RESPONSIBLE INVESTMENT IN SOUTH AFRICA: A REFLECTION

Nicole Martens
Head of Africa & Middle East, UN-supported Principles for Responsible Investment

Introduction

In early 2005, the then United Nations Secretary-General Kofi Annan invited a group of the world's largest institutional investors to join a process to develop the Principles for Responsible Investment. A 20-person investor group drawn from institutions in 12 countries was supported by a 70-person group of experts from the investment industry, intergovernmental organisations and civil society. These principles were launched in April 2006 at the New York Stock Exchange.

As the largest asset owner on the African continent, and a founding signatory to the principles, the Government Employees Pension Fund played a significant role at that time in:

- catalysing the adoption of responsible investment (RI) practices across the country
- showcasing leadership in the issue across the region.

Since then, both the number of signatories to the principles and representative assets under management have grown exponentially around the world, to over 2 700 and USD90 trillion, respectively. Somewhat disappointingly though, adoption of the RI approach by African investors seems to have stalled.

South Africa, the market once seen as a vocal advocate for RI and a definitive leader on the issue for the region, complete with progressive regulatory frameworks, has been largely silent in terms of advocacy and predominantly uninspiring in RI activity over the last few years. Asset owners have been particularly slow to adopt the principles, preferring instead to delegate (or in many cases abdicate entirely) their responsibilities. This attitude is not unique to African asset owners but in a market this size, the impact it has on investor attitudes and behaviour is significant.

While there are examples of investment managers that are implementing truly innovative approaches and working hard at refining what it means to be a responsible investor in practice, asset owners – and other stakeholders – may (and should) be disappointed to learn that a far greater proportion of managers are paying alarmingly little attention to the issue.

In a world where ESG integration and RI are receiving increasing attention globally, how are those local investors already committed to RI doing? Are they ahead of the curve?

What follows is a brief look at the data collected through reports submitted to PRI by South African investment manager signatories, to get a sense of just how this group of investors is fairing in "walking the talk" when it comes to RI.

Where we stand

At the time of writing, there are 92 PRI signatories across Africa and the Middle East. Of the 66 investment manager signatories that operate out of this region, 46 are based in South Africa. The list includes a selection of some of the larger as well as some of the smaller managers in the market.

Using the PRI data stores[1], we can reflect on the relative performance of these managers going back as far as 2015. For the purposes of this assessment, we will review signatory assessment results related to strategy and governance to identify key trends in this component of RI.

1 PRI reporting is the largest global reporting project on responsible investment. It was developed with investors, for investors. Signatories are required to report on their responsible investment activities annually. This ensures accountability of the PRI and its signatories; a standardised transparency tool for signatories' reporting; and that signatories receive feedback from which to learn and develop. More detail on the reporting framework and the assessment process can be found on the PRI website.

Trend #1: On average, we're slightly less than average

2019 strategy and governance module performance

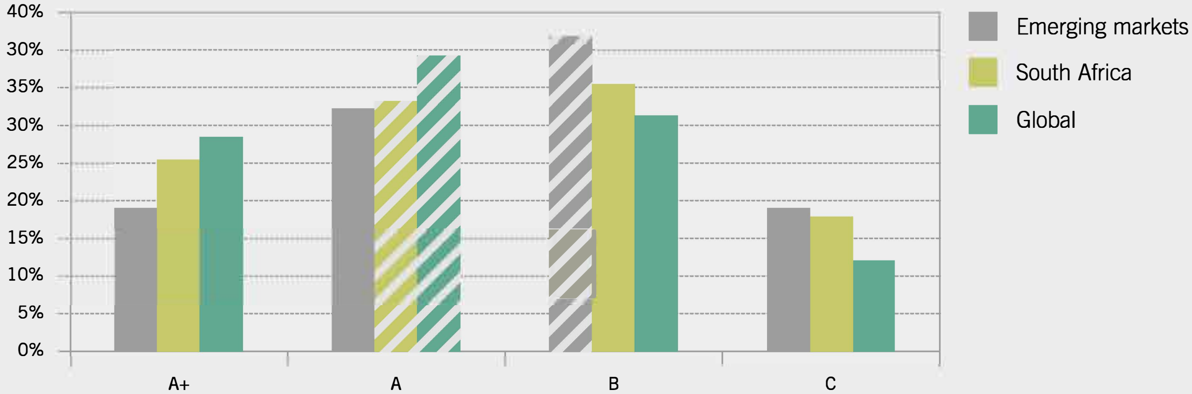

Figure 1: SG module performance of global, emerging and South African Investment Managers (median represented by striped bar); 2019 data

The data reveals that the median score for South African managers for this section is an A, which aligns to the median score for investment managers globally, and is higher than the median score for emerging market managers, which rings it at B. So, one could consider South African investors to be either emerging market leaders or developed market middle-of-the-road performers when it comes RI.

Despite aligning to the median, the proportion of South African managers who achieve A and A+ scores trails behind that of global peers (barely a third of South African investment manager signatories scored an A in 2019), with the proportion of B and C scores greater than global comparators, suggesting that South African managers in general are operating at a slightly lower standard than is the global trend.

Trend #2: Performance is stagnant

Strategy and governance band performance (South Africa)

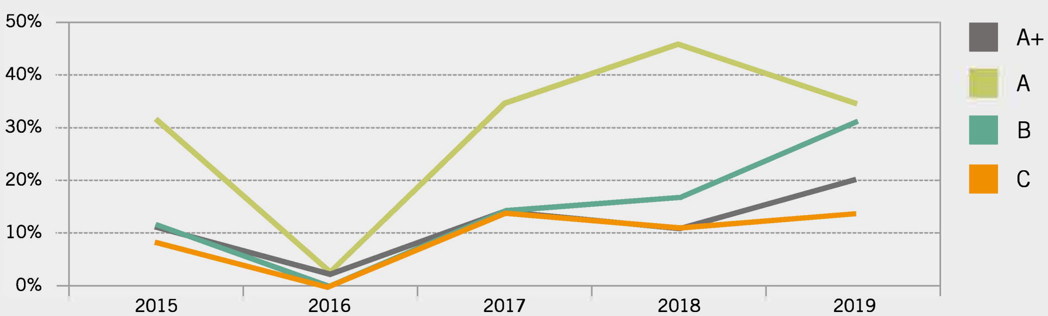

Figure 2: PRI assessment performance of South African investment managers over time (strategy and governance)

Over time, the proportion of managers achieving an A+ score has remained relatively low, reflecting the fact that very few local investment manager signatories are operating at the highest levels of international best practice.

At the same time, the proportion of South African managers achieving an A in this area is dropping, while the number of managers receiving a B is increasing. This suggests that, when it comes to strategy and governance in relation to RI, South African managers are not keeping pace with the evolution of international best-practice standards.

Where we are heading

At the launch of the PRI Africa Discussion Group (PADG)[2] held in Johannesburg in October 2019, African investors identified four key areas of priority for ESG. The issues identified as those which African investors feel present the greatest threat to the sustainability of their investments are:

The consensus in the room was that if asset managers in South Africa are to stand a chance at even generating – let alone maximising – sustainable long-term returns, it is in their interests to ensure that their portfolio companies have in place appropriate policies and practices to identify, assess, monitor and manage these risks.

Of the issues identified, climate change is arguably the most pressing – in the sense that it is time sensitive (it is happening **now**) and because it exacerbates the risks presented by almost every other ESG factor that investors could possibly face.

Yet, despite the crushing importance of the issue, of the South African investment managers required to submit reports to PRI in 2019, less than a third opted to report on voluntary climate change indicators.[3] This reflects the fact that to date, barring a few exceptions, the required urgency related to the climate emergency is nowhere to be found in South Africa's investment industry.

Whether investors like it or not, a massive shift is coming. If the increasing evidence on financial materiality (see the recent and persistent drop in Steinhoff's share price[4] as a result of the problems with governance) and growing market demand (see the recent shareholder resolution on climate at FirstRand, which passed with 99% of the vote[5]) are not enough, regulation will soon force the hand of laggard investors. The latter point is underpinned locally by the FSCA's Guidance Note on Sustainability of Investments[6] and in the PRI's Inevitable Policy Response (IPR)[7] project, which forecasts a response by 2025 that will be forceful, abrupt and disorderly because of the delay in action. To quote from the report, "The question for investors now is not if governments will act, but when they will do so, what policies they will use and where the impact will be felt."

In this context, the task now at hand for South African investors is one of pre-empting disruption and moving proactively to mitigate the worst of the risks and to claim their share of the rewards that will undoubtedly be available to first movers. This is no small feat – especially considering that to date we seem to be struggling simply to keep up with international best practice – but equally, if managers want to stay in business, there is no other option.

2 Hosted on PRI's collaboration platform: https://collaborate.unpri.org/
3 PRI Climate Snapshot Report, 2019; available at: https://dataportal.unpri.org/admin/dashboard
4 https://www.fin24.com/Company/Steinhoff-international-holdings-nv
5 https://www.fin24.com/Companies/Financial-Services/firstrand-says-shareholders-reject-climate-change-proposal-20191128
6 See https://justshare.org.za/wp-content/uploads/2019/07/FSCA-Guidance-Notice-1-of-2019-PFA-Sustainability-of-Investments-and-Assets.pdf
7 Available on PRI website: https://www.unpri.org/inevitable-policy-response/what-is-the-inevitable-policy-response/4787.article