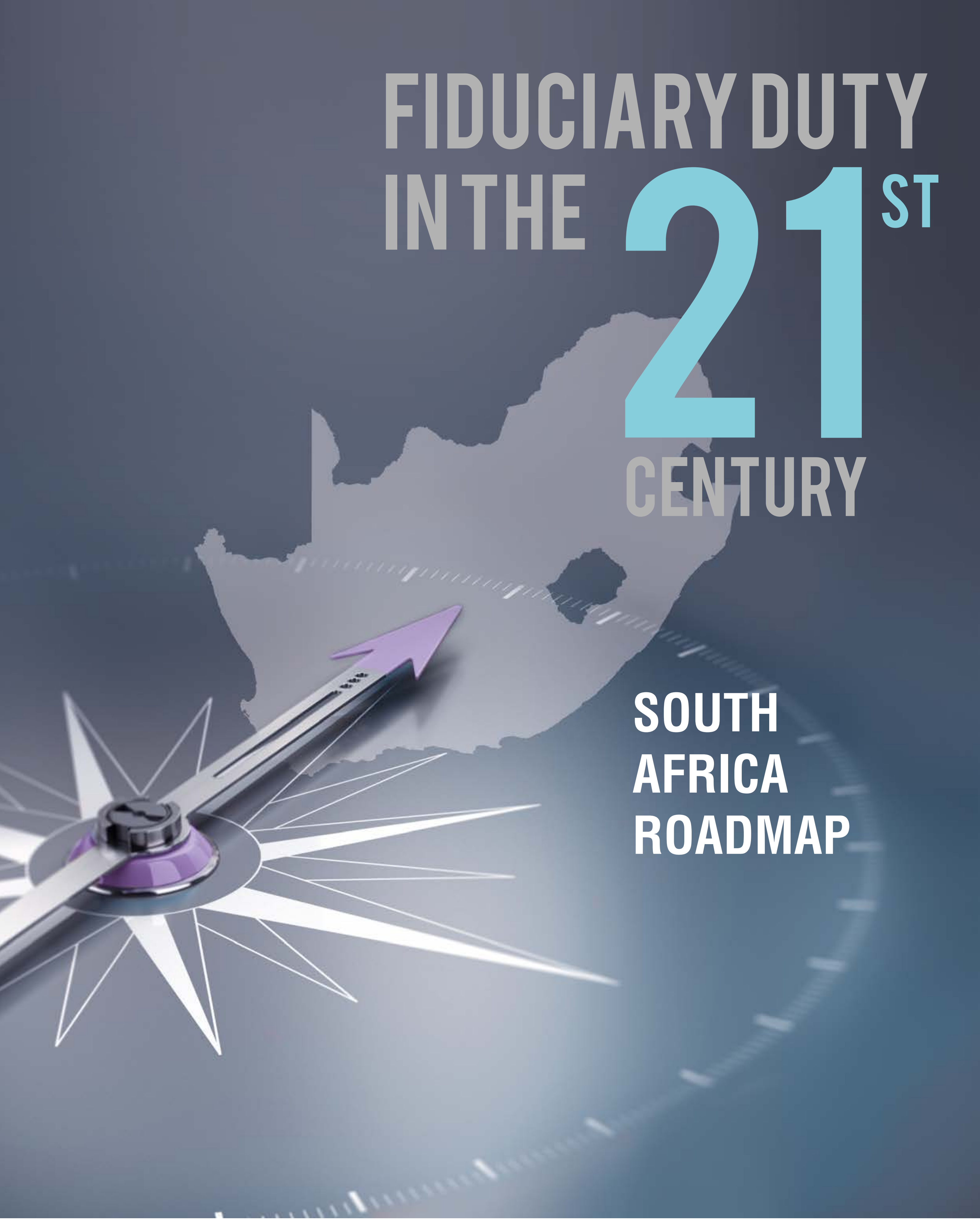
FIDUCIARY DUTY IN THE 21ST CENTURY

SOUTH AFRICA ROADMAP



generation foundation

UNEP FINANCE INITIATIVE

PRI Principles for Responsible Investment

THE PROJECT

Fiduciary duty in the 21st century concluded that failing to consider long-term investment value drivers, which include environmental, social and governance (ESG) issues, in investment practice is a failure of fiduciary duty. Despite significant progress, many institutional investors have yet to fully integrate ESG issues into their investment decision-making processes.

In January 2016, the PRI, UNEP FI and The Generation Foundation launched a three-year project to implement the report's recommendations, including the preparation of country roadmaps. These roadmaps enable the PRI and UNEP FI to work with national stakeholders to implement clear and accountable policy and practice that embraces the modern interpretation of fiduciary duty.

This South Africa roadmap was developed through industry consultation and sets out recommendations to ensure that the modern interpretation of fiduciary duty is reflected in the practice of South African institutional investors. It also sets the South African capital market in a broader international context as regulators and investors respond to a rapidly-changing investment environment.

Our recommendations cover four categories and focus on the practices of South African retirement funds: regulatory guidance, enhanced stewardship, investor education and corporate reporting.

1. Regulatory guidance:

a. The South African Financial Services Board (FSB) should:
   i. provide practical guidance to enhance the impact of Regulation 28 on the investment practice of South African pension schemes and actively monitor progress in scheme practice;
   ii. review the implications of the size and structure of pension schemes on governance quality.

b. The FSB should review investment manager mandates to ensure that they reflect the expectations for investment practice set out in Regulation 28.

c. South African industry associations and the FSB should provide practical guidance to trustees on interaction with investment consultants on ESG integration.

2. Enhanced stewardship:

The Code for Responsible Investment in South Africa (CRISA) should be supported with more resourcing and a permanent secretariat to enable its work on stewardship and responsible investment in South Africa.

In connection with this roadmap, the PRI, UNEP FI and The Generation Foundation will provide complimentary access to the trustee module of the PRI Academy for 40 trustees at pension funds across South Africa. This practical response to some of the training, capacity and awareness challenges identified in this roadmap directly supports our recommendations

3. Investor education:

ESG issues should be a core competency in the National Qualification Framework for trustee training. Training and accreditation groups and industry organisations, such as Batseta and the Association for Savings and Investment South Africa (ASISA), should collaborate to provide training and raise market awareness of ESG investment approaches.

4. Corporate governance and reporting:

South African stakeholders, including the FSB and the Johannesburg Stock Exchange (JSE), should review the quality of the reporting of material ESG factors following the report of the international Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).

Wherever possible we propose that ASISA, Batseta, CRISA and the PRI seek to align their work on ESG integration in South Africa to ensure continuing regulatory support, market awareness and momentum.

ESG integration is: the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions

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This roadmap is prepared by the PRI, UNEP FI and The Generation Foundation and does not necessarily represent the views of interviewees and reviewers.

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STAKEHOLDER FEEDBACK

This roadmap draws on events and interviews with more than 25 stakeholders at different points in the South African capital market (see list above). The common themes in the feedback provided by stakeholders have formed the basis for the analysis and recommendations that follow.

South Africa has a fragmented pension fund market; more than 3,000 funds have an AUM of less than R1billion (approximately US$70million). This causes governance and capacity constraints at many South African funds. As a result, South African asset owners lean heavily on investment consultants and investment managers for advice, investment practice and scheme infrastructure. This requires increased guidance for capacity-constrained asset owners to help build ESG issues into advice and product selection and improve scheme outcomes[1].

Several stakeholders noted that the move to consolidate schemes could help overcome governance and capacity constraints. Many smaller schemes have been merged into "umbrella" funds. However, they come with their own governance challenges. It was highlighted that such funds have been slow to adopt ESG integration practices. Consolidation is not necessarily a viable or advisable option for many funds, so the recommendations set out in this document were developed with consideration for a long tail of smaller, capacity-constrained funds. This means that consideration of cost and capacity issues have informed the recommendations set out in this document.

The majority of the PRI's 54 South African signatories are investment managers and service providers; asset owners make up a small number of signatories[2]. This reflects the underlying capacity and cost constraints faced by many South African asset owners. However, the South African asset owners that are PRI signatories are strategically important to the South African pensions and insurance markets. Asset owners such as the Government Employees Pension Fund (GEPF) can perform an important role developing scheme practices which smaller South African pension schemes can then adopt.

The PRI has been a consistent and high-profile presence in South Africa, contributing to and sponsoring work on "acting in concert"[3] and the Emerging Market Disclosure Project[4]. PRI in Person was also held in South Africa in 2013. This is in addition to the PRI's broader work on the adoption and implementation of the six Principles[5].

The FSB was identified as the key regulator for advancing ESG factors in pension scheme practice. Through its oversight of Regulation 28, being enabled to issue guidance in the form of board notices, and its oversight of investment mandates and accrediting training providers, the FSB had the ability to significantly advance the adoption of ESG. However, stakeholders suggested that the FSB had its own capacity constraints and was undergoing restructuring as part of the "twin-peaks" reorganisation of financial regulators[6]. It was expected though to retain its key functions once restructured to become the Financial Sector Conduct Authority.

Our stakeholders thought that the FSB would seek to build on industry initiatives to develop new products, guidance and approaches, potentially endorsing or adopting such initiatives to give them the force of regulation. Given the capacity constraints of many South African asset owners, our stakeholders thought guidance, whether provided by the FSB or industry associations, such as Batseta or ASISA, should be provided in the form of practical toolkits to simplify the adoption of improved scheme practices, particularly around ESG issues.

1 Defining Momentum, SinCo (page20): http://sustainablereturns.org.za/downloads/Defining%20Momentum_Final_June2013.pdf
2 PRI Signatory Directory: https://www.unpri.org/signatory-directory/?co=250&sta=&sti=&sts=&sa=join&si=join&ss=join&q
3 Acting in concert in RSA: http://africasri.co.za/tag/acting-in-concert/
4 Emerging Markets Disclosure Project: http://www.ussif.org/files/Emerging_Markets_F2012.pdf
5 The Six Principles: https://www.unpri.org/about/the-six-principles
6 Twin peaks guidance: https://www.fsb.co.za/Departments/twinpeaks/Pages/What-is-Twin-Peaks.aspx

The National Treasury has established a working group to develop an action plan for sustainable finance and is beginning by mapping the state of the sector in South Africa in consultation with stakeholders. This builds on previous policy initiatives that have received significant government support, such as the Sustainable Returns report and its implementation roadmap[7]. Consequently, there is an opportunity for industry stakeholders to meaningfully engage with South African regulators on sustainability topics.

The JSE was an early adopter of advanced corporate governance disclosures. The JSE requires reporting companies to disclose the extent to which they comply with the principles of the King Code[8] on an "apply or explain" basis and has adopted integrated reporting as part of its listing requirements. JSE has also led the market in the development of responsible investment indices and continues to expand its range of related products[9]. JSE has also developed its Empowerment Segment[10] to create a secondary market for shares in companies that have implemented Broad-Based Black Economic Empowerment (B-BBEE) share schemes (whether or not the main shares are listed with the JSE).

Stakeholders identified improving the quality of corporate reporting of material ESG factors as a crucial requirement for enabling ESG integration. The JSE had a role as a convenor of both investors and issuers to improve the comparability and usefulness of corporate reporting. The South African Institute of Chartered Accountants (SAICA) was also working on the quality of corporate disclosures of material ESG factors[11] supporting the work of the Integrated Reporting Committee of South Africa (IRC SA).

As is the case in other emerging markets, the investable universe of large-cap South African companies was limited. There was an expectation that listing activity would increase in-line with continuing economic development. However, critical investment opportunities with a large ESG footprint would be found in unlisted assets (such as infrastructure projects).

CRISA sets out principles that institutional investors voluntarily report on annually on an "apply or explain basis". CRISA was identified as an important body for advancing ESG and sound stewardship practices in South Africa, particularly given its broad and influential membership. To meet its full potential, it was felt that CRISA required additional resourcing in order to maintain continuity of activity.

Our stakeholders indicated that significant knowledge-gaps existed throughout the South African investment market, particularly around ESG. This is a common feature across both mature and emerging markets and is not specific to South Africa. There was an important role for industry associations, such as ASISA, in identifying and promoting ESG investment practices among its asset management membership. Given its role in advancing training and education for the trustees of South African pension schemes, Batseta was also identified as a crucial organisation.

7 Sustainable Returns, actions steps for South African pension schemes: http://sustainablereturns.org.za/downloads/Roadmap_download.pdf

8 The King Code: http://www.iodsa.co.za/?kingIII

9 JSE / FTSE Russell RI index: https://www.jse.co.za/services/market-data/indices/ftse-jse-africa-index-series/responsible-investment-index

10 JSE Empowerment Segment: https://www.jse.co.za/empowerment-segment

11 SAICA: https://www.saica.co.za/Default.aspx

ESG ISSUES AND FIDUCIARY DUTY IN SOUTH AFRICA

South Africa's National Development Plan features governance, infrastructure and climate change among its priorities[12]. Poor management of ESG issues have contributed to major corporate failures in South Africa, destroying investment value and generating significant national outcry (such as the Marikana massacre[13]). Governance flaws at pension schemes have eroded investment value[14]. South Africa as a country also faces its own material ESG issues.

ESG issues are not generic, but rather are sector, market and often country specific. The material ESG issues for a bank are not the same as those for a mining company, those for the UK will not be exactly the same as for South Africa[15]. The risks from poorly managing social issues and the implications of high levels of domestic wealth inequality are particularly important for South Africa. These have implications for the way capital is deployed across the country, particularly under the B-BBEE initiative.

The development of a sustainable financial system and the incorporation of ESG factors into investment processes can contribute to addressing South Africa's economic priorities in several ways.

The analysis of ESG factors can help companies move towards long-term investment horizons, enabling investors to understand the quality of a firm's management and the sustainability of its business model[16]. ESG analysis can help direct more capital into unlisted products, such as domestic infrastructure (such as transport, and energy generation and transmission), as well as sustainability themed investments (such as green bonds). These investment opportunities are critical to South Africa's national development. In this context, it is important that regulation does not unduly restrict the potential for pension fund capital to be directed towards investment opportunities of domestic economic significance[17].

For a country with a significant dependence on extractives and carbon intensive industries, it is worth stating that ESG integration does not involve a narrowing of the available investment universe (unlike negative screening). Neither does it involve relegating the pursuit of a financial return to unrelated objectives.

ESG analysis offers investors an expanded set of tools to evaluate the operational performance and financial prospects of investee companies and development projects. It also enables a broader understanding of the social and environmental impacts of investment decisions. Neglecting analysis of ESG factors may cause the mispricing of risk and poor asset allocation decisions, overlooking value-relevant factors undetected by out dated financial-only analysis[18]. In the context of broader national economic objectives, ESG factors can also be regarded as a significant business opportunity for South African companies and investors.

An enabling environment for ESG issues

Statute and regulation in South Africa expressly requires the consideration of ESG factors in investment decisions.

Regulation 28[19] states that a pension fund's fiduciary duty "supports the adoption of a responsible investment approach to deploying capital into markets that will earn adequate risk adjusted returns". It states that prudent investing should consider factors which may materially affect sustainable long-term performance of a fund's assets "including factors of an environmental, social and governance character". It further clarifies that this is an approach across the portfolio to promote the interests of the fund "in a stable and transparent environment", giving funds significant flexibility as to how to apply the regulation in practice.[20] Regulation 28 also requires pension funds to include B-BBEE as part of their service provider selection process.

15 Sustainable Investment in Sub-Saharan Africa, RisCura and SinCo: http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/learning+and+adapting/knowledge+products/publications/publications_report_si-subsaharanafrica__wci__1319578679952

16 Turning a Profit While Doing Good: https://www.brookings.edu/research/turning-a-profit-while-doing-good-aligning-sustainability-with-corporate-performance/

17 Such as the asset class limits set out in Regulation 28: http://www.stanlib.com/Institutional/KnowledgeCentre/Pages/Regulation28.aspx

18 ESG Research Works: https://www.ft.com/content/b22c49c8-06e8-11e2-92ef-00144feabdc0

19 Regulation 28, under section 36 of the Pension Funds Act 1956: http://ww2.oldmutual.co.za/docs/default-source/old-mutual-south-africa/omig/omig-about-us/responsible-investments/regulation28ofthepensionfundsact.pdf

20 Explanatory Memorandum to Regulation 28: https://www.fsb.co.za/Departments/communications/Documents/Memorandum%20to%20explain%20the%20revised%20regulation%2028.pdf

The National Treasury has sought to undertake reforms in the retirement product market to reduce complexity and cost[21], including moves toward umbrella-fund arrangements and to reduce fee-based erosion of retirement assets[22].

Work by government agencies is supplemented by other non-governmental initiatives. The latest version of the King Code (King IV), developed by the Institute of Directors of South Africa, was launched in November 2016. The King Code seeks to provide a clear, coherent and integrated model for corporate governance and has been extended through its retirement supplement to provide principles applicable to pension schemes[23]. CRISA has also furthered awareness of responsible investment in South Africa. Through these initiatives investors and companies in South Africa have established reinforcing industry-led principles for responsible business and investment practices.

The challenge for South Africa is for the intent of regulation and principles-based codes to be reflected in the investment processes and decisions of South African institutional investors.

Given the usefulness of ESG analysis as a tool for investors, the strong trend of market-wide adoption of ESG investment strategies and increasing public expectations of the role of the corporation in society, there is a promising ESG environment in South Africa. This is also supported by key investor institutions such as ASISA, Batseta and the JSE actively engaging on ESG and sustainability related issues. Translation of these efforts into business practices is the key challenge, exacerbated by the fragmented market of small asset managers and pension funds.

Fiduciary duty in other markets

Regulators and government agencies across capital markets have confirmed interpretations of fiduciary duty regarding ESG integration – in many ways reinforcing the content set out in South African regulation. In Canada, the Financial Services Commission of Ontario noted that the decision to incorporate ESG factors in investment processes of pension funds is in line with pension administrators' fiduciary duty to monitor and mitigate risk[24]. In the UK, the Law Commission, in its report Fiduciary Duties of Investment Intermediaries, stated that "there is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material"[25]. This clarifies that it is not the origin of the factor (or the label ascribed to it), but rather its financial materiality that is relevant to whether it should be considered[26].

21 http://www.treasury.gov.za/publications/RetirementReform/FAQ%20on%20Retirement%20Reform.pdf

22 http://www.treasury.gov.za/public%20comments/Charges%20in%20South%20African%20Retirement%20Funds.pdf

23 As noted above, JSE listed companies are now required to report on the King IV principles on apply and explain basis

24 Financial Services Commission of Ontario, Investment Guidance Notes: IGN-004: Environmental Social and Governance (ESG) Factors, https://www.fsco.gov.on.ca/en/pensions/policies/active/Documents/IGN-004.pdf

25 Fiduciary Duties of Investment Intermediaries, UK Law Commission 2014

26 The evaluation of financial materiality is at the well-reasoned discretion of pension scheme trustees having taken appropriate advice.

RECOMMENDATIONS

1. Regulatory guidance

a. The FSB should provide practical guidance to enhance the impact of Regulation 28 on the investment practice of South African pension schemes and actively monitor progress in scheme practice

Regulation 28 of the Pension Funds Act[27], overseen by the FSB, codifies fiduciary duty applicable to trustees of pension funds expressly stating that such duty "supports the adoption of a responsible investment approach to deploying capital". It states that prudent investment processes should consider factors materially influencing the sustainable long-term performance of a fund's assets, including ESG factors. Regulation 28 requires schemes to maintain an investment policy statement subject to annual review.

It is hard to determine the extent to which pension funds have incorporated the investment approach outlined in Regulation 28. Several stakeholders have suggested that weak implementation in investment practice is often driven by capacity constraints and a lack of awareness at many funds. Transparency is lacking around the practices employed by pension funds – particularly those funds that have not formally adopted either the CRISA principles[28] or the PRI Principles, which both provide for reporting and accountability mechanisms[29].

The FSB has issued guidance to funds for compliance and best practice in connection with the Pension Funds Act. Circular PF-130[30] was issued by the FSB in 2007. This sought to amplify the duties set out in the Pension Funds Act[31] and sets out several governance principles for funds to adopt[32].

Our stakeholders regarded PF-130 as having had some practical impact on scheme practice. The general view was that the FSB should issue an updated version of Circular PF-130 or replace it with an expanded suite of guidance[33]. Such renewed guidance issued under the FSB's mandate could reflect changes to the Pension Funds Act since 2007 and the significant expansion in expectations on pension funds and the analytical tools available to them regarding the process and impact of their investment decisions.

In addition to expanding the FSB's guidance, several stakeholders suggested that regulation should require pension schemes to produce a qualitative statement regarding compliance with Regulation 28 in scheme practice. For many funds, we would expect such a statement to be prepared by the scheme consultant, rather than by a fund staff member or principal officer. Such statements would provide a useful addition to the information that schemes currently disclose in their annual compliance statements. These statements could draw on the Sustainable Returns[34] roadmap for pension schemes previously endorsed by the FSB.

The National Treasury, in its launch of a long-term programme of pension reform, expressly indicated that one of its aims of pension reform was to: "Improve standards of retirement fund governance, including trustee knowledge and conduct, and the protection of

27 Regulation 28, under section 36 of the Pension Funds Act 1956: http://ww2.oldmutual.co.za/docs/default-source/old-mutual-south-africa/omig/omig-about-us/responsible-investments/regulation28ofthepensionfundsact.pdf

28 Reported on by signatories on an "apply or explain" basis

29 The Six Principles: https://www.unpri.org/about/the-six-principles

30 Circular PF-130: https://www.fsb.co.za/Departments/retirementFund/Circulars/PF%20Circular%20130.pdf

31 With particular reference to sections 7c and 7d of the PFA

32 Published before Regulation 28 came into force

33 The FSB is understood to be considering a replacement

34 Sustainable Returns, actions steps for South African pension schemes: http://sustainablereturns.org.za/downloads/Roadmap_download.pdf

members' interests"[35]. That is a broad ranging brief which reflects many of the challenges in pension fund governance in South Africa identified by our stakeholders.

In this context, the FSB – given its regulatory function in relation to the Pension Funds Act – should seek to make a number of strategic interventions to enhance monitoring of compliance with Regulation 28 and focus on improving investment practices. In the development and dissemination of such work, the FSB should seek extensive input from industry associations and national stakeholders and should also reflect the principles set out in the King IV "retirement supplement". Several stakeholder organisations have been working with the FSB on developing such guidance, particularly in reference to disclosures relevant to Regulation 28.

Next steps:

- The FSB should significantly update or replace PF-130. Expanded content could include the Sustainable Returns guidelines and roadmap[36]; the PRI's report, How asset owners can drive responsible investment: beliefs, strategies and mandates;[37] and reflect the content of the King IV Retirement Supplement. The FSB should also set out stewardship expectations, such as those outlined within CRISA, on regulated pension schemes. In that context, it should consider providing guidance on service provider interactions (noted in recommendation (c) below) and best-practice case studies to simplify adoption of ESG investment practices and help frame asset owner expectations of service providers.
- The FSB should require asset owners to prepare a public, annual report describing how they have integrated responsible investment into their investment policy statements, practices and processes, and their investment manager selection, appointment and monitoring processes[38]. The FSB should prescribe a common framework for such reports to enable comparability between pension funds. This would comprise an addition to the FSB's annual compliance reports but should be publicly available.
- The FSB should establish a standing committee to prepare and publish tools and guidance on ESG integration for South African pension funds, drawing on the expertise of organisations such as, Batseta, ASISA, CRISA, PRI, Sustainable Returns and others encouraging collaboration. This would enable the FSB to effectively monitor progress in investment practice against the content of Regulation 28.

These recommendations acknowledge that the highly fragmented structure of South African pension schemes creates a weakened governance environment in which regulatory guidance can be implemented. As a result, we also propose that the FSB review overall market structure given the concerns raised in relation to both small capacity constrained schemes and umbrella fund arrangements.

35 http://www.treasury.gov.za/public%20comments/Charges%20in%20South%20African%20Retirement%20Funds.pdf

36 http://sustainablereturns.org.za/downloads/RIO-Guide.pdf

37 How Asset Owners Can Drive Responsible Investment: Beliefs, Strategies and Mandates (produced by the PRI in partnership with United Nations Environment Program – Finance Initiative and United Nations Global Compact)

38 Such information could be published on the fund's website to enable wide accessibility and accountability

b. The FSB should review investment manager mandates to ensure that they reflect the expectations for investment practice set out in Regulation 28

Investment mandates are critical to defining the relationship between an asset owner and asset manager. Mandates influence manager behaviour and help define an asset owner's ability to project its investment preferences into investment practice.

CRISA's practice note on the ICGN model mandate[39] indicates that ESG factors and related stewardship, risk management and reporting requirements can be added into investment management mandates in a manner that reflects Regulation 28 and is consistent with existing regulation.

Investment managers submit specimen mandates to the FSB under the provisions of the FAIS Act[40]. These mandates then form the basis of the investment mandates that South African pension schemes enter into with their investment managers; material changes to such mandates are required to be submitted by investment managers to the FSB for approval.

Mandates tend not to consider ESG factors as part of the services to which the mandate applies. Given the content of Regulation 28, which requires an assessment of responsible investment practices, it is arguably inconsistent that the FSB does not require mandates to contemplate ESG factors.

Several stakeholders noted that it was easier, in process terms, to document ESG approaches in Investment Policy Statements (IPS) than in mandates, as an IPS was a set of investment principles, where a mandate is a contract seeking to frame and determine a particular set of activities rendered for a fee. The interpretation of the mandate is coloured by the fairly common practice of the relevant asset owner's IPS being appended to the investment management mandates.

The mandate is only one feature of an asset owner's interaction with its investment manager, which is comprised of both legal and relational aspects (often led by its investment consultant). A mandate may not mention ESG factors but if an asset owner asks ESG questions in performance reviews it is likely that the manager will ensure that they are considered in investment processes.

Nonetheless, stakeholders thought it was useful for the FSB to issue guidance stating that ESG issues are a legitimate feature of mandate content and their consideration is required by the content of Regulation 28. This would help ensure that the ESG themes that have been explicitly incorporated into asset owner Investment Policy Statements are reflected in day to day investment practice.

Next step:

The FSB should review investment manager mandates to ensure that they reflect the expectations for investment practice set out in Regulation 28. To review mandates, the FSB can draw on CRISA's practice note, in addition to working with other organisations such as ASISA to reflect best practice in mandate content. The PRI's report, "How asset owners can drive responsible investment: beliefs, strategies and mandates", can inform this.[41]

39 CRISA practice note, ICGN model mandate: http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/2BB91484-C408-4372-A045-FAF4E98560F5/Position_Paper__Model_Mandate.pdf

40 FAIS Act 2002, codes of conduct: https://www.fsb.co.za/Departments/fais/legislation/BoardNotice_ByYear/bn79of2003.pdf

41 How Asset Owners Can Drive Responsible Investment: http://globalsustain.org/en/story/11009

c. South African industry associations and the FSB should provide practical guidance for trustees on interaction with investment consultants on ESG integration

South Africa has a highly fragmented pensions sector. This causes its pension schemes to be comparatively small (on average) and to suffer from the governance and capacity constraints that many small schemes in other markets face[42]. Such schemes often lack the internal resources required to keep abreast of changes in law and regulation and to shape best investment practice accordingly.

Under such circumstances, trustees of smaller funds outsource most of the operational functions of pension scheme management to investment consultants. Consequently, investment consultants strongly influence the investment strategies and resulting asset allocation decisions of South African pension schemes. They also act as an investment manager selection mechanism. Trustees tend to lean heavily on the advice of investment consultants, often seeming to interpret advice as instruction.

There is then a role for guidance from industry associations, and ultimately regulators, on ESG factors to ensure that capacity constrained asset owners have access to guidance to analyse the advice, products and practice of investment consultants. Such guidance can help simplify the technical aspects of holding these strategically important service providers accountable in light of the requirements of Regulation 28.

By way of international example, the Pensions Regulator in the United Kingdom[43] has recently concluded a consultation regarding expanding its suite of guidance to include interaction with investment consultants[44]. Leading pension plans, such as GEPF, can also develop internal guidance on issues such as service provider interactions that can then be shared with other plans. This can assist in the creation of a baseline of market practice.

Such guidance could be a useful tool to assist asset owners to adequately account for ESG issues in the services provided by investment consultants, consistent with the board's expected rigorous oversight function (as expressly set out in Circular PF-130).

Next steps:

- Asset owners should ensure that ESG factors are structured into the selection, appointment and monitoring processes used by their investment consultants and that investment consultant asset allocation advice incorporates ESG analysis. The PRI has produced a substantial suite of guidance documents[45] to help structure asset owner interactions with service providers on ESG factors[46].
- The FSB should develop and adopt guidance, drawing on PRI's work, as part of its explanatory toolkit to South African pension schemes. There will be on-going collaborations with South African stakeholders to share these approaches with South African asset owners.

42 Evidence from The Pensions Regulator in the UK indicates that scheme size is positively correlated with good governance and ESG practices: http://www.thepensionsregulator.gov.uk/press/pn15-46.aspx

43 Which has a somewhat similar remit to EBSA within the Department of Labor

44 The Pensions Regulator, 21st century trusteeship and governance discussion paper: http://www.thepensionsregulator.gov.uk/doc-library/21st-century-trusteeship-and-governance-discussion-2016.aspx

45 How Asset Owners Can Drive Responsible Investment: Beliefs, Strategies and Mandates (produced by the PRI in partnership with United Nations Environment Program – Finance Initiative and United Nations Global Compact)

46 Crafting an investment strategy: https://www.unpri.org/about/pri-teams/investment-practices

2. Enhanced stewardship: The Code for Responsible Investment in South Africa (CRISA) should be supported with more resourcing and a permanent secretariat to enable its work on stewardship and responsible investment in South Africa.

CRISA identifies a set of principles that institutional investors can voluntarily report against on an "apply or explain basis"; such reporting occurs on an annual basis and is publicly available. CRISA is closely aligned with the six PRI Principles and has the support of key stakeholders in South Africa such as National Treasury, FSB, ASISA, Batseta and GEPF.

CRISA provides a reporting practice note to help investor organisations use their reporting framework[47]. We note that reporting frameworks are constantly undergoing revision to remain relevant and to reflect the increased rigour and analytical precision of information available to be reported.

In Fiduciary duty in the 21st century we recommended that CRISA strengthen oversight of the code "by conducting more detailed analysis of current practice". We understand that the CRISA Committee is reviewing the effectiveness of reporting against the CRISA code.

Our stakeholders widely viewed CRISA as an important forum to develop and share responsible investment best practice in South Africa. They noted, however, that CRISA lacks a permanent infrastructure and relies on volunteer effort (in addition to a limited secretariat provided by IoDSA). That makes it difficult for CRISA to maintain continuity of activity. This current structure was regarded as a barrier to CRISA's effectiveness. Several suggestions were made to empower CRISA, including ensuring that it has permanent staff to enable it to set policy priorities and update its guidance. With greater capacity, CRISA will also be able to perform a greater monitoring role of progress in scheme practice on ESG integration and responsible investment.

Next step

CRISA should have a permanent secretariat to enable it to develop and follow through on policy priorities. As part of such additional resourcing, the CRISA Committee would be able to issue updated practice notes to reflect established industry reporting and enhanced stewardship standards.

47 Guidance on disclosure of the application of CRISA: http://www.iodsa.co.za/?CRISAPN

3. Investor education: ESG issues should be a core competency in the National Qualification Framework for trustee training. Training and accreditation groups and industry organisations, such as Batseta and ASISA, should collaborate to provide training and raise market awareness of ESG investment approaches.

Regulatory requirements have helped to raise awareness of ESG practices in South Africa. That awareness has been relatively shallow and unevenly distributed. Participants in the investment chain are often aware of ESG issues in theory, but may not understand what it means in practice.

The Pensions Registrar (appointed by the FSB) determines the skills and training that pension fund boards must possess. The registrar is in the course of developing a non-compulsory National Qualification Framework for trustee training with the South African Qualifications Authority, the elements of which will be subject to third-party[48] accreditation[49]. As indicated by FSB Circular PF-130[50], trustees are expected to receive rigorous and comprehensive training. However, trustee training is often ad-hoc and limited in extent. In practice, a significant quantity of the training provided to trustees is vendor-led, through investment managers and investment consultants. Cost concerns limit schemes' willingness to support paid training. Given the range of tasks that fall to trustees, time for accessing training was often limited[51]. The effect limits the knowledge base and capacity of pension schemes – a problem we have encountered in every market in which we have worked (including the US and UK).

There is a significant role for industry associations, such as ASISA and Batseta, to promote understanding and best-practice of integrating ESG into investment processes and decision-making. Industry associations can leverage the existing knowledge of organisations such as the PRI, which have produced practical guides to enable ESG integration (A Practical Guide to ESG Integration in Equity Investing[52]) and assist asset owners to develop effective policies and investment strategies that incorporate ESG approaches (Investment Policy: process and practice[53]). The PRI academy is also a source of additional training on ESG themes and competencies[54]. It is a mainstream trend to incorporate ESG methodologies into fiduciary training and core competencies of investment professionals, as reflected in recent developments in the CFA's training programme[55]. This work can supplement and form an extension to existing training initiatives in South Africa, such as those accredited through Batseta and the investor training provided by ASISA, the JSE and others.

To support the recommendations in this roadmap, the PRI, UNEP FI and The Generation Foundation will provide complimentary access to the trustee module of the PRI Academy for 40 trustees at pension funds across South Africa. On completion of the module, trustees will be invited to participate in an event, hosted by the PRI's South African network, to further develop the ESG capacity of their pension fund board. This is our practical response to some of the capacity and awareness challenges identified in this roadmap.

The PRI Academy provides industry-leading training on ESG issues impacting company performance, shareholder value and investment decision making. The PRI Academy courses feature content from leading international experts, in addition to case studies and financial modeling of ESG concepts. The programme has been designed to help maximise the practical application of key ESG concepts. The training is completely web-based, which means participants can take a course at any time that is convenient for them.

The trustee module, which will be launched in September 2017, includes training on ESG issues and fiduciary duty, how to incorporate ESG issues into the RFP process, how to speak about ESG issues to other board members, and how to engage investment managers and investment consultants around ESG issues.

48 Batseta has been named as the Assessment Quality Partner for the trustee qualification currently being developed: http://www.batseta.org.za/pages/118/pmit-130

49 Existing draft of the Assessment Specifications for the NQF Trustee qualification: http://www.batseta.org.za/uploads/ftp/FSB_Trustee_Qualification/03_ASSESSMENT_SPEC_PPEO_Trustees.pdf

50 FSB Circular PF-130, page 7: https://www.fsb.co.za/Departments/retirementFund/Circulars/PF%20Circular%20130.pdf

51 See Defining Momentum, page 47

52 A Practical Guide to ESG Integration in Equity Investing: https://www.unpri.org/news/pri-launches-esg-integration-guide-for-equity-investors

53 Investment Policy: process and practice: https://www.unpri.org/about/pri-teams/investment-practices

54 PRI Academy: http://priacademy.org/

55 CFA exam going green: http://www.bloomberg.com/news/articles/2016-10-20/the-cfa-exam-is-going-green

Next steps:

- The National Qualification Framework for trustee training which the FSB is developing with the South African Qualifications Authority should provide that ESG awareness is a core competency for pension scheme trustees (consistent with their fiduciary duties under Regulation 28).
- South African training entities and accreditors such as Batseta and ASISA and others should engage their membership on ESG factors and identify specific areas of training and awareness-raising required for ESG issues. These organisations can partner with the PRI through the PRI Academy and PRI's ESG integration road shows to spread the knowledge of ESG integration approaches among their respective memberships. Such training can be incorporated into the core competencies and relevant certifications provided by these industry bodies.

4. Corporate governance and reporting: South African stakeholders, including the FSB and the JSE, should review the quality of the reporting of material ESG factors by corporations following the report of the international Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).

The King Code, as revised in November 2016, has been reduced from 76 to 17 principles (King IV). The code has increased its reporting expectations on applicable institutions from "apply or explain" to "apply and explain". This is intended to increase its impact on the operational processes of reporting institutions and give practical effect to the principles set out in the code. The "retirement supplement" seeks to extend the application of the code to pension funds[56].

The King Code provides for integrated reporting by South African companies, where ESG factors are reported at the same time and in the same report as conventional accounting outputs. However, no common framework has been adopted for such integrated reporting[57]. South African companies have used several different frameworks for integrated reporting, leading to a lack of comparability in reported data and the data that is shared being of little direct use to informed investment and voting decisions.

South African investors agree that social issues are often material to the performance of South African companies, but find corporate disclosure on social issues lacking. There is an enabling context for the consideration of social issues by South African corporations stemming from the Companies Act requirement that listed and state owned enterprises maintain a Social and Ethics board committee[58]. Nonetheless, several stakeholders were frustrated by the reporting quality of material ESG factors across corporations (both domestic and international).

This concern reflects international initiatives on corporate reporting. The most recent intervention is by the Financial Stability Board, which established a Task Force on Climate-related Financial Disclosures (TCFD) to undertake an assessment of what constitutes efficient, consistent and effective disclosures of climate-related risks and opportunities[59]. In the US, the Securities and Exchange Commission (SEC) conducted a comprehensive review of its disclosure framework for reporting companies, including the disclosure of material ESG information[60]. We also note that the SEC has begun a review of the reporting practices of carbon intensive corporations, relating to the valuation of assets exposed to climate change regulation[61]. In Canada, the Canadian Securities Administrators (CSA) has also announced a thematic review of the quality of corporate disclosure of climate change risks, which will also address broader categories of ESG disclosure.

Next steps:

Key stakeholders in South Africa should convene a taskforce, following the report of the international Financial Stability Board's TCFD, to seek to focus the information provided by South African companies and increase its decision-relevance to investors.

56 Retirement supplement: http://c.ymcdn.com/sites/www.iodsa.co.za/resource/resmgr/King_IV/sector_supplements/Retirement_fund_supplement.pdf

57 South African stakeholders are very familiar with IIRC, IRC and GRI reporting frameworks

58 Social and Ethics Committee, Deloitte overview: https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_SocialAndEthicsCommitteeAndTheManagementOfTheEthicsPerformance_24032014.pdf

59 The Task Force was convened in December 2015

60 Securities and Exchange Commission, Business and Financial Disclosure Required by Regulation S-K https://www.sec.gov/rules/concept.shtml

61 http://www.wsj.com/articles/sec-investigating-exxon-on-valuing-of-assets-accounting-practices-1474393593

About the PRI

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions. The six Principles were developed by investors and are supported by the UN. They have more than 1,700 signatories from over 50 countries representing US$73 trillion of assets. They are voluntary and aspirational, offering a menu of possible actions for incorporating ESG issues into investment practices. In implementing the Principles, signatories contribute to developing a more sustainable global financial system. For more information, see www.unpri.org.

About UNEP FI

The United Nations Environment Programme Finance Initiative (UNEP FI) is a unique global partnership between the United Nations Environment Programme (UNEP) and the global financial sector founded in 1992. UNEP FI works closely with over 200 financial institutions who have signed the UNEP FI Statements as well as a range of partner organizations to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realize the adoption of best environmental and sustainability practice at all levels of financial institution operations. For more information, see www.unepfi.org.

About The Generation Foundation

The Generation Foundation ('The Foundation') is the advocacy initiative of Generation Investment Management ('Generation'), a boutique investment manager founded in 2004. The Foundation was established alongside Generation in order to strengthen the case for Sustainable Capitalism. Its strategy in pursuit of this vision is to mobilise asset owners, asset managers, companies and other key participants in financial markets in support of the business case for Sustainable Capitalism, and to persuade them to allocate capital accordingly. For more information, see www.genfound.org.

CREDITS

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