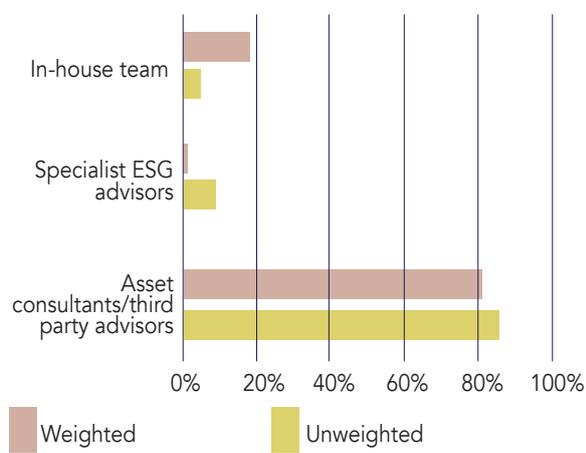
Note: Each respondent provided a ranking of engagement areas which was aggregated to determine the unweighted result. For weighted results, the rankings were weighted by relative AUM and then aggregated.

The results show that corporate strategy was important to respondents on both a weighted and unweighted basis, though it dropped to second most important in the weighted results, in favour of diversity as an issue. A similar question in an international survey²⁹ that excluded Africa delivered different results. In that study corporate strategy and climate change were the top concerns, with diversity ranked fifth. The prominence of diversity for South African respondents is an indication of the level of concern with social issues in the country.

Expert Panel view

D’Alton: That diversity emerges as the top issue does not come as a surprise for Anne-Marie D’Alton, CEO of Batseta, the council for retirement funds of South Africa. In her view, “Diversity is likely coming up high because of the emphasis on BBBEE in the industry at the moment.” Further, she clarifies that “diversity should be read in the broad sense of workforce diversity, board diversity, diversification in the value chain (especially in terms of suppliers such as black asset consultants)”.

Sources of expertise in portfolio construction



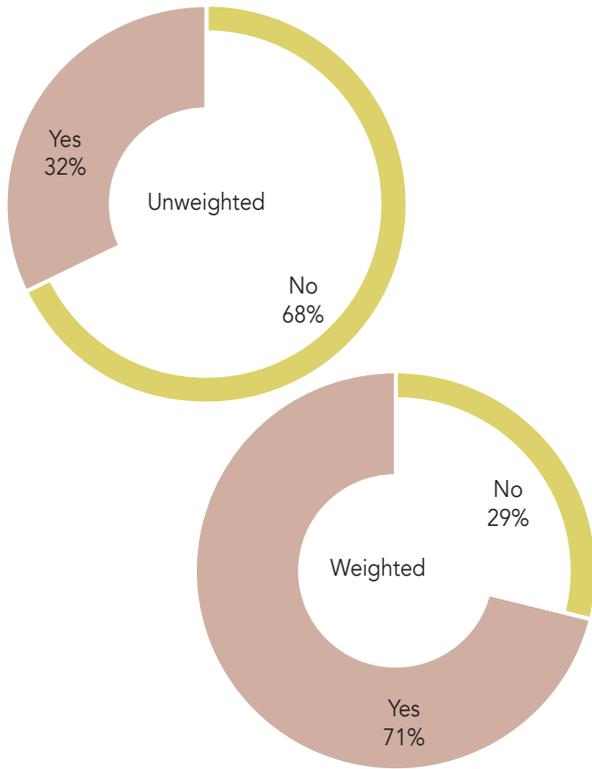
The results in figure 8 reflect the important role that investment consultants play in the investment decisions of funds, with 86% of respondents relying on them for investment decisions. On a weighted basis, more in-house teams played a relatively larger role, with 18% of respondents indicating that they relied on in-house teams for investment expertise. On an unweighted basis, 9% of respondents use specialist ESG advisors. Large funds therefore have a greater in-house capacity, though overall third-party advisors are critical to the industry across fund sizes.

Q12. How does your fund get expertise for portfolio construction?

Note: respondents could choose just one option

²⁹ See the Schroders Institutional Investor Study 2019 report here: https://www.schroders.com/en/sysglobalassets/digital/institutional-investor-study/sustainability/pdf/Schroder2019_SIIS_Sustainabilityv2.pdf

Voting on shareholder resolutions



Q13. Do you actively consider and vote on shareholder resolutions of the companies you are invested in?

This result indicates that most pension fund decision makers are passive investors who do not play an active role as shareholders in directing companies they are invested in, with 68% indicating they do not consider shareholder resolutions. However, the figures reverse on a weighted basis, with 71% of weighted respondents actively considering and voting on resolutions. This indicates that larger funds are far more engaged in directing companies they are invested in than small funds.

Next we consider issues which are of concern to those respondents who do consider and vote on shareholder resolutions.

“Clarity on the classification of the ‘new’ types of investment vehicles available for Regulation 28 purposes is urgently required. Merely ‘considering’ or ‘reporting’ on ESG may not yield the desired outcomes.”

Survey respondent



Factors affecting shareholder voting

The results here again reveal differences in attitudes between large and small funds but note that the responses are a relatively small subset of the overall sample, with 16 respondents answering this question. Larger funds were more concerned with environmental

and social practices of their investments as well as remuneration policies than small funds; however small funds were more concerned about the Code for Responsible Investing by Institutional Investors in South Africa (CRISA).



Q14. If yes, please indicate how important the following factors are when making shareholder voting decisions. (Respondents could only select one answer per factor.)



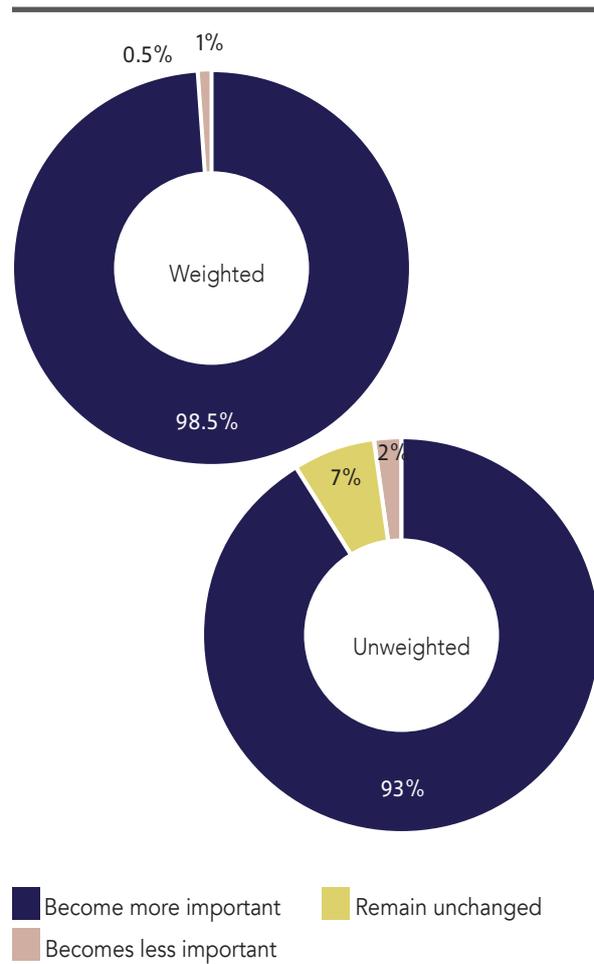
“Domestic equity market already too concentrated and strict ESG considerations will concentrate it further.”

Survey respondent

The role of sustainable investments in the next five years

Almost all respondents indicated that they expect sustainable investing to play a more important role in the next five years, which was even more pronounced on a weighted basis.

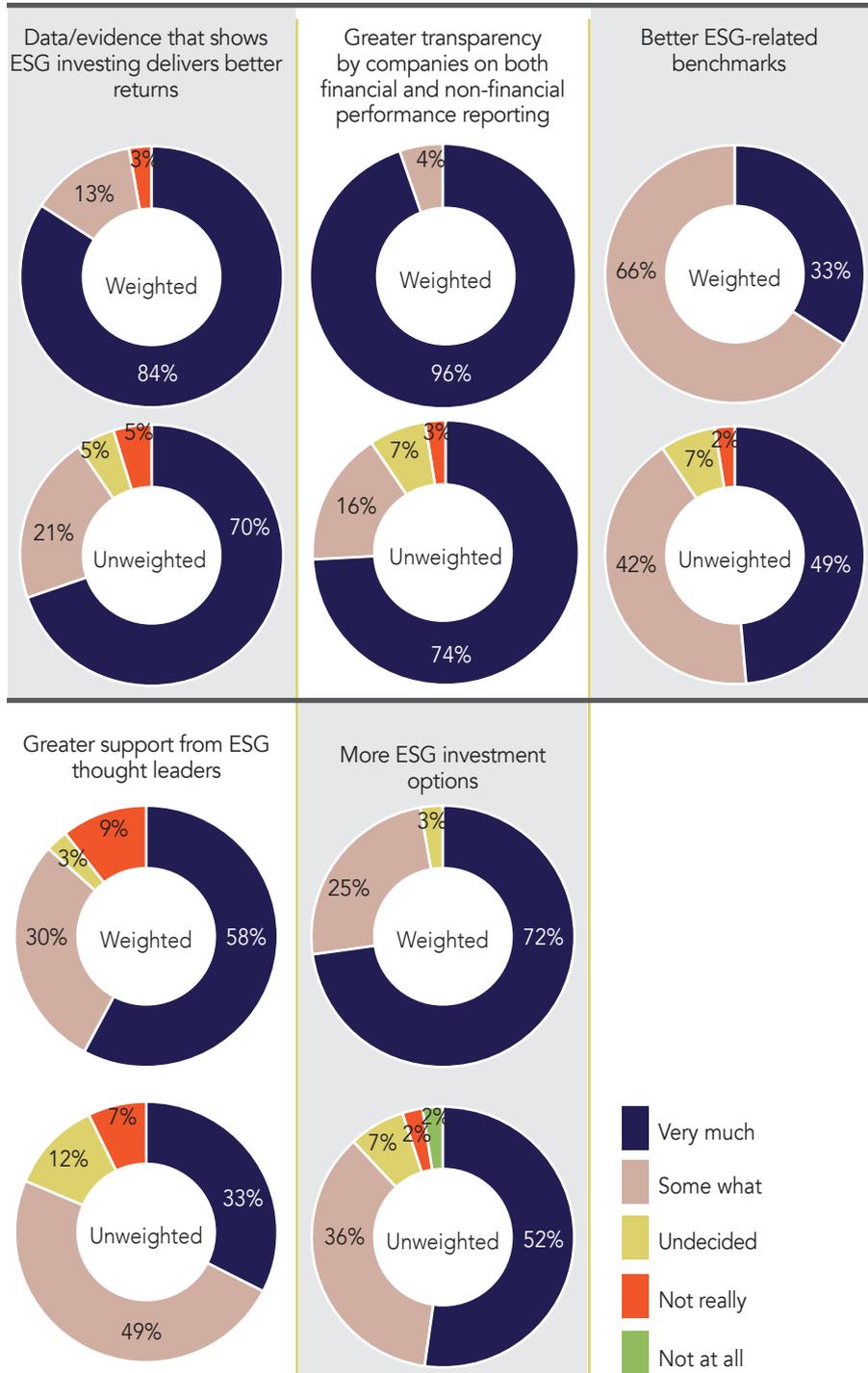
Respondents indicated that they expect sustainable investing to play a more important role.



Q15. How do you expect the role of sustainable investing to change in the next five years?

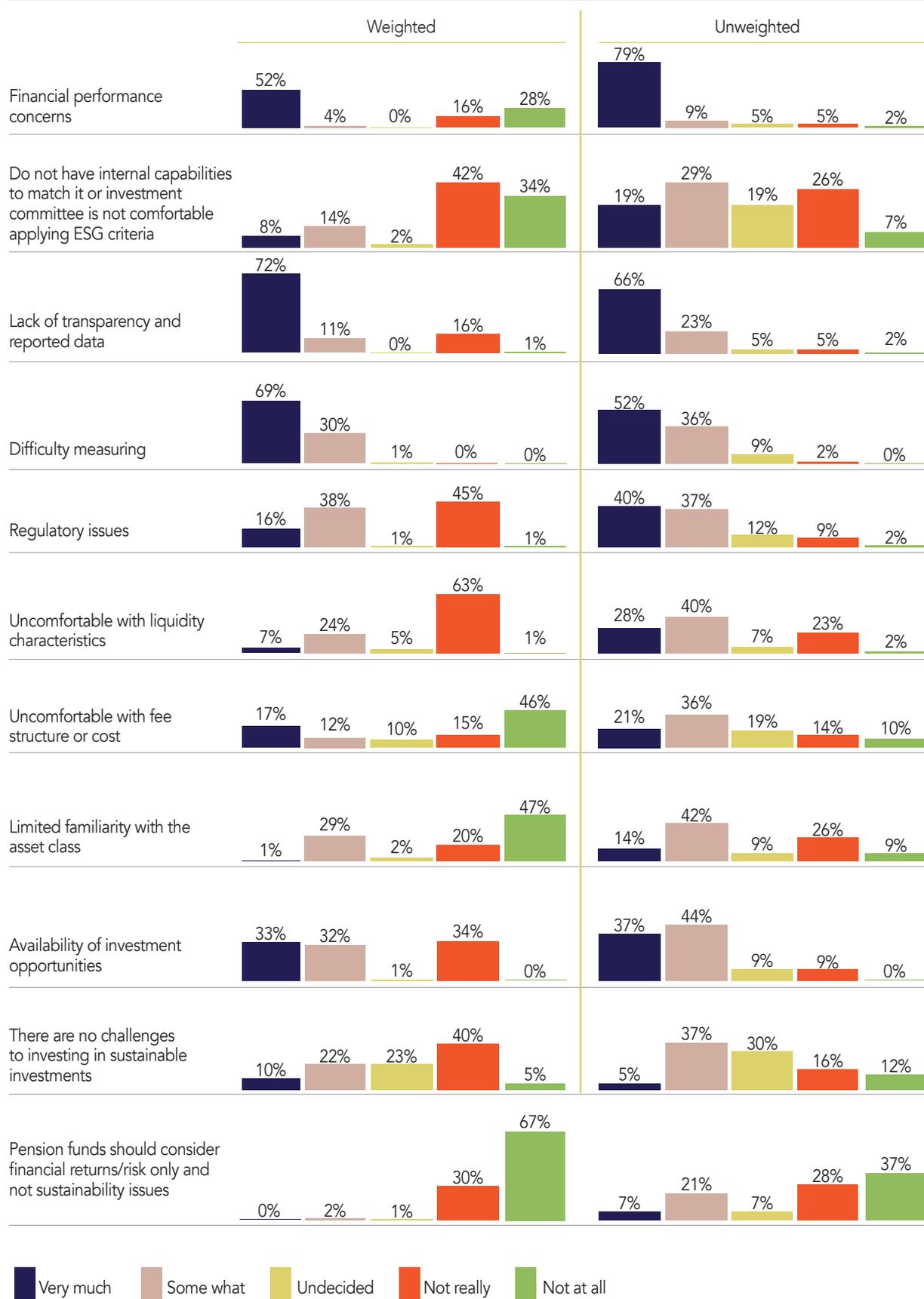
Factors enabling ESG integration in investment decisions

Respondents say greater transparency as well as more evidence that ESG investing delivers better returns would help them incorporate ESG issues into investment decisions. ESG benchmarks and thought leadership are considered to be less important.



Q16. In your opinion, to what extent will the these factors help you to integrate ESG into your investment decision-making?

Challenges affecting interest in undertaking sustainable investments



Q17. To what extent do each of the following challenges affect your interest to undertake sustainable investments?

Challenges affecting interest in undertaking sustainable investments

The results to this question reveal several interesting features in respondents' views on sustainable investing. First, few respondents believe that pension funds should worry only about financial returns and not sustainability issues. However, more than half of respondents on both weighted and unweighted results are concerned about financial performance anyway. Another clear standout is the concerns respondents have about the difficulty

of measuring sustainability aspects of investments. Still, most respondents say they are quite familiar with the asset class and have internal capabilities to manage exposures. They are also not generally concerned about the liquidity features of sustainable investments, nor with regulatory issues. While the issue of liquidity of sustainable investments do not concern many of the respondents, it is an important element to clarify, nonetheless.

Expert Panel view

Difficulties with measurement

Seiso: "Without a consistent way of measuring sustainability across the board, it could all be PR. Asisa needs to write the standard. Until then, you can't really compare."

Lack of transparency and reported data

D'Alton: "It is not that data is not available, access to data is the real underlying problem – trustees are potentially not getting enough data. This is not going to be uniform, for example Eskom's fund, which has an inhouse team, is unlikely to say they have this problem. The guidance note from FSCA forces disclosure and gives guidance on what and how to report. This will help trustees know what to ask for."

Fair: "We can create more transparency through setting up an entity to verify and check. We forced frequent valuations on the industry, then it became legislated. We need to make it a safer environment through regular valuations like, for example, quarterly valuations."

Liquidity characteristics

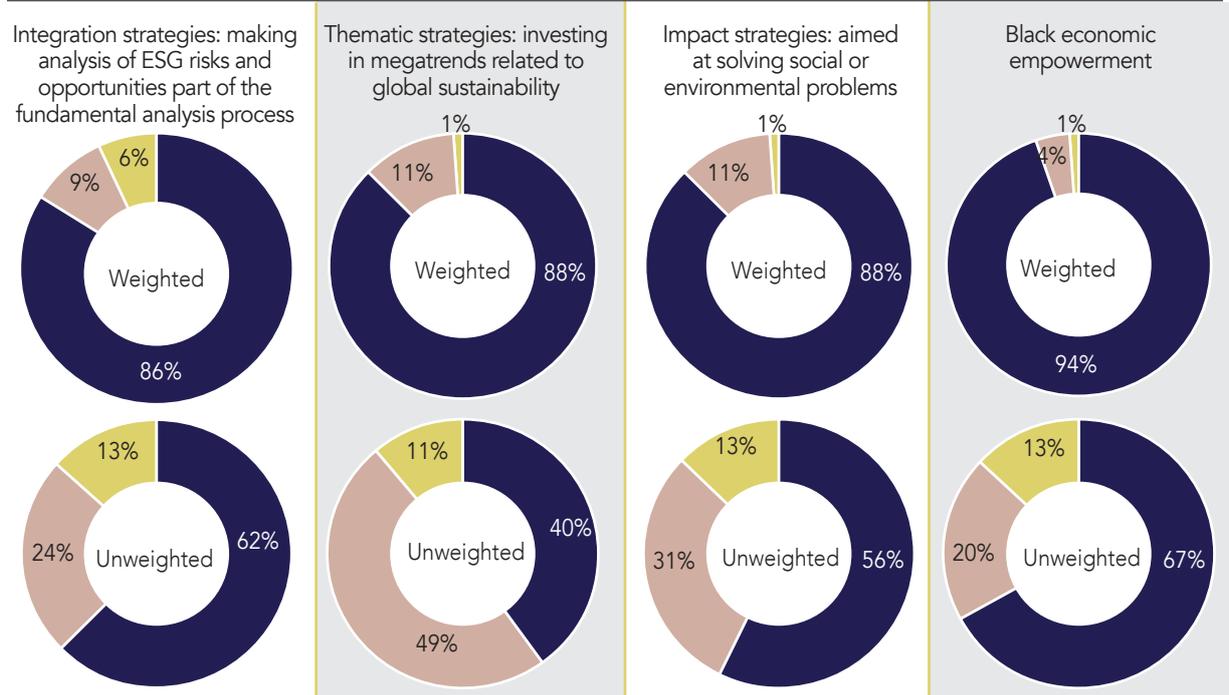
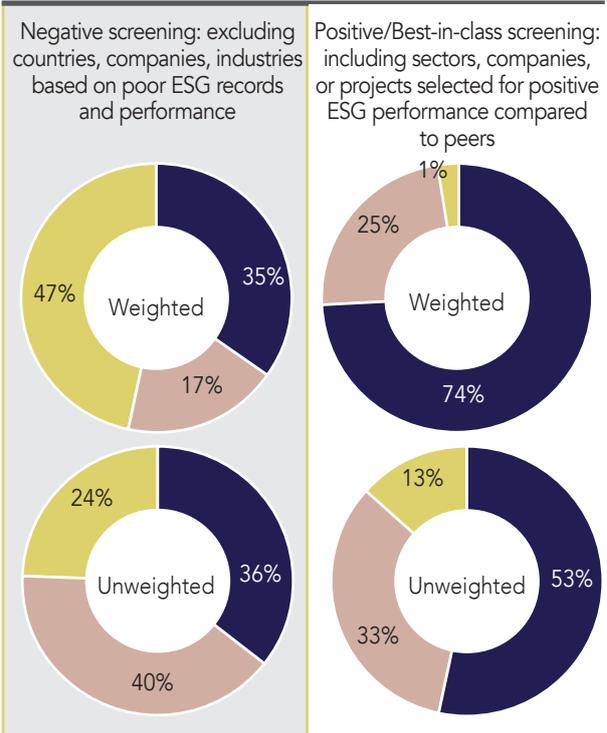
D'Alton: "The assumption that sustainable investments are inherently illiquid is because they are often associated with alternative assets. This in turn means that they are associated with private equity and infrastructure. Both of these are less liquid than investments in listed firms. This is an erroneous assumption because ESG should be seen as integrated across all assets classes and not just those specific ones which tend to be less liquid than others."

Fair: "A lot of the problem is language, ESG vs sustainable vs responsible investments. For example, in Europe, they tend to use the term responsible investments."

Incorporation of sustainability strategies into investment policy statements

Most funds have considered all the main techniques associated with sustainable investments and in many cases have explicitly incorporated them into their investment strategies. This was, however, more pronounced in the weighted results, indicating that larger funds more commonly incorporate sustainability issues. Black economic empowerment is the most common concern, followed by impact strategies that aim to solve social or environmental concerns. Most respondents also say they have integrated ESG risks and opportunities analysis into their fundamental analysis process.

Interestingly, relatively few respondents apply negative screening in their investment decisions despite it being a common mechanism used internationally, while more than half apply positive screening to select investments with positive ESG performance.



Yes
 Have not considered it
 Considered it but decided not to implement

Q18. Have you explicitly incorporated any of these issues into your investment strategy (investment policy statement)?

Incorporation of sustainability strategies into investment policy statements

Expert Panel view

D’Alton: “There has been quite a drive on BEE in the industry, especially focused on transforming the value chain by giving black asset managers and consultants access to opportunities. Eskom in particular is a good example, where members are pushing for thematic investments related to affordable housing, building hospitals, shopping centres and student accommodation. Funds are getting these inputs from their road shows where they are engaging with members, and consultants are also driving a lot of the change.”

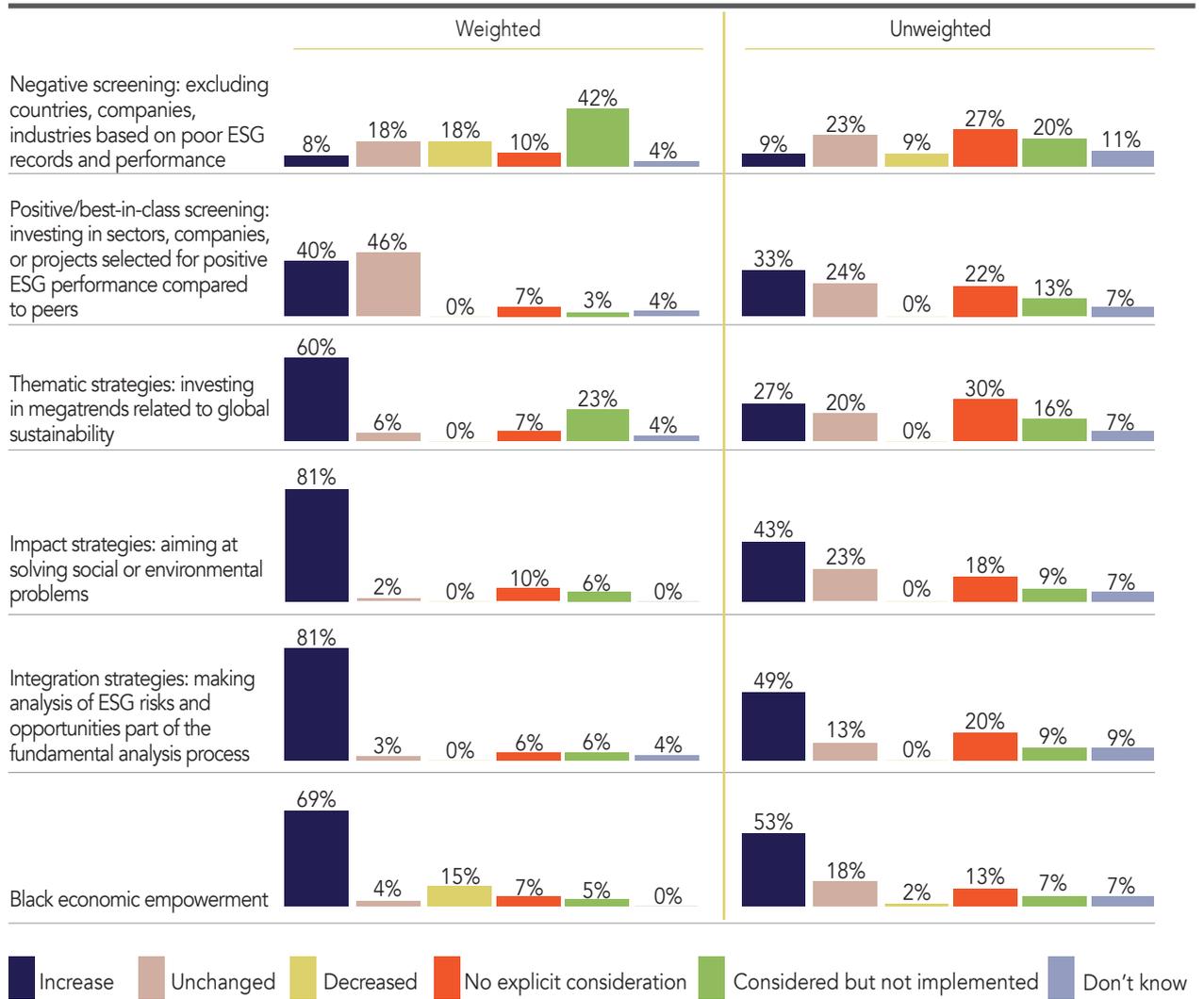
Fair: “The smaller funds are the ones to be concerned about because they may not be absolutely clear that their own investment strategies do not explicitly include these issues. People don’t draw a distinction between their funds’ investment strategy, the advisor strategy and their asset manager strategy. They may not have captured this explicitly in their investment strategies.”



“Where possible we focus on engagement, leadership, capital structure and remuneration of our investees. Screening and censure of investments do not have a convincing record. We prefer active but not necessarily activist. It is important to consider the investment merits and the portfolio fit compared to our liabilities.”

Survey respondent

Changes in portfolio exposures over five years



Q19. Over the last five years, have you changed your portfolios' exposure based on these considerations?

Most respondents, particularly on a weighted basis, have changed their portfolio composition to reflect BEE, ESG and impact investing strategies. Interestingly, several respondents say they have considered but not implemented or even decreased the use of negative

screening. The difference between weighted and unweighted results indicates that larger funds are more active in considering sustainability criteria broadly in their portfolio strategies.

Expert Panel view

The rise of thematic investments

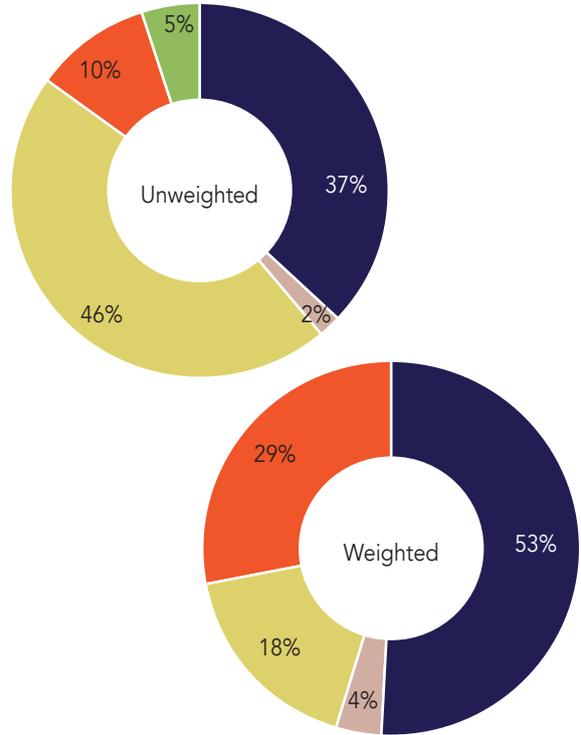
Seiso: "This is a result of active campaigning by workers and unions. Workers are saying that we want our money to work for us. We have good examples from the transport sector where there have been notable investments in truck stops where drivers can get first aid, stop for sleep, vehicle maintenance and proper nutrition."

Mkorosi: "Unions are asking questions about how pensions are benefiting our members."



“
Specific mandatory ESG provisions are needed.
 ”
 Survey respondent

Changes in investment policy or disclosures



- No, we already met or exceeded the guidance provided by FSCA
- No, we have no interest in the guidance note
- Yes, we have reviewed our policy and not yet implemented the change
- Yes, we have reviewed our policy and implemented the change
- Don't know

Q21. Did the FSCA's guidance note "Sustainability of investments and assets in the context of a retirement fund's investment policy statement" of 14 June 2019 lead to any change in your investment policy or disclosures in terms of sustainability/ESG?

Note: Verbatim responses, lightly edited for punctuation

The FSCA guidance note did have a notable impact on funds with 56% of respondents (unweighted) saying they have reviewed their policies as a result of it. Interestingly, 37% unweighted and 53% weighted say that they had already met or exceeded the guidance in the FSCA note.

Respondents' recommendations for changes to Regulation 28

Clarity on the classification of the "new" types of investment vehicles available for reg 28 purposes is urgently required. Merely "considering" or "reporting" on ESG may not yield the desired outcomes.

Specific mandatory ESG provisions.

Regulation 28 should be instructive rather than saying funds should consider ESG.

Limitation to offshore exposure to SARB exchange control limits (30%) should be relaxed. Domestic equity market already too concentrated and strict ESG considerations will concentrate it further.

Increased allocation limits into certain asset classes.

If it become compulsory.

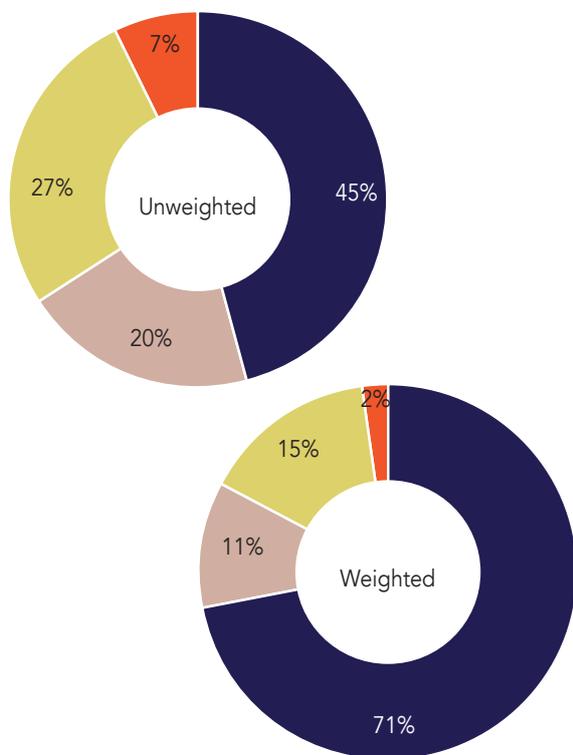
Recognition needs to be given to pooled portfolios (as most of ours are) and the ability of the board of the fund to influence the managers of those portfolios.

Allocate a specific percentage.

Prescription on due diligence and engagement with company directors by boards of management.

Q21. Are there any changes to Regulation 28 that you believe would improve your ability to apply ESG and related investment strategies?

Changes in investment decisions based on sustainability criteria



The results show that respondents tend to have a clear view about future investment decisions in respect of sustainability with most saying they will avoid investments that fail to meet sustainability requirements and will also avoid them if they are unable to assess them. A quarter of unweighted respondents and 15% of weighted respondents say sustainability is unlikely to make any difference while 7% unweighted and 2% of weighted respondents say they have no sustainability criteria.

-  We will in future avoid investments that fail to meet our sustainability requirements
-  We will in future avoid investments about which we are unable to assess sustainability factors
-  Our investment decisions are unlikely to be any different
-  We do not have any sustainability criteria in our investment statement

Q22. To the extent that your investment policy statement stipulates criteria that investments must meet, do you anticipate that

n=27

Factors that most influence sustainable investments

Rank	Unweighted result	Weighted result
1	Track record of investment	Value proposition
2	Value proposition	Track record of investment
3	Proposed strategy	Impact focus
4	Impact focus	Proposed strategy
5	Reputation	Reputation
6	Consultant recommendation	Consultant recommendation

Funds are fairly consistent in saying that seeing the track record and value proposition are most important in considering a sustainable fund for investment. Interestingly, despite the high number of funds reporting that they rely on consultants for investment decisions, this was ranked bottom by funds as an influence on investing in sustainable funds.

Q23. Rank the factors that would most influence your decision to invest in a sustainable fund? n=41



“
ESG is only a subset of components of sustainable asset performance. All investments should be made responsibly and to only have a portion in a so-called ESG fund will leave us exposed in the other part of the portfolio.
 ”
 Survey respondent

ESG priorities

The following tables show what respondents' priorities are in ESG investing, separated into environment, social and governance concerns. The order of the sustainability factors here reflects the relative rankings we found in question 11. The results of that question showed that South African institutional investors consider the ESG factors in the following order: social, governance and environment.

Social

Rank	Unweighted result	Weighted result
1	Employment creation	Economic inequality
2	Economic inequality	Employment creation
3	Access to social goods and services	Access to social goods and services
4	Human rights	Human rights
5	Gender equity	Gender equity

Funds were fairly consistent in social factors that are important, with impact focus and value proposition topping the rankings.

Governance

Ethics and bribery and corruption are top of mind for respondents when it comes to governance concerns, with compensation and shareholder rights at the bottom of the list.

Rank	Unweighted result	Weighted result
1	Business ethics	Bribery and corruption
2	Bribery and corruption	Business ethics
3	Executive compensation	Executive compensation
4	Shareholder rights	Shareholder rights

Environment

Rank	Unweighted result	Weighted result
1	Water use	Climate change
2	Renewably energy	Water use
3	Climate change	Renewably energy
4	Pollution	Pollution
5	Waste and recycling	Waste and recycling

From the weighted results, climate change emerges as the top concern for funds when it comes to the environment. This outcome is consistent with other global research on ESG concerns of pension funds.³⁰

Q24. In your view, what matters most to investors when it comes to ESG?

Expert Panel view

Mokorosi: "Asset consultants play an important role in how funds direct their investments. The results of this set of questions are possibly influenced by their guidance. Trustees are often out-educated by the asset consultants who have much more expertise."

Fair: The difference in the weighted vs unweighted results is due to the resources available to the larger funds. Bigger funds have more resources, more funds and can pay trustees. Small funds have no dedicated resources to deal with the issue. Bigger funds can also afford to employ a CIO, like Eskom and Sentinel, Sasol. A solution could be in the form of a collective intervention such as umbrella funds that can then hire investment consultants to spread across multiple funds."

³⁰ See the Schroders Institutional Investor Study 2019 report here: https://www.schroders.com/en/sysglobalassets/digital/institutional-investor-study/sustainability/pdf/Schroder2019_SIIS_Sustainabilityv2.pdf

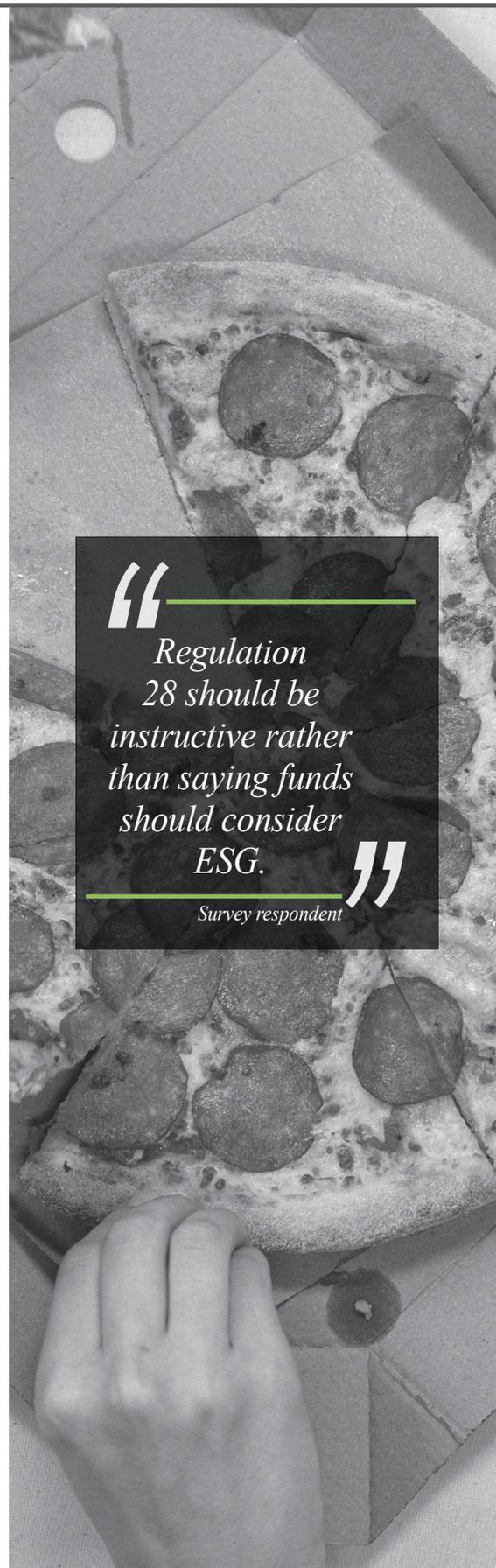
Policies influencing investment approaches

	Unweighted votes	Weighted votes
Principles for Responsible Investing (PRI)	82.5%	85.0%
Code for Responsible Investing by Institutional Investors in South Africa (CRISA)	67.5%	85.4%
Climate change issues	45.0%	47.0%
UN's Sustainable Development Goals (SDGs)	30.0%	73.6%
National Development Plan	30.0%	52.9%
Global Reporting Initiative (GRI)	20.0%	38.3%
Global Sustainable Investment Alliance	7.5%	1.7%

Q27. Which of the following policy positions has influenced your investment approach? (You can choose more than one option.)

Note: Unweighted votes represent the proportion of respondents who chose the relevant option. The weighted votes are a score that represents the relative weight of respondents in terms of AUM who voted for each policy.

The UN-supported Principles for Responsible Investment launched in 2006 is the policy that has had the most influence on funds' investment approach, with more than 80% of respondents saying it has influenced their investment approach on both a weighted and unweighted basis. The Code for Responsible Investing by Institutional Investors in South Africa (CRISA) that came into effect in 2012 also had a great influence on their approach, particularly on a weighted basis, with more than 85% of weighted respondents saying it had influenced them. Despite the substantial global attention paid to the UN's Sustainable Development Goals (SDGs), only a third of unweighted respondents say it is influential, but 74% of weighted respondents consider it to have influenced them. Fewer than half of respondents consider climate change issues to be an influence on their investment approach.

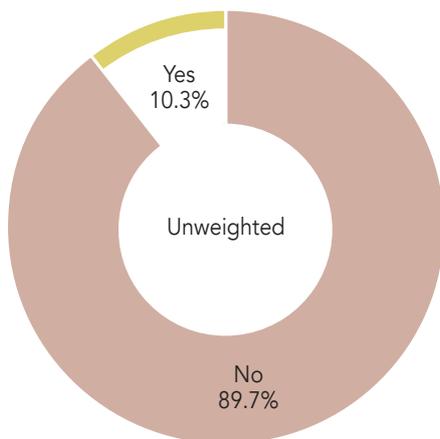


“
Regulation 28 should be instructive rather than saying funds should consider ESG.
 ”
 Survey respondent

Expert Panel view

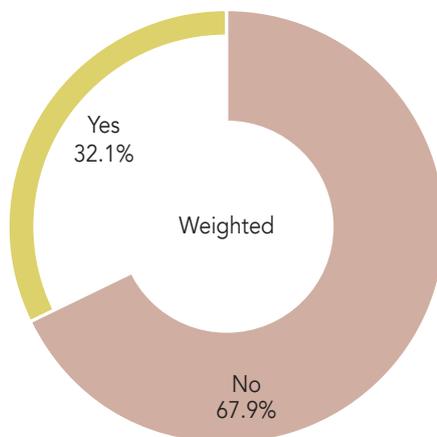
D'Alton: "I suspect the climate change issues would be proportionately higher in developed countries. The SDG and NDP responses suggest that large funds are significantly more sophisticated in understanding national and international agendas."

Publication of sustainability policies



Even though the FSCA guidance note encourages funds to make a copy of their investment policy statements available on their websites as well as information on sustainability, few of the respondents do so. (Another question asked specifically about IPS disclosure on websites with 77% saying they do not disclose on an unweighted basis). This was slightly less the case on a weighted basis with about a third of respondents saying they do provide their sustainability policy for anyone to access.

Of funds who do not make it generally available, 21 respondents (60%) say they do distribute it in other forms including in annual reports or in response to requests.



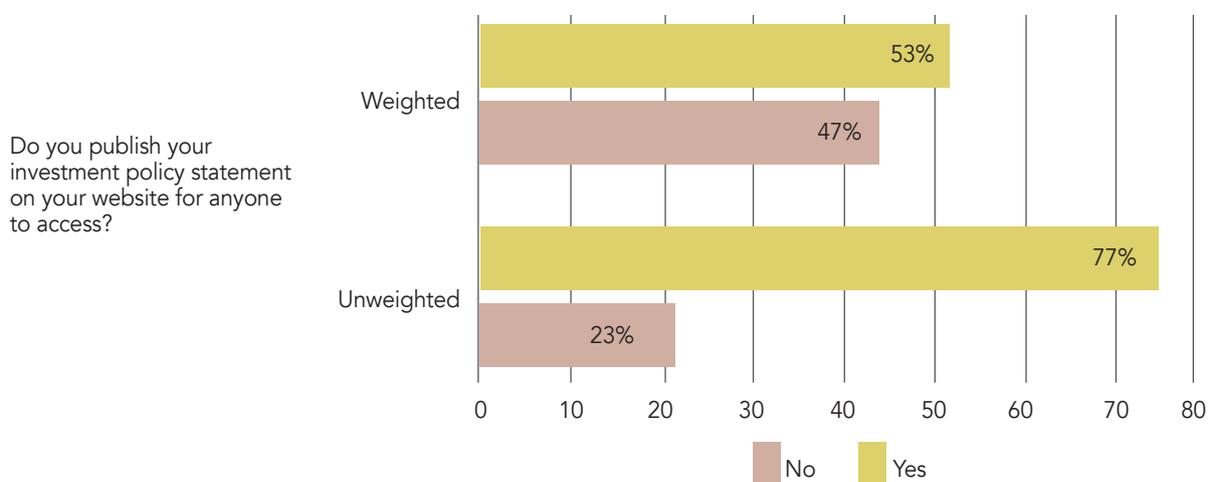
Expert Panel view

Mokorosi: "Unless you legislate, it won't happen. Larger funds are likely to be more compliant because of this FSCA focus on them. These respondents don't want to be seen to be non-compliant. They don't want their name tainted or have their names appear in the papers in negative light."

Q28. Do you publish your fund's sustainability policy for anyone to access?

n=39

Publication of investment policy statements



Q8: Do you publish your investment policy statement on your website for anyone to access?

n=44

Sustainability and asset classes

	Unweighted votes	Weighted votes
Infrastructure	70.7%	98.5%
Alternatives	53.7%	94.9%
Credit	39.0%	92.3%
Equities	68.3%	88.9%
Real estate	41.5%	72.7%
None of the above	0.0%	0.0%

Q31. In which of the following asset classes are sustainability considerations important?

Note: Unweighted votes represent the proportion of respondents who chose the relevant option. The weighted votes are a score that represents the relative weight of respondents in terms of AUM who voted for each policy.



Equities and infrastructure assets stand out on an unweighted basis as asset classes in which sustainability is an important consideration. On a weighted basis, however, respondents say sustainability is also an important consideration in credit and alternatives. Real estate is least often considered to be an asset class in which sustainability is important.

Opinions on the role of ESG investing in South Africa

ESG is only a subset of components of sustainable asset performance. All investments should be made responsibly and to only have a portion in a so-called ESG fund will leave us exposed in the other part of the portfolio. We have a significant reliance on the leadership of our investee companies to drive the right behaviour and incorporate sustainability within the investee. Where possible we focus on engagement, leadership, capital structure and remuneration of our investees. Screening and censure of investments do not have a convincing record. We prefer active but not necessarily activist. It is important to consider the investment merits and the portfolio fit compared to our liabilities.

Influence education method and assist in job creation to absorb new graduates to job markets.

Insufficient attention has been given to creating financial instruments in which funds can invest which can be readily valued.

Job creation.

Public entities such as Eskom, Transnet and SAA should be privatised. Will be more inclined to invest for ESG purposes in these types of infrastructure if it is managed in terms of sound business principles.

The fund does impact investing in developing truck stops for its members who are mostly truck drivers.

The typical trustee needs asset managers to lead the debate in terms of creating standards and protocol.

Q32. Is there anything else you think we should consider that is relevant to the role of ESG investing in South Africa?

Note: Verbatim responses, lightly edited, from those who gave any answer:



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