Regulator calls on boards of Trustees to set the tone for sustainability reporting and disclosure

Boards of Trustess are now expected to recognise and incorporate sustainability considerations like ESG into their investment assessments and investment activities as part of the delivery of superior risk adjusted returns to members.

For some time now there has been a strong call for boards of Trustees as institutional investors, to consider responsible investing principles in their investment strategies and investment activities.

The preamble of regulation 28 issued under section 36 of the Pension Funds Act, 1956, states that prudent investing should 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 and governance (ESG) character. Boards of Trustees are becoming more and more cognisant of the fact that they cannot only focus on financial return in their investment decision making but are to recognise and incorporate sustainability consideration like ESG into its investment assessment and investment activities as part of the delivery of superior risk adjusted returns to members.

The question always asked by Boards of Trustees is how to implement and ensure responsible investing principles are effectively incorporated across the Fund's investment portfolio. Recent corporate scandals like Steinhoff, has seen heighten calls by Government and the different stakeholders within the investment community for Boards of Trustees to be more vigilant when it comes to investment decision making and to consider the long-term interest and needs of its members on whose behalf they are entrusted to act.

We have seen in March 2018, the Financial Sector Conduct Authority (FSCA), formerly the Financial Services Board (FSB) publish a Draft Directive on Sustainability Reporting and Disclosure Requirements. The Draft Directive follows several related regulations, guidelines

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and codes of good practice ranging from the United Nations Principles for Responsible Investment (UNPRI) to the Code for Responsible Investment in South Africa (CRISA), Regulation 28 and the King IV Report on Corporate Governance for South Africa, that have advocated for consideration by Boards of Trustees of sustainability and ESG principles in their investment strategies.

The Draft Directive aims to provide guidance to Boards of Trustees on the disclosure and reporting requirements by pension funds on sustainable long-term performance of fund assets. It encourages Boards of Trustees to shift their thinking when it comes to responsible investing as it calls upon Boards of Trustees to detail as part of its investment policy statement, how it is going to ensure the sustainable long-term performance of its assets.

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It also calls for commitment by Boards of Trustees to applying ESG factors to assets it acquired and a commitment to active ownership. Its goes on further to define sustainability as the ability of an entity to conduct its operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs and includes managing the impact that the business entity has on the life of the community, the broader South African economy and to also include economic and ESG considerations.

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Whether the Draft Directive does in fact provide adequate guidance is unclear and needs to be assessed. In the recent Trustee Today (Aug-Oct 2018) we read that "the terminology as set out in the draft directive is vague and unhelpful for application by funds or enforcement by the Regulator …… devoid of detail, lacking yardsticks for measurement"

Some pension funds have however over time attempted to embrace the broader principles of sustainability and responsible investing. Pension funds like the Government Employees Pension Fund (GEPF) recognised the importance of incorporating responsible investing principles into their investment decision making way back in 2006. Being Africa's largest pension fund, the GEPF was the first institutional investor to become a signatory to the UNPRI.

The GEPF's approach in terms of its responsible investing policy is to encourage companies they invest in, to strike a balance between profits and being socially responsible and to actively manage their environmental impact while maintaining high levels of corporate governance standards. Engagement with companies is through the GEPFs asset managers, who are mandated to act on its behalf in terms of their respective investment mandates.

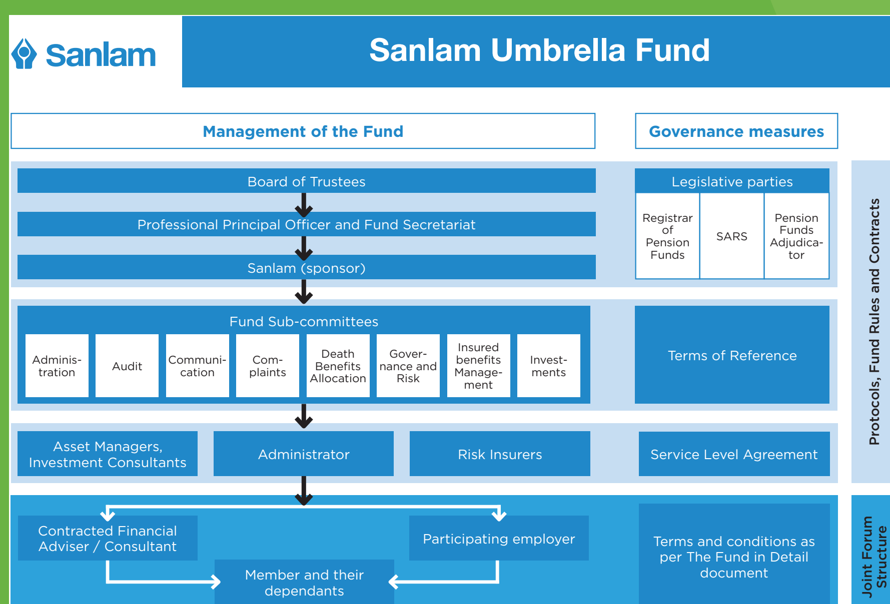

Illustration: *Board of Trustees management structure for the Sanlam Umbrella Fund*

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Many large commercial umbrella funds like the Sanlam Umbrella Pension Fund have also recognised the importance of considering the sustainable long-term performance of the assets they invest in. The board of Trustees of the Sanlam Umbrella Fund are consistently reviewing its delegation framework and risk management matrix to ensure that its Investment Committee can engage appropriately with its asset managers and investment service providers on the board's commitment to the principles of responsible and sustainable investing. There are however certain practical challenges, to effective implementation, that are experienced by commercial umbrella funds which may not be experienced by very large standalone funds, such as the GEPF. Challenges such as the ability to directly influence investee companies by assuming position/s on their Boards and or by voting at its AGMs.

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Commercial umbrella funds and small to medium standalone funds do not invest directly in companies as they usually invest in pooled investment vehicles such as insurance policies and collective investment schemes alongside many other investors and as such these funds are generally considered small minority investors, within such pooled schemes. They are not seen as the actual owner of the underlying company shares, with the owner being rather the insurance company represented by the investment manager.

A possible solution is for commercial umbrella and small to medium standalone funds to consider the appropriateness of the sustainability investment policy and proxy voting policies of their asset managers and if their asset managers do not have one in place, Board of Trustees should request that one be put in place, such policies should consider and incorporate the views of the Board of Trustees.

According to the article in Trustee Today (Aug- Oct 2018) "retirement funds typically delegate ESG to their underlying managers and then don't bother to monitor it. It is hoped that the draft directive (own emphasis) will force trustees to be more assertive"

Finally, no matter how pension funds are to approach the requirements of the Draft Directive once it issued as Directive by the FSCA, it will be critical for Boards of Trustees to assess the role and mandate given to their asset managers. The asset managers in turn when undertaking investments on behalf of pensions funds should be cognisant of the views of the institutional investor. The need for effective reporting by the asset managers and adequate monitoring by the Board of Trustees goes without saying. ■

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