



SOCIALLY RESPONSIBLE INVESTING (SRI)

360° SNAPSHOT OF RESPONSIBLE INVESTING *By Given Phaladi*

UNDERSTANDING SOCIALLY RESPONSIBLE INVESTING (SRI)

In early 2008, the Government Employees Pension Fund (GEPF), South Africa and Africa's largest pension fund, signed the United Nations Principles of Responsible Investment (UN PRI), thereby setting an example to the South African retirement industry that SRI should no longer be a secondary investment consideration way down on a long list of prioritiesⁱ. Signatories to the UN PRI agree to ensure that all their investment activities incorporate environmental, social and governance (ESG) factors into the decision-making process and in doing so, strive to put an end to business-as-usual investing, which in many cases ignores these factors by claiming that they are not financially material. RisCura also became a signatory to the UN PRI in 2007.

Responsible investing should be high on every South African pension fund's agenda and signing the UN PRI will certainly demonstrate a strong level of commitment. The PRI principles can be summarized as followsⁱⁱ:

- Integrating ESG issues into investment analysis and decision-making processes;
- Incorporating ESG issues into ownership policies and practices;
- Encouraging greater ESG disclosure in investable companies;
- Including PRI requirements in investment mandates;
- Collaboratively implementing the principles, on either a systematic or ad hoc basis;
- Reporting on activities and progress towards implementing the principles.

A recent progress report indicates that the African continent represents only 2% of the total signatories of the UN PRI, compared to Europe (41%), North America (25%), Latin America (10%), Asia (6%) and Oceania (15%). Our standing is however better than the Middle East countries that represent only 1% of the totalⁱⁱⁱ. In order to benchmark themselves against international standards, South African investors should focus on adopting the principles. Signing up to the UN PRI would commit a fund (and by implication its service providers) to incorporate ESG issues into all its investment decision-making processes.

SO WHAT THEN IS SRI?

Socially responsible investing is an alternative way of addressing responsible investment and one that has been around in various guises for a while. It is a trend that South African pension funds have picked up from their international counterparts. The definition of SRI remains vague, meaning different things to different people. Definitions also differ between countries. Environmental investing, ethical investing, sustainable investing, socially responsible investing etc., are all different labels that can be attached to the broad SRI banner^{iv}. In essence though, SRI refers to a group of investment mandates and products that in one way or another take into account ESG factors.

Many people believe SRI to be an asset class, when it's really a theme that cuts across many different types of investment mandates, asset classes and investment products. Internationally, the responsible investing concept began with environmental concerns and now includes social issues, such as human rights, employee relations and business ethics. South Africa has unique issues relative to many of our international counterparts and the SRI approach should focus on addressing these specific issues.



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Given joined RisCura as a research analyst in July 2007 from Sanlam Investment Management. He is a member of RisCura's research and ALM team. Given loves working at RisCura because of the passion, intelligence and energy of its people.



risk and investment
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SRI IN THE SOUTH AFRICAN CONTEXT

Different countries have different focuses and priorities – for some, environmental changes are important, others are concerned about corporate governance and others have social issues at heart. In South Africa, SRI funds were set up in the 1990's in response to the government's call for transformation and policies that support it, for example, Masakhane, Reconstruction and Development Program (RDP), Growth Employment and Redistribution (GEAR) and Black Economic Empowerment (BEE). More recently we are starting to integrate environmental concerns into our investment processes to address global warming issues.

In May 2004, South Africa launched the JSE SRI index to promote the sustainability concept. This index includes companies that integrate social, economic and environmental business practices with good corporate governance, and complements international benchmark indices like the Dow Jones Sustainable World Index, FTSE4Good, etc.

Most Trustees are fairly cautious about SRI and believe that incorporating the theme into their processes may conflict with their fiduciary duties, one of which is to maximise long-term performance. Some investment managers may argue that incorporating SRI factors into their processes narrows an already limited investment universe thus compromising fund returns.

CLASSIFYING SRI

There are three criteria that SRI investors use globally (including South Africa).

1. The first criterion is the practice of screening or filtering companies based on ethical criteria. Screening can be positive (potential companies are included in an investment universe because they fulfill certain positive criteria), or negative (excluding companies for products or practices that are considered negative). Screening can go as far as screening out emerging market countries with power regimes that investors oppose.

2. The "you can't influence if you don't invest" concept defines the second strategy, which is shareholder activism or engagement.

Shareholders own a piece of companies they invest in, and with that ownership come both rights and responsibilities. Shareholders can positively influence company behavior and achieve socially responsible outcomes through their ownership stakes and voting rights. Many pension funds unknowingly hold an enormous amount of clout in this area.

3. Targeted investment or community investment is the third criterion available to SRI investors. This focuses on real economy projects via, e.g. equity or debt financing, which have a direct impact on areas such as infrastructure development (like energy, telecommunications, education, water and waste management, health facilities, roads etc.), low-income housing, agricultural development and SME's.

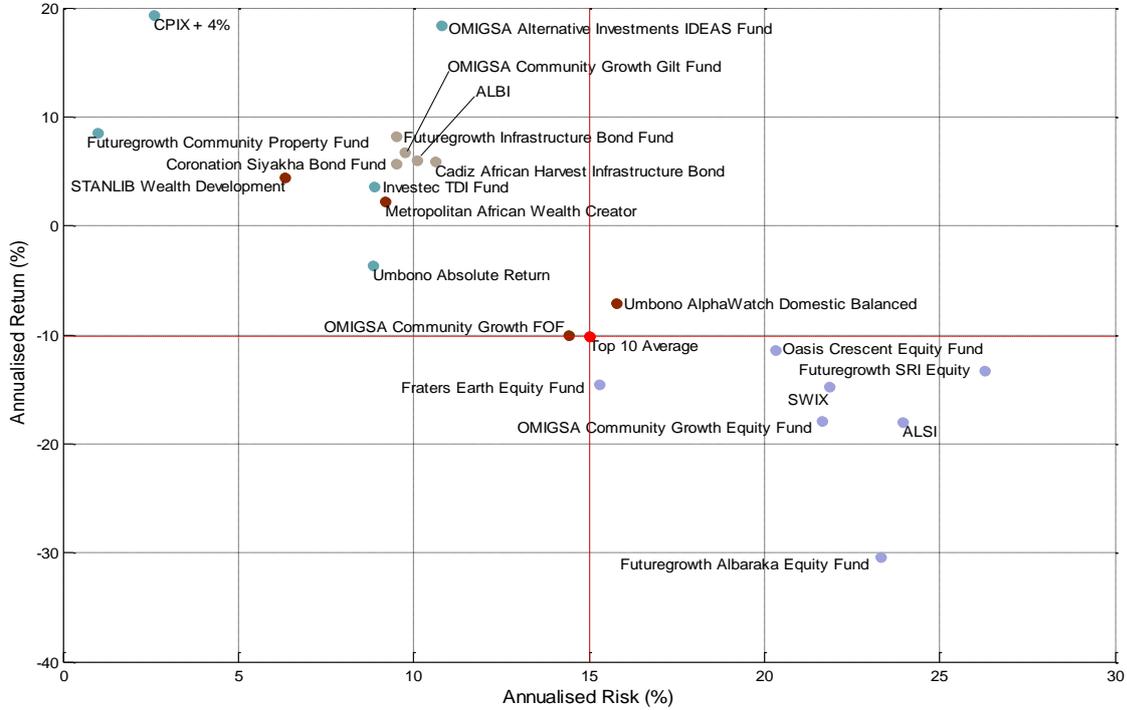
IMPACT ON PERFORMANCE AND RISK

A number of investment managers offer SRI products. The charts on the following page show the performance of these products as reflected by RisCura's SRI survey, over 12 month and 36 month periods. The charts illustrate that performance of these products is acceptable given the relevant benchmarks for each asset class.

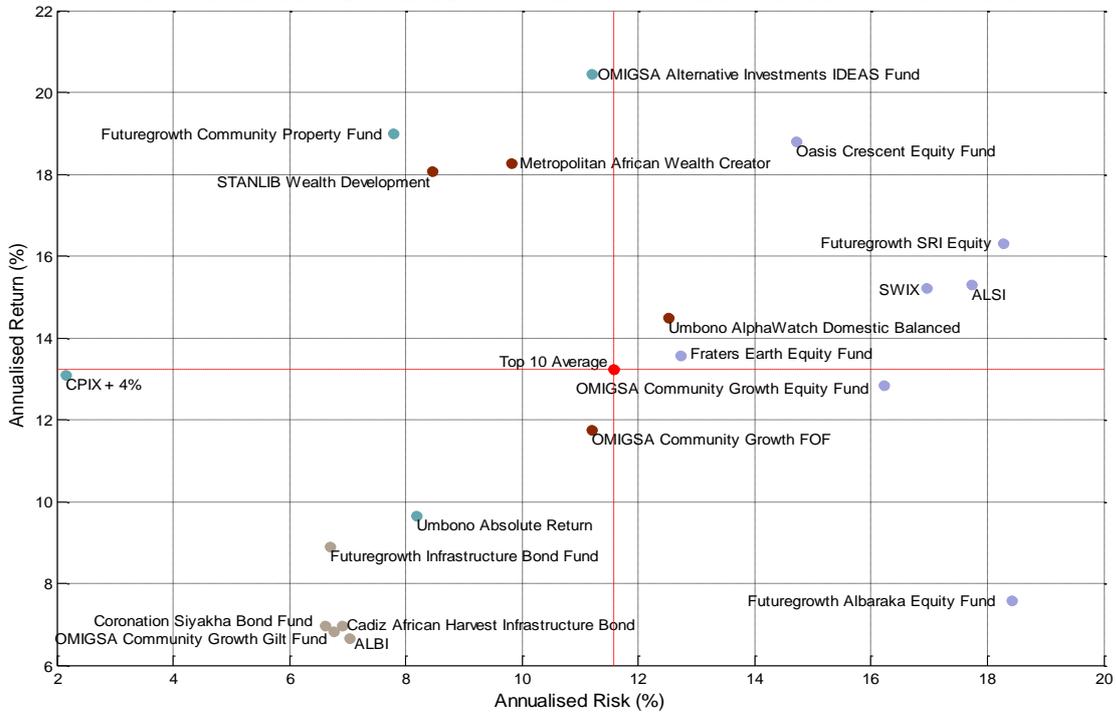
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the Sustainability concept
 SFI should no longer be way down
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SRI FUNDS: 12 MONTHS SCATTER FOR THE PERIOD ENDED SEPTEMBER 2008



SRI FUNDS: 36 MONTHS SCATTER FOR THE PERIOD ENDED SEPTEMBER 2008



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This is a snapshot at a particular time, but what matters for retirement funds that have long-term liabilities, is how companies perform over an extended time period. Incorporating SRI processes or funds into a pension portfolio provides a good opportunity to generate strong returns while at the same time contributing to social, environmental and grassroots economic development in South Africa, resulting in improved economic growth.

SOUTH AFRICA'S CHALLENGE

It might not seem that South Africa is doing enough relative to other countries, but in essence it is doing well by addressing its own challenges that fall under the responsible investment umbrella. Once these grassroots challenges are overcome, it will then step up to international challenges.

Proper corporate governance is increasingly becoming a priority for companies and the shareholders that invest in them. The Financial Services Board (FSB) is looking to beef up corporate governance and make sure that the laws and principles stipulated in the King II report are implemented. The practice of price discrimination by Mittal Steel South Africa^{vi} as a company that has a strong environmental focus, questions the credibility of the process used to categorise companies as part of SRI funds by fund managers and the JSE SRI committee, as this company is a top choice of many SRI fund managers and also a constituent of the JSE SRI index. The process of categorising companies as part of SRI funds needs to be looked at more holistically, reviewing the way ESG factors are weighted individually.

THE CHALLENGE FOR THE SOUTH AFRICAN PENSION FUND INDUSTRY

In his speech at the launch of the UN PRI in South Africa in 2007, Martin Kuscus, Chairman of the Government Employees Pension Fund (GEPF), challenged fiduciaries, investment managers, consultants and other service providers in the retirement industry to follow in the footsteps of the GEPF and sign the UN PRI. In doing so, these signatories will be forced to relook at the criteria that constitute "good investments". This will have a knock-on effect of forcing companies to change their way of doing business to accord with "good investment standards", resulting in improved governance, better social and environmental conditions and stronger economic growth for South Africa.

Retirement investing therefore becomes not only about the amount of money that individuals have to retire on, but the state of the world/environment that they will retire into and ultimately leave behind.

Notes:

ⁱ "State's R700bn pension fund to sidestep PIC", Business Day, 4 October 2007.

ⁱⁱ "Global charter puts spotlight on ESG issues", Global Pensions, June 2006.

ⁱⁱⁱ "PRI: Report on Progress 2007", Principles of Responsible Investment, 2007.

^{iv} "Rewards of virtue", Global Pensions, November 2003.

^v "Doing well while doing Good? The Investment performance of South African Socially Responsible Equity Unit Trusts", G. Meharchand.

^{vi} "Mittal: the choice of ethical investors?", Moneyweb article, September 2007.