



Responsible Investment in the South African Pension Fund Industry: A Critical Analysis.

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ABSTRACT

South African regulation requires pension funds and their trustees to act in the best interest of their beneficiaries, according to their fiduciary duty. According to the preamble to Regulation 28 of the Pension Fund Act of 1956, this includes responsible investing (RI). However, the South African RI landscape, barring a few exceptions, is dominated by financial institutions other than pension funds who do not necessarily have the same legal and fiduciary imperatives. Using data gathered from semi-structured interviews with key people in the industry a grounded theory approach and content analysis this research addresses why there is limited RI action on the part of pension funds. The findings show that pension fund trustees lack understanding of RI as well as the full scope of their fiduciary duties mainly due to issues with trustee competency, resource allocation, and legacy behaviour and interpretations of legislation. Additionally, there is little accountability to both the regulators and members in this regard. The importance of addressing these reasons is brought into focus by considering the role of pension funds as constituents of the social security system, as savings institutions, as allocators of capital, and as part-owners of companies making RI consideration a natural and integral part of decision making.

Based on the findings, this paper recommends appropriate training interventions for trustees, in addition to a review of trustee selection, appraisal and tenure. Furthermore, industry consolidation and agreement around RI frameworks and definitions would serve to improve understanding of RI. To improve accountability, the paper recommends the introduction of non-prescriptive, demonstrative reporting requirements. Important themes for further research include the competency of South African trustees and the development of frameworks for the understanding of RI in the industry.

Keywords: Responsible Investment, Pension Funds, Trustees, Regulation 28, Fiduciary Duties, South Africa

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1 INTRODUCTION

This research explores responsible investment (RI) in the context of the pension fund industry in South Africa by examining why South African pension funds fail to demonstrate RI action commensurate with the spirit of the preamble to Regulation 28 of the South African Pension Funds Act of 1956, as well as the principles in the Code for Responsible Investment in South Africa (CRISA).

The intersection of RI with pension funds is unique in that unlike other financial entities pension funds have unique characteristics - they are non-commercial and have long term liabilities and obligations (Richardson, 2007). Sustainability considerations, in that environmental, social, and governance (ESG) issues have become integral to the delivering of healthy long term investment returns (Thomas, 2015; Clarke, Feiner, & Viehs, 2014), therefore naturally correspond. Additionally, the fiduciary duties of pension fund trustees results in the primary duty of loyalty to the beneficiary; in other words to act in the best interests of the beneficiary (Richardson, 2008). Together with ensuring investment returns, this involves a fiduciary relationship which should serve the best interests of the beneficiary (Richardson, 2011). Understanding this primary duty provides a platform for RI advocates, in that practicing RI to the benefit of beneficiaries can be considered a fundamental component of the pension fund trustee's duty. It must however be noted that the interpretation of fiduciary duties as the maximisation of returns has posed obstacles to the implementation of RI strategies (Viviers et al., 2008). The rise of fiduciary capitalism provides further reasoning for RI implementation in the form of active ownership, as pension funds wield increasing influence as ownership concentrates in the hands of these fiduciary entities (Giamporcaro, 2011; Clarke et al., 2014). The literature review, results and discussion sections address these ideas further.

Acknowledging the case for RI in pension funds, the South African investment industry advocated for the inclusion of RI in pension fund legislation, which resulted in the inclusion of RI in the preamble to the amended Regulation 28 (promulgated in 2011) and the launch of CRISA in 2011. Viviers (2007) lists the introduction of RI into pension fund legislation as one of the key variables which drives demand, citing RI experts Manley (2001), Schwartz (2003), and Sparkes and Cowton (2004), who claim that the inclusion of RI in legislation has been one of the most influential factors in driving RI internationally.

However, three notable reports on the state of RI in South Africa provide interesting evidence which suggests that pension funds have not been active in this area, although it is to them that legislation applies. The first ‘State of RI in South Africa’ report (UNEP FI, 2007) found that the general awareness of RI was noticeably lower among principal officers of pension funds compared to other financial institution representatives. In addition, lack of demand for RI (indicated as low or non-existent) from pension funds is cited as a significant barrier to the growth of RI.

The second ‘State of RI in South Africa’ report (Ernst & Young, 2013) shows improvement in awareness and implementation of RI by institutional investors. The report does not disaggregate findings for various categories of institutional investors (asset manager, pension fund, and life insurer), but does reiterate that the uptake and action on the part of pension funds with respect to RI is significantly lower than other institutional investors. The difference in the awareness and implementation of RI by the various institutional investors is reiterated in a third report: CRISA disclosure by institutional investors and their service providers (Ernst & Young, 2013).

Unlike the first two reports, the third speaks to demonstrated or reported (disclosed) action, rather than survey responses concerning RI. The case for RI in pension funds comprise many reasons; consequently it could be argued that there is therefore no single approach to RI. Therefore disclosure on approach, and rationale provides a clearer view on the commitment, approach and implementation of RI. This is apart from the transparency and disclosure requirements in both the United Nations backed Principles for Responsible Investment (UNPRI) and CRISA (see Table 1: United Nations Principles for Responsible Investment and the Code for Responsible Investment in South Africa). The report states that less than 20% of pension funds have RI policies available, and although close to half of institutional investors in the sample disclose information as recommended by CRISA, only 30% of the pension funds provided any information.

This is a concern as pension funds and their members are significant investors with investments which total three quarters of South Africa’s GDP (Towers Watson, 2014). And while there is reasonable focus on RI in South Africa in general, there is yet to be concerted academic effort which explores the status of RI within the paradigm of the pension fund industry solely. Little is published regarding the synthesis by, and understanding of pension funds with respect to RI as an independent concept and as it stands in Regulation 28 and CRISA. In addition there is almost no representation by number of pension funds (as opposed to value) on the UNPRI

platform (Signatories to the Principles for Investment, 2014), little disclosure around CRISA, and no requirement to report any activity regarding responsible investment, as outlined by Regulation 28 (Ernst & Young, 2013), or otherwise.

This dissertation therefore explores the reasons why pension funds demonstrate little action on RI. A view of RI using the pension fund industry as the sector of analysis, as opposed to RI strategies, asset managers or the history and development of RI is presented. In doing so, not only does the body of knowledge regarding responsible investment in South Africa grow, but it allows practitioners and academics to suggest recommendations where appropriate, guide further policy and best practice. Furthermore it illuminates issues of ownership and the accompanying responsibilities, particularly as applicable to pension funds in light of their fiduciary duties to their beneficiaries. By initiating the conversation using pension funds as the unit of analysis, this research contributes to a fuller and more holistic understanding of RI in South Africa.

Qualitative research methods are used, as is common to research on RI, particularly in South Africa, as seen in the work of Giamporcaro (2011) and Viviers et al. (2008). In particular semi-structured interviews with eight industry experts are conducted, and elements of content analysis and grounded theory methods used in the analysis process.

The dissertation continues as follows: a background section firstly providing the context and necessary information to fully appreciate the research topic. This is followed by the literature review which demonstrates that there is limited research on the topic and similar topics, and presents current theories regarding the barriers and challenges to RI. Then the methodology section covers the research approach and strategy, data collection and sampling, data analysis and research reliability. The results, discussion, and lastly, the research conclusion and recommendations sections follow.

2 BACKGROUND

Presented in this section are five topics each detailing a different area with respect to South African pension funds and RI. The first, a more general section, is followed by four sections which address specific areas, namely: the pension fund landscape, pension fund reform, fiduciary and other duties, and RI investment strategies.

2.1 South African pension funds and RI

It is not uncommon for South Africa to feature in both the discourse and literature on RI. Particularly prominent in domains of discussion around the origins of RI, South Africa is typically cited as the foremost example with respect to the case for divestment on ethical grounds during the Apartheid regime (Richardson, 2008). However, more recently, and of more relevance to the topic at hand, South Africa's regulations, codes, and, in some instances, practices are considered to be at the forefront of responsible business and investment thinking. As such, the discourse has broadened to include these elements as examples and case studies (UNEPFI, 2007; Bertrand, 2011).

There are several contributing factors which continue to play significant roles in driving the RI movement forward in South Africa. Arguably, the most significant factor would be the inclusion of RI within South African legislation. While voluntary codes, relevant disclosure, and other forms of best practice are features of RI in other leading countries, South Africa stands out in this respect (Bertrand, 2011). The Amended Regulation 28 of the Pension Funds Act of 1956 is a significant piece of legislation, the preamble of which captures the spirit of RI and outlines the commensurate responsibility to which the dominant institutional investor, the South African pension fund, is beholden. The preamble reads as follows:

“A fund and its agents have a fiduciary duty to act in the best interest of those for whose assets they are responsible. This duty supports the adoption of a responsible investment approach to deploying capital into markets that will earn them adequate risk adjusted returns for the fund's member profile, liquidity needs and liabilities. Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long term performance of their investments, including those of an environmental, social and governance character. This applies across all asset classes and should promote the vested

interest of the fund in a stable and transparent environment.” (The Republic of South Africa, 2011)

It has been the expectation of many in the industry that the promulgation of the Amended Regulation 28 in 2011 would spur a flurry of responsible investment activity in the South African investment industry, with the South African pension fund community as the ultimate driver of the practice of RI. However, while environmental, social and corporate governance (ESG) considerations are addressed in the preamble, there appears to be little evidence of the adoption of the spirit of this message by pension funds (Ernst & Young, 2013).

Therefore, while from the perspective of RI, Regulation 28 is laudable, it has perhaps not done for the RI practice what has been expected. In addition to Regulation 28 other contributing factors to South Africa’s status and voice in the RI industry are the guidelines provided in CRISA, the influential role of the Government Employment Pension Fund (GEPF), and the strong South African network for the UNPRI (see Table 1 for the CRISA and UNPRI principles). These complementary factors emphasise the incongruity of the conduct and performance of South African pension funds within the environment they operate.

The introduction to the CRISA principles acknowledges that institutional investors, such as pension funds, have, by virtue of their ownership of significant equity in the market, the ability to influence, intervene, guide and encourage companies to apply sound governance principles and practices. The Code premises part of the need for its existence on the fact that local and international examples, with respect to market and company failure, can often be traced to an absence of active shareholders, who are typically institutional investors (CRISA, 2011). The Code is voluntary and has been created and is supported by a number of stakeholders within the investment industry. It relies on public disclosure to encourage self-regulation, with the expectation that all institutional investors and their service providers implement the prescribed principles (as seen in Table 1) on an ‘apply or explain’ basis, a common practice in the industry with respect to these types of codes. However, according to the report: Responsible Investment Research, CRISA disclosure by investors and their service providers (2013), commissioned by the CRISA committee to evaluate the progress made towards responsible investment, pension funds lag substantially behind other financial institutions.

While CRISA provides guidelines and industry support the traction of the practice and exploration of RI in the South African investment industry is largely a result of the championing

of the cause by the GEPF. The support the responsible investment movement has garnered from the GEPF, which according to the 2014 Towers Watson Pensions and Investments 300 Analysis Report (2014) is one of the world's top 20 pension funds by size and value, has been invaluable to its cause. The fund's commitment to ESG and position as a founding signatory to the UNPRI has often been used to explain the early and rapid adoption of UNPRI by the South African asset management industry (Today's Trustee, 2009). The resources and institutional clout of the GEPF has allowed RI to, firstly, find a place on the national and international agenda of the investment community, and secondly, to progress slowly up that agenda (Kganyago, 2010).

The GEPF's influence in this regard is evidenced by the fact that there are 35 investment managers in South Africa who are signatories to the UNPRI (Signatories to the Principles for Investment, 2014). Many in the industry attribute this to the GEPF's insistence and focus on RI which has led investment managers to realise the commercial necessity of evidencing a commitment to RI. Many see establishing themselves as a UNPRI signatory as a proxy for this commitment which of course holds them to a standard, aligned with the principles as seen in Table 1. The UNPRI describes itself as an international network of investors and asset owners, working together to uphold the six principles composed by the initiative, the goal of which is to understand sustainability implications and incorporate this into investment decision making and ownership practices (UNPRI, 2013). While there may be many investment managers who are signatories, the same cannot be said of asset owners. In total there are 45 South African UNPRI signatories, of whom five are asset owners, and of the five asset owners, two are pension funds (UNPRI, 2014). This supports the notion that pension funds are absent in this arena.

Therefore, while the South African investment industry is able to boast of many RI triumphs, it appears that pension funds in general may not be responding with the commensurate commitment and progress. There are a number of potential factors which may explain this. The first being a lack of mechanisms incentivising adherence to any RI requirement (legislation or otherwise). Currently, there is no requirement for pension funds to report on ESG in their Annual Financial Statements as stipulated by the South African Financial Services Board (FSB). In addition, the documents and procedures as outlined by the FSB in Circular PF 130 in 2007 on the governance of pension funds do not include any items which address ESG (FSB, 2007).

United Nations Principles for Responsible Investment (UNPRI) and the Code for Responsible Investing in South Africa (CRISA)

Principle	United Nations Principles for Responsible Investment	Code for Responsible Investment in South Africa
Principle 1:	Incorporate ESG issues into investment analysis and decision-making.	An institutional investor should incorporate sustainability consideration, including, ESG, into its investment analysis and investment activities as part of the delivery of superior risk- adjusted returns to the ultimate beneficiaries.
Principle 2:	Be active owners and incorporate ESG into ownership policies.	An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.
Principle 3:	Seek appropriate disclosure on ESG issues by the entities invested in.	Where appropriate, institutional investors should; consider a collaborative approach to promote acceptance an implementation of CRISA and other codes and standards applicable to institutional investors.
Principle 4:	Promote acceptance and implantation of the Principles within the investment industry.	An institutional investor should recognise the circumstances and relationships that hold potential for conflict of interest and should proactively manage these when they occur.
Principle 5:	Work collaboratively to enhance effectiveness in implementing the principles	Institutional investors should be transparent about the content of their policies, how their policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.
Principle 6:	Report on activities and progress towards implementing the principles	-

Table 1: United Nations Principles for Responsible Investment and the Code for Responsible Investment in South Africa

Apart from the lack of enforcement, there are numerous other challenges to RI. Viviers et al. (2008) cite ‘concerns regarding fiduciary responsibilities’ as a key barrier to responsible investment in South Africa. It is generally accepted that there are two central tenets to fiduciary responsibilities or duties. The first is that trustees are to manage their funds in the best interests of their beneficiaries. The second is that in the managing of the funds due care and prudence

should be exercised (Sandberg, 2011). These two emphases together are referred to as the duty of loyalty and the duty of prudence or standard of care (Hawley, Johnson, & Waitzer, 2011).

A natural accompaniment to the concern cited above are the perceptions regarding risk-adjusted returns of portfolios within RI strategies (Viviers et al., 2008). The dominant theme of much of the literature on RI justifies RI in the context of fiduciary duties, with respect to returns, which suggests that these barriers are not uncommon globally. However, while this debate is common, others have argued that Regulation 28 can be viewed as having highlighted the broader interpretation of the scope of the fiduciary responsibilities of pension fund trustees to include ownership and ESG considerations (Kirima as cited in Responsible investing toolkit for retirement fund trustees, 2012). The CRISA Disclosure Report (2013) also presents the high level of outsourcing and delegation within the industry and a lack of clarity regarding investment mandates as potential hindrances.

2.2 South African Pension Fund Landscape

According to the 2012 Annual Report by the Register of Pension Funds (2014), there were approximately 6500 active pension funds in 2012. These funds cumulatively controlled R2 749 billion of some 15 million members' assets. In US Dollars the cumulative value of all South African pension funds is equivalent to between 65 and 75 per cent of the country's GDP with a 10-year compound annual growth rate of 9 per cent in USD and 14 per cent in ZAR (Towers Watson, 2014). The importance of the quantum and growth of these funds cannot be ignored. In fact it could be argued that the large value of pension funds in South Africa places an even greater importance on their approach and responsibly to RI.

It is also important to note that in the 1980s and 1990s saw a dramatic transfer of employees from defined benefit (DB) to defined contribution (DC) funds (National Treasury, 2004). Today there are only a few large DB funds as many of the smaller funds have shrunk out of existence (George, 2006). Under DB arrangements members are guaranteed a specific retirement income, with employers funding the shortfall, while under DC funds members receive a benefit at retirement based on their contributions and the performance of the fund (George, 2006).

While Circular PF 130 was issued by the FSB, South African legislation also covers the governance of pension funds. According to Section 7A (1) of the Pension Funds Act of 1956, South African pension funds are to be governed by at least four trustees, of which members of the fund have the right to elect 50 per cent. The balance of the trustees are elected by the

employer. A chairperson is elected from these trustees, and together, as a board of trustees, they appoint a principal officer, an auditor, as well as an actuary. The principal officer is an official accountable to the Registrar of Pension Funds and often serves as the board of trustees' representative in the context of industry initiatives and regulatory matters, while the auditor and actuary provide their respective expertise to the board.

Trustees of a pension fund have both fiduciary duties and general duties (fiduciary duties are covered in section 2.4). General duties relate to the sound operation of the fund, ensuring that operational functions perform as required and that solid governance is maintained (Greenblo, 2006). Section 7D of the Pension Funds Act of 1956, provides that trustees may obtain expert advice on matters where the board may lack sufficient expertise. The Act also provides for the outsourcing of the administration of a pension fund as well as the use of the services of consultants who provide investment guidance (most often independent of the actual investment service) alongside other previously mentioned services often needed by pension funds. Clark (2001) outlines the spatial and functional structure of the investment management industry which uses pension funds as the sector of analysis. Figure 1 illustrates this landscape.

The typical chain of events and the relevant entities as explained by Clarke (2001), and illustrated in Figure 1, are as follows. The process is initiated by the collection of the contributions to the fund, by both the employer and employee, which is managed by the pension fund administrator. The pool of funds to which these contributions are added, would have a board of trustees constituted of employee and employer elected individuals, and often additional individuals seated on a separate investment committee, the institution of which would have been decided upon by the trustees. The trustees, along with the investment committee decide on the appointment of an asset consultant if the function cannot be performed or managed internally. The asset consultant in turn advises and assists the fund in the management of the capital at hand, including creating and implementing investment strategies, deciding on asset allocation and the selection and monitoring of asset managers who would be responsible for the ultimate investment decisions and performance of the fund. The last piece of the central chain includes the distribution of funds, by way of tax paid to the government, financial returns and pay outs to the members of the fund. In addition periodic reporting to both the members of the fund and the relevant regulatory authority would be necessary. In South Africa, the regulatory authority is the FSB.

Figure 1 shows additional entities alongside the main chain of events and players. These entities are representative of the services provided to pension funds and their trustees in the execution of their duties; namely custodians (the institutions who hold the investments in their accounts on behalf of the pension fund), consultants (as discussed previously), bankers (for institutional banking purposes), insurers (often an element of the entire social security package the pension fund represents), lawyers (who advise, represent and provide training), auditors, and actuaries.

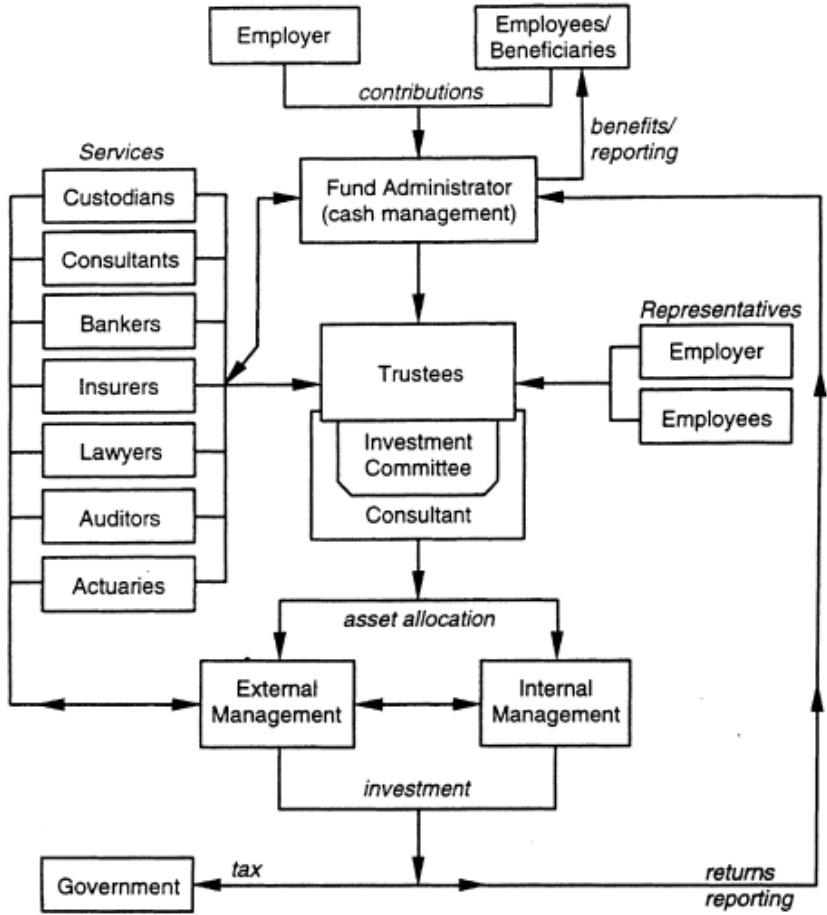


Figure 1: Pension fund investment management: institutions and services (Clarke, 2001)

It is useful for institutional investors, and the trustees of pension funds in particular, to be aware of the extent to which their decisions or lack of decisions and action inform other stakeholders in the investment management industry (Rusconi, 2008). As the ultimate customers and owners (of course on behalf of their beneficiaries), trustees of pension funds should recognise the length of the value chain, potential inefficiencies, and their central role in policy and decision making in accordance with appropriate regulation. As the next section highlights, trustees, by law, remain accountable for all decisions made, regardless of which responsibilities have been devolved to other entities.

2.3 Pension fund reform

Understanding that the organisation and financing of income security in retirement is a fundamental component of a nation's sound and prosperous functioning, the South African government embarked on a retirement fund reform journey in 2002 (National Treasury, 2004; FPI, 2007). There are features of the South African retirement fund industry, built on the legacy of Apartheid, which meet and in some cases exceed the expectations one would have of developed nations. However, there remains a significant schism between the depth, structures, and practices found in the various racial groupings of South African people (National Treasury, 2004).

It is against this backdrop, particularly given that low household savings is a major concern, that National Treasury seeks measures to improve the retirement landscape of South Africa (National Treasury, 2014). The pension fund reform thus addresses three main categories. The first: modernisation of the South African retirement funding landscape. The second: access, compulsion and preservation. And the third: benefits, contribution rates, and member protection (National Treasury, 2004). Within the actual reform process six key objectives are identified by the chief director of financial investments and savings at the National Treasury, the implementation of three of which pose marginal, if any, additional work on pension funds. Those three being: the alignment of taxation of contributions and benefits, the introduction of individual tax free savings accounts, and the encouragement of good value retirement products, primarily through fees reduction (Makhubela, 2015)

However, three other objectives: encouraging preservation, encouraging annuitisation, and enhancing the governance of retirement funds have been more onerous on trustees. Some of the messaging in public forums on these topics, has also had negative implications such as early withdrawal of lump sums from provident funds, resulting in more complications and work on the part of pension fund trustees and other stakeholders (National Treasury, 2014).

2.4 Fiduciary and other duties of South African pension funds duty

The term 'fiduciary' is derived from a Latin verb which means 'to trust' and is universally accepted as the central tenet on which the role of the trustee is defined (Sandberg, 2011). It is based on this concept that we refer to the responsibilities of the trustees of a pension fund to the fund's beneficiaries as 'fiduciary duties'.

Ultimately it can be argued that there are two core tenets of fiduciary duties. The first is that trustees are to manage their funds in the best interests of their beneficiaries and the second that in the managing of the funds due care and prudence should be exercised (Sandberg, 2011). These two emphases together are referred to as the duty of loyalty and the duty of prudence or standard of care (Hawley, Johnson, & Waitzer, 2011).

The fiduciary duties of the trustees are captured in terms of section 7C of the South African Pension Funds Act of 1956 (see Table 2). In essence, the Act captures the spirit of fiduciary responsibilities by addressing the requirement of the trustees to act in the best interests of a fund’s beneficiaries, with due care, and with impartiality between beneficiaries.

<u>Pension Funds Act 24 of 1956, Section 7C: Object of the board</u>	
(2)	In pursuing its object the board shall-
(a)	take all reasonable steps to ensure that the interests of members in terms of the rules of the fund and the provisions of this Act are protected at all times, especially in the event of an amalgamation or transfer of any business contemplated in section 14, splitting of a fund, termination or reduction of contributions to a fund by an employer, increase of contributions of members and withdrawal of an employer who participates in a fund;
(b)	act with due care, diligence, and good faith
(c)	avoid conflicts of interest
(d)	act with impartiality in respect of all members and beneficiaries
(e)	act independently
(f)	have a fiduciary duty to members and beneficiaries in respect of accrued benefit or any amount accrued to provide benefit , as well as a fiduciary duty to the fund, to ensure that the fund is financially sound and is responsibly managed and governed in accordance with the rules and this Act; and
(g)	comply with any other prescribed requirements

Table 2: Pension Funds Act 24 of 1956, Section 7C: Objectives of the board

The Mouton Report, *Report of the Committee of Investigation into a Retirement Provision system for South Africa* (1992) explains the spirit of what is laid out in the Act in six sections. The first section, the duty to act with due care, requires a standard of care of trustees greater than that which would be expected of a reasonable person, which includes keeping members of

the funds fully acquainted with all matters as relevant to them. The second duty, the duty to act with good faith, emphasises that there are no degrees with respect to good faith, and any breach, regardless of how minor it may appear, would render the trustees at fault with regard to their fiduciary duties.

The four remaining sections follow from the first two. The third requirement is arguably what has led to the large spatial structure of the investment management industry, discussed in section 2.2, in that it requires that trustees should obtain the advice of experts if their knowledge is insufficient. As such trustees may delegate their duties, but still remain ultimately accountable. The fourth requirement is that trustees are to avoid all conflicts of interest and remain independent. The fifth requirement asserts that the trustee may not have any personal interest in the relevant trust and that the assets are held for the benefit of the fund and its members, implying the strict management or avoidance of any conflicts of interest. The last requirement as outlined by the Mouton Committee (1992) requires the trustees to act with impartiality in respect of all beneficiaries. As such, all beneficiaries must receive equal and objective treatment. This last requirement interestingly proves to be significant in the understanding of the interaction between fiduciary duties and responsible investment, particularly in the context of sustainability (see results section 5.2.2 and discussion section 6.2.1).

It is also important to note that along with the provisions of Section 7C of the Pension Funds Act, trustees also have common law duties arising from the fiduciary relationship (Newdigate, 2006) As such the main remedy for aggrieved parties with respect to negative consequences of a breach of fiduciary duties is the common law remedy of delict. This, along with the statement found in Circular PF 130, means that trustees can be found personally and jointly liable for breaches of their fiduciary duties (KPMG, 2010).

“The accountability requirement of the board means that collectively and individually the board members may be held liable for any breach of governance which results in any loss to the fund and to the members or beneficiaries in the provision of benefits. The board should adhere to the rules of the fund and should institute disciplinary measures in the event of an alleged breach by a board member. Furthermore, members and beneficiaries may request the Pension Funds Adjudicator or a court of law to determine the liability of the board.” (FSB, 2007, paragraph 7)

2.5 Responsible Investment Strategies

2.5.1 Active Ownership, and Corporate Governance

The Second principle of CRISA refers specifically to institutional investors demonstrating their ownership responsibilities, also referred to as active ownership or stewardship. The primary requirement in this regard includes, for institutional investors, the need to have in place policies which govern:

“...mechanisms of intervention and engagement with the company when concerns have been identified and the means of escalation of activities as a shareholder if these concerns cannot be resolved.” (CRISA, 2011, p 10)

Similarly the UNPRI defines active ownership as:

“Active ownership involves investors using their formal rights (e.g. the ability to vote shareholdings) and informal influence (e.g. their ability to engage) to encourage companies to improve their management systems, their ESG performance or their reporting. Engagement with public policy makers is increasingly seen as an integral part of active ownership.” (UNPRI, 2013, p 2)

Corporate governance is an integral component of the system and approaches which constitute active ownership, as it governs shareholders voting rights, directly referred to in the UNPRI definition of active ownership (Giamporcaro, 2011). While a diligent voting practice is important, it is often considered as the most basic form of shareholders honouring their shareholder ownership responsibilities. Rather, corporate governance is essential to active ownership as it speaks to the agency alignment of shareholders and company management, ultimately providing the opportunity for the realisation of the will of the shareholders (Solomon, 2004).

From an active ownership perspective it is logical to seek to influence ESG and other areas of companies in which investors are invested. Proxy voting, shareholder resolutions, and management dialogue are the key methods through which this is realised (Clarke, Feiner, & Viehs, 2014). Clark et al. (2014) explain that engagement can be meaningful, but that the next steps in the engagement evolution would be the inclusion of the customers of the investee companies, as well as the ultimate beneficiaries of pension funds.

Ferraro and Beunza (2014) present a useful model to assist in the understanding of meaningful dialogue and engagement. The model as seen in Figure 2 illustrates a meaningful engagement process, where stakeholders, for the purposes of this paper, would be asset managers or pension fund trustees. In essence shareholders and companies would dialogue on a particular issue to arrive at a solution, which considers all parties’ responsibilities and concerns. While Ferraro and Beunza (2014) present the first step, from a stakeholder perspective, as ‘moral outrage,’ the same process applies to any issue raised, whether based on moral understanding, ESG issues, or simply any other company related matters.

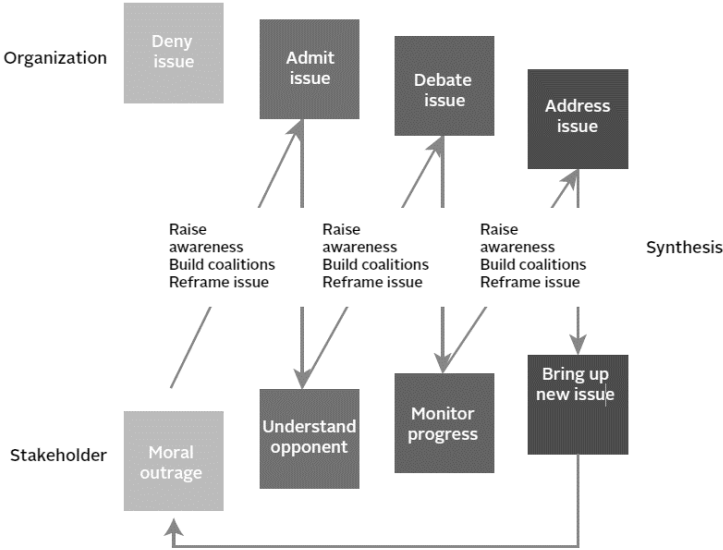


Figure 2: The dialogue/engagement process (Ferraro and Beunza, 2014)

2.5.2 ESG Integration

ESG integration is perhaps the most widely accepted definition of RI (Eccles and Vivers, 2011). It involves the analysis of environmental, social and governance factors in order to comprehensively assess the risks and opportunities of any investment. From the perspective of pension funds, the integration of ESG factors into the investment process assists in addressing non-alignment of the long term nature of pension funds and the typically acknowledged short-term approach of asset managers (MSCI, 2013). In addition the importance of addressing sustainability topics through ESG integration should ensure that the financial impact of a company’s risk profile, performance potential, and reputation are well understood and accounted for (Clark et al., 2014)

2.5.3 Screening

Eccles and Viviers (2011) in the explorations of the meanings of RI provide three classes of screening: negative screening, positive screening, and best-in class screening. Negative screening is typically what first comes to mind when considering the intersection between RI and screening. In this case investors avoid investing in particular, pre-defined entities, based on pre-defined criteria. This could be due to a number of reasons, most often related to the values of the asset owners. By way of example, most church funds would avoid investments in pornography, tobacco, or gambling- so-called ‘sin stocks’. In the same vein, positive screening looks to include entities which display particular characteristics, deliberately and intentionally selected by the investor, rather than excluded. These characteristics are often quite general in nature (when compared to impact investing) and are normally framed as the absence of negative characteristics. The last variation of this particular theme, best-in-class screening, looks to select entities which display the best of a particular set of characteristics within a certain group, most often a sector. Alternatively it could also be screening on a ‘least bad’ approach. (Harrington, 2003)

2.5.4 Impact Investing

Impact investing is an investment practice which pursues investment opportunities which have both appropriate financial returns and social and environmental impact (Bugg- Levine & Emerson, 2011). It is important to bear in mind that the addressing of any social or environmental issue on the part of the investor needs to be intentional and therefore appropriate measurement mechanisms and targets need to be in place (Bugg-Levine & Emerson, 2011; Paton, & Balandina- Jaquier, 2015).

3 LITERATURE REVIEW

This literature review addresses three sections on overarching topics. The first, RI in South Africa, addresses literature on the landscape and response of pension funds to RI as well as RI strategies and their corresponding performance. The second section, the role of pension funds and trustees, addresses literature on social security and the governance of funds, capital allocation, and fiduciary capitalism and active ownership. The third section addresses the literature on fiduciary duties.

3.1 Responsible Investment in South Africa

3.1.1 The landscape and response of pension funds

Literature on RI in South Africa is dominated by a small group of academic voices and supplemented by industry research efforts. The literature is relatively sparse with particular focus areas which correspond to the small number of academic writers for whom RI in South Africa is a focus. RI within the investment industry is yet to mature, and due to its fragmented nature and the use of inconsistent and disparate terminology, can sometimes be a tricky topic to navigate (Vivers and Eccles, 2012).

Two key pieces of research, *The State of Responsible Investment in South Africa* (UNEPFI, 2007) and a later publication of the same title, *The State of Responsible Investment in South Africa* (van der Ahee & Schulschenk, 2013), drive at answering questions regarding the response of the South African investment industry to responsible investment. This was done from the perspective of a number of stakeholders, but primarily focuses on asset managers and pension funds as the most influential players in the investment value chain (UNEPFI, 2007). From the perspective of pension funds, both pieces either interview or send a questionnaire to the principal officers of funds, typically with a low response rate, which van der Ahee and Schulschenk (2013) attribute to the substantial work responsibilities of principal officers as well as a lack of interest in RI. While each report approaches the investigation into the state of RI in South Africa differently, many of the final conclusions converge. Given that the reports were published several years apart, this seems to suggest that RI in South African pension funds may be experiencing a large degree of inertia, although Ahee and Schulschenk (2013) do assert that focus on RI has generally increased considerably given the increase in awareness of institutional investors.

The earlier report supports the notion that the demand side, dominated by institutional investors who in turn comprise mainly of pension funds with respect to value (Berry, 2014), is not present in dialogue nor is it a substantial player in the development and practice of RI (UNEPFI, 2007). Consequently, responsible investment is driven by the investment management industry, where there is commitment to varying degrees (UNEPFI, 2007). Van der Ahee and Schulcschenk (2013) include asset managers in their representation of institutional investors, and as such it is difficult to disaggregate their findings so as to evaluate the trajectory and state of pension funds in this context. However, on the whole, their conclusions show that disregard for RI practices can be attributed to perceptions of potential negative or low financial performance, as well as a lack of adequate environmental, social and governance measurements (van der Ahee & Schulschenk, 2013).

Concerns regarding financial performance and problems with the availability of adequate ESG information are not uncommon themes when examining factors which may lead to the disregarding of RI practices. In addition to these themes however, Herringer, Firer, and Viviers (2009) include insufficient human capital and lack of expertise, the absence of a substantial and recognised RI universe, interpretations of trustee fiduciary duties, and the influence of South African pension funds and their lack of engagement as key challenges. Viviers et al. (2008) include, as barriers to responsible investment, confusions regarding the definition of RI, lack of sufficient evidence regarding returns on RI portfolios, short termism, and the cost of ESG information and expertise. These findings are extremely informative, particularly as pension funds form the majority of the survey sample. However, while Viviers et al (2008) identify the barriers, drivers and enablers of responsible investment in South Africa, their research does not include information on the response and actions of the pension funds in this regard.

Important to note is that much of the research regarding barriers or challenges to responsible investment was undertaken prior to the promulgation of the Amended Regulation 28 of the Pension Funds Act and the launch of CRISA in 2011. This however did not preclude Viviers et al. (2009) from referring to the lack of clarity regarding, at that time, the proposed amendments to pension fund legislation, as an obstacle to growing RI in South Africa. Post the promulgation of the legislation and the launch of CRISA, the question regarding the impact of the legislation and CRISA on the RI industry in South Africa remains. In this respect the Ernst & Young CRISA Disclosure Report (2013) suggests that CRISA has not lead to substantial action on the part of pension funds in this regard.

From an international perspective, when considering why institutional investors, and in the case of this research, pension funds, do or do not apply RI considerations in their investment practices, there is currently no unified view (Sievanen, 2014). While this may be the case Juravale & Lewis (2008) identify three themes which consistently come to the fore in the context of impediments to the implementation of RI. The agency problem, fiduciary duty, and financial performance are cited regularly and across many markets (Jurvale and Lewis, 2008). Typically the agency problem addresses conflicts of interest; while fiduciary duty addresses the need to act in the best interests of members; and financial performance addresses investment returns. In many cases fiduciary duty is regarded singularly as the maximizing of financial returns (Sievanen, 2014).

From this position, Jurvale and Lewis (2008) present three levels on which impediments to RI may be identified: institutional, organizational, and individual. Figure 2 illustrates these three levels as well and the components which make up the body at each level. In this regard two important distinctions must be drawn between fiduciary duties, and regulation and accountability. A finding by Eurosif (2011) shows that globally there appears to be two camps with respect to RI and the honouring of fiduciary duties. The first camp, the case where pension funds incorporate RI as part of their investment strategy, believe that considering RI as part of their investment strategy is a fulfilment of their fiduciary duty. The second camp, on the other hand, hold contrary beliefs, specifically since that by not having an RI strategy, not adhering to one is also not considered a violation. Thus Viviers et al's (2008) findings which identify that fiduciary duties is a significant impediment to RI is not dissimilar to what is found globally. However, literature and industry studies, due in part to limited responses on the part of pension funds, do not clearly conclude what the view of pension funds are with respect to RI and fiduciary duties.

The finding by Sievenan (2014), that most consider fiduciary duties to be maximising investment returns, is not unexpected, and perhaps is generalisable to some degree. Such a conclusion would explain some of the conduct in a South African context. Firstly, Sievenan (2014) finds that while conceptually RI is understood by key decision makers, practical understanding is lacking. Standards and compliance are well understood, but accounting for RI within an investment decision-making process yields very little rigour. While Sievenan (2014) finds that lack of understanding across the industry more broadly hinders implementation, of greater distinction with respect to difficulty in implementation, is the potential for RI to have

an adverse impact on financial performance. For many pension funds in this study, lower financial returns would have been unacceptable and thus an impediment to RI for those funds. Sievenen’s (2014) findings in this regard do not deviate from the work of Guyatt (2006), Herringer et al (2009) and Lewis and Jurvale (2010). For the purposes of this research, it is important to reiterate that the preamble to Regulation 28 of the South African Pension Funds Act, requires only, adequate risk adjusted returns. Thus South African pension funds should not be bound by the fear of lower returns, as long as the return is adequate (The Public of South Africa, 2011). This conversation of course, neglects the view that incorporating RI considerations could actually enhance investment returns. This is discussed in further detail later with respect to fiduciary duty (section 3.3).

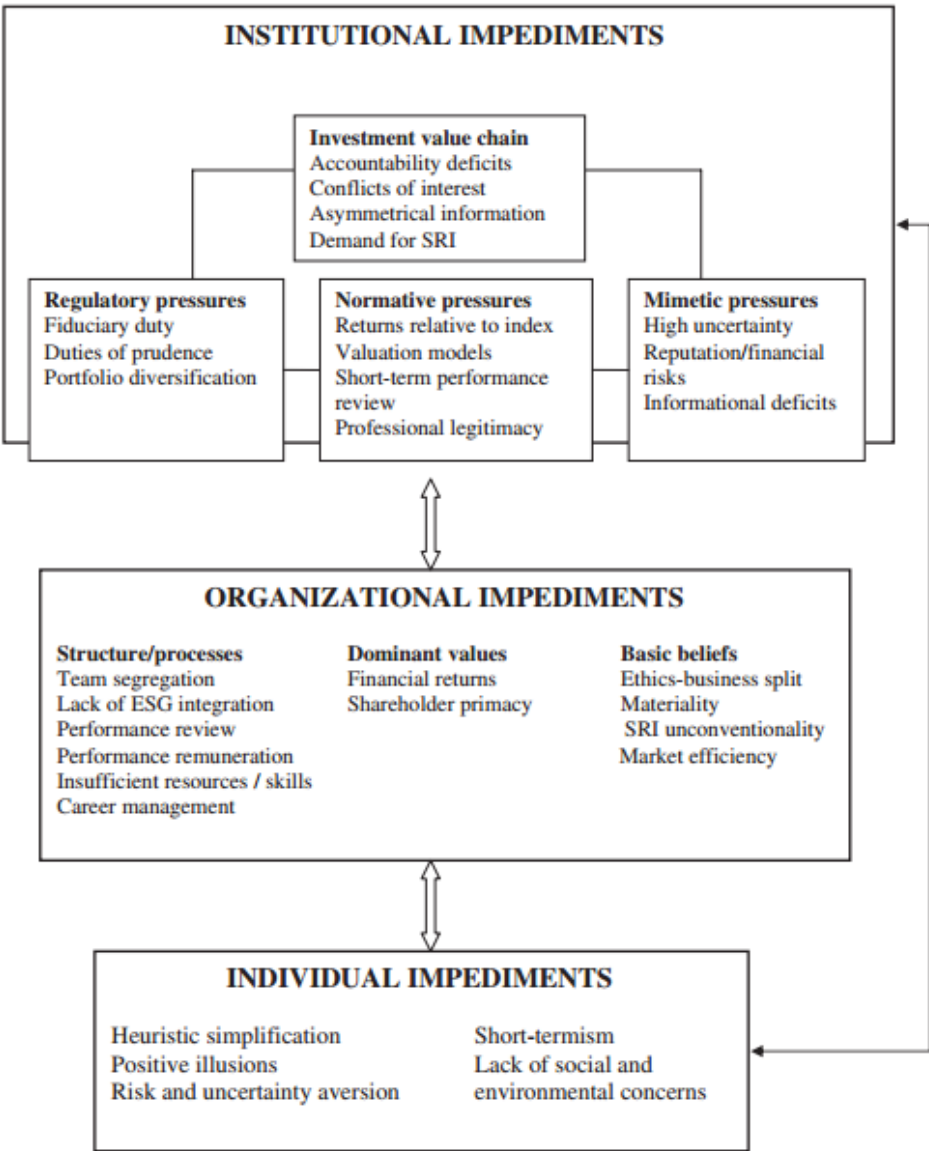


Figure 3: Multi-level analysis of the impediments to SRI (Jurvale & Lewis, 2008)

3.1.2 Performance and strategies

Viviers, Bosch, Smit, and Buijs (2008) provide a further angle on the South African RI industry. Their focus on the risk adjusted financial performance of South African RI labelled funds is unique and yields important results for the market to consider. Given that financial performance as it relates to fiduciary duties dominates industry discussion, studies which examine performance in relation to various RI considerations are an important component in untangling arguments and driving RI action in either direction (Freshfields Bruckhaus Deringer, 2005).

Although Viviers et al.'s (2008) work is significant, it is important to note that the sample of funds in the study, consists solely of funds labelled as RI funds. The broader RI movement, specifically within the pension fund space, seeks ESG integration and engagement as investment enhancement as aligned with Regulation 28, as opposed to specifically designed products which are typically targeted development or screened funds (Viviers, 2007). Therefore while the study does present important results, it is not completely compatible with pension fund investment in a generalisable sense. Viviers et al.'s (2008) findings suggest that over time, RI funds with specific strategies - screening, shareholder activism, and impact investing (Viviers, 2014)- perform at least on par with their respective benchmarks and the general South African equity market. Interestingly ESG integration as an RI strategy is not generally acknowledged or included in the fold of RI strategies with respect to literature (Viviers, 2014). Rather, screening strategies, shareholder activism, and impact investing are branded as 'ESG' products. This is important to note as most investment managers and pension funds look to ESG integration as a more holistic and sustainable approach, and it is to the consideration of environment, social, and governance factors within the investment process that Regulation 28 speaks.

While Viviers (2014) and Viviers et al. (2009) address broad categories of RI strategies, Giamporcaro, Pretorius, and Visser (2010), Giamporcaro (2011), and Giamporcaro and Pretorius (2012), address the specific area of the incorporation of environmental criteria. The findings of the earliest study point to a focus on social issues within targeted or cause-based investing, and highlighted that within the South African context environmental issues have been of a lesser concern (Giamporcaro et al., 2010). Giamporcaro and Pretorius (2012) report similarly while Giamporcaro (2011) highlights that the vocal role played by the GEPF in the discussions around SRI is important. This is specifically as the GEPF has the platform to educate, lead and articulate the wider implications of negative environmental impacts and

externalities, specifically as they relate to negative social consequences. All of the above studies make use of the typologies used by Viviers et al (2008, 2009) to classify South African RI funds. Therefore, similar to the Viviers et al. (2009) study on performance, these studies do not necessarily include ESG integration explicitly as an RI approach.

3.2 The role of pension funds and trustees

3.2.1 Social security and governance

The role of pension funds is not a topic commonly explored in literature. This is not necessarily surprising due to the very tangible workings of pension funds when one considers contributions and eventual distribution. At the most basic level retirement funding, and the role of pension funds is to ensure the adequate provision or financing of income security in retirement (National Treasury, 2004). While this may be the case, there is much commissioned and written on pension funds as social and economic institutions as countries seek to understand how best to think about social security systems and the well-being of their citizens (Merwe, 2010).

South Africa demonstrates this through a number of commissions which have investigated the intricacies of retirement funding. The Mouton commission (1992), Katz commission (1995), Smith Commission (1995), National Retirement Consultative Forum (1997), and the Taylor Committee (2002), are such reports. While none of these reports explore the place of RI, at their core is the situating of the purpose of pension funds and consequently how best to execute on that purpose. More recently South African publications have focused on retirement reform. Although the South African National Treasury (2004) proposed changes before the advent of RI in South Africa (the UNPRI launched in 2007, and the amended Regulation 28 was promulgated in 2011) many of the items could apply equally in addressing greater efficiency and implementation of RI.

The Mouton (1992) and Taylor (2002) Reports, in particular, locate the existence of retirement funds within the greater South African social security regime. Typically, most discussions around the purpose of pension funds originate here. The Alexander Forbes Benefits Barometre (2013, 2014) provides further commentary on the role of pension funds in South Africa. Here too pension funds are situated within the context of the entirety of the employee benefits spectrum. Particular emphasis is placed on the need to recognise the interconnectedness of benefits, meeting individual needs, and improving financial engagement with members. In using a lens of interconnectedness and holistic understanding, the role of pension funds

develops into more than simply maximising returns or achieving the best replacement ratios. Cabot- Alletzhasuer (2014) addresses a similar notion when considering goals-based investing on the part of pension funds, importantly acknowledging the need to move away from performance obsession, should the industry seek to meet the needs and interests of beneficiaries more holistically. The Financial Planning Institute of Southern Africa (FPI) similarly supports a holistic provisioning, but is careful to include that individuals' needs during each life stage are provided for. In addition, the FPI, address all individuals or citizens as opposed to those who are or have been members of corporate pension funds (2007). This, of course, does make for a slightly different perspective to Cabot-Alletzhauser (2014).

For the purposes of this research, the focus is on corporate pension funds as opposed to any funding provided on a grant basis by the government. It is in this space that retirement policy objectives as stated by National Treasury (2004) make sense. In particular, the objectives of the retirement policy are to encourage provision for retirement; ensure cost efficiency, prudence, transparency and fairness; promote retention of purchasing power (National Treasury speaks specifically to inflation in this case, but this perhaps could be extrapolated to address some of the concerns for the future that current RI proponents may have); improve the standards of governance, trustee knowledge and conduct, advance the protection members interests, accountability, and disclosure of material information to members and contributors (National Treasury, 2004).

The last objective cited suggests that there exists a deficiency with respect to certain key elements which provide a platform for true RI. The role of the trustee, along with fund governance cannot be underestimated. Similarly the importance of the ability of a regulator to intervene cannot be ignored (National Treasury, 2004). A further technical paper published by the National Treasury (2012) addresses governance and the trustee, referencing the 2007 and 2012 PWC South Africa surveys on trustees. Not contrary to the conclusions of Clarke, Caerlewy-Smith and Marshall (2005) that many trustees lack the skill or necessary competence to make decisions in the best interest of members or beneficiaries, investment related or otherwise, the surveys suggest that employee-elected trustees are often elected with no consideration given to skill and ability (PWC, 2007). In addition there is a great disparity found in the level of skill between employee-elected trustees, and employer elected trustees (PWC, 2012).

The PF 130 Circular does act as a governance mechanism, however, there are concerns regarding its non-enforceability, and proposals that it be legally enforceable by the Registrar of retirement funds (National Treasury, 2012). The identification of PF 130 Circular as non-enforceable by law is not a new revelation in terms of pension fund governance. Hunter (2002) makes this very point, but reiterates that it is an important document in that it provides guidelines to boards of trustees.

The need to ensure that trustees are statutorily fit and proper and that adequate and appropriate training is provided is often reiterated (National Treasury, 2012; Hayton, 2004; Hunter, 2002). Hayton (2004) emphasises the extent of the legal obligations of trustees, and in doing so the need for competence and diligence in the execution of duty. Hunter (2002) does not necessarily speak to governance from the perspective of the legal obligation of the trustee; in fact she states that trustees owe their fiduciary duties to the fund itself before members. However, in addition to the requirements of section 7A of the Pension Funds Act, Hunter (2002) lists seven characteristics of good corporate governance to which, she asserts, should be adhered. These characteristics: corporate discipline, transparency, independence, accountability, responsibility, fairness, and social responsibility (Hunter, 2002), by extrapolation, cannot be achieved by pension funds if the trustees are found wanting in capacity, and capability. In a later address Hunter (2012) contributes further to the duties of trustees with respect to prudence, establishing an important heuristic: prudence is process not performance. Hunter (2012) presents the necessity for a trustee to act prudently, with care and diligence, and to possess the capability to do this.

Internationally, there have been, over the last several years, academic enquiries into the role and contribution of trustees, given their statutory authority over pension funds. While South African rhetoric has expressed concern regarding the ability of trustees, Kakabadse, Kakabadse, and Kouzmi, (2003) find otherwise in the UK market. Kakabadse et al. (2003) find that harsh critique of trustee capabilities from training to governance and decision making is not warranted. However, later studies do not concur and purport that funds are in fact not well structured to meet the best interest of members (Clarke, Caerlewy-Smith Smith and Marshall, 2005; Clark, 2004). The OECD working paper on pension fund governance asserts that despite regulatory and industry initiatives, weakness in the governance of pension funds for both OECD and non-OECD countries persist (Stewart and Yermo, 2008). Stewart and Yermo (2008) suggest that one means to combat governance weakness as higher levels of expertise of the

stakeholders on governing boards, which may be achieved through appropriate training and the use of independent or professional trustees.

3.2.2 Capital Allocation

The theme of pension funds as allocators of capital is also not popular in literature. The typical narrative in this respect centres on long-term investing. Sethi (2005) and Amalric (2006) both place the pension fund, as a large institutional investor, in a critical position in the investment value chain as it evaluates and directs capital. Importantly, it is possible to realise an overall improvement in the quality of corporate conduct, influenced by investment philosophies and pension funds' mandates which encourage an holistic approach to evaluating corporate performance (Sethi, 2005). In addition, an acknowledgement of the power held by corporations with the backing of capital in terms of impacting environmental, social and economic trajectories should be a key consideration on the part of pension funds (Almaric, 2006). The Mouton Report (1992) addresses capital allocation from an RI perspective by linking capital allocation to general social development which benefits pension fund members. Additionally and perhaps more directly related to specific ideas around capital allocation the Mouton Report (1992), albeit cautiously, states that:

“... efforts be made to create investment instruments that are appropriate for funds and that can be used to raise funds for development agencies in their field” (Mouton Report, 1992, p. 17)

From a South African perspective, the focus with respect to capital allocation is typically around targeted development investment, which Viviers (2014) and Gimporcaro (2011) speak to as a strategy within the RI quiver, more commonly labelled as cause-based investing and now currently included under the umbrella of impact investing (Vivers et al. 2009). Capital allocation can also be viewed through the lens of purposed government funds and policy which aligns pension fund capital allocation with job creation or governance, for example (Jackson, 2012). The Impact Barometer which explores the scope and depth of funding into the impact investing space, suggests that funding into impact investing is significantly less than other forms of RI investing (Giamporcaro & Bakker, 2013) . However, it is difficult to accurately identify what the funds in the sample define as their RI strategy and whether such strategies are truly applied to the assets under management as presented by asset management companies.

From a global perspective, literature does address the role of pension funds in terms of capital market development. The role of pension funds need not only find an expression post the establishment of capital markets, but rather pension funds can and do play a crucial role in the establishment and the going concern of well run, functioning and governed markets (Vittas,1996). In particular Vittas (1996) speaks to the role pension funds have as a pool of long-term financial savings, a force for innovation, as players in corporate governance, and their role in privatisation as appropriate. Meng and Pfau (2010) draw similar conclusions, emphasising the fact that pension funds increasingly provide a source of investment funds to their own domestic markets and as such have the ability to shape and influence growth and development. Davis (2005), addresses, more specifically, the role of institutional investors in emerging markets as forces for financial development, leading to the spurring of economic growth. Meng and Pfau (2005), Vittas (2000), and Davis (2005) agree that if governed correctly, while simultaneously having appropriate flexibility, pension funds can and do have positive impacts on capital market development and economic growth. However they do not address the development of particular sectors or potential impacts from disinvestment from particular sectors.

There is not much by way of literature on the allocation of pension fund capital so as to support certain sectors, other than perhaps as mentioned earlier, what is addressed from an impact investing perspective. Bugg-Levine and Emerson (2011) emphasise the power of capital by citing examples of where capital is needed but not provided, hampering economic growth as well as the development of communities and individuals. They emphasise the need for traditional views around the allocation of capital to be challenged and blended value paths to be explored (Bugg-Levine and Emerson, 2011). Jackson (2011) presents the same message albeit in a South African context indicating that capital allocated through the private sector can underpin job and economic growth.

Della Croce, Kaminker and Stewart (2011) address the role of pension funds in financing green growth initiatives. Acknowledging interest in this area on the part of pension funds, particularly as it relates to the best interest of members and beneficiaries, Della Croce et al. (2011) explore why pension funds allocation to green investments remains low. They cite lack of appropriate investment vehicles, liquidity concerns, regulatory misalignment, lack of history and associated risks, and general lack of knowledge, expertise and education with respect to boards of trustees.

This list is not dissimilar to the findings of Giamporcaro and Pretorius (2012) when looking at the adoption of general environmental criteria.

3.2.3 Fiduciary Capitalism and active ownership

Monk (2014), refers to the “New Dawn” of fiduciary capitalism, however the concept and its constructs have been in development for at least two decades. Clarke and Hebb (2005) refer to fiduciary capitalism as the fifth stage of capitalism, while Hawley and Williams (1997) begin to develop the concept post world War II and into the early 1990s as ownership of corporates begins to re-concentrate, not in the hands of individuals such as Carnegie, Dupont, and Ford (Giamporcaro, 2011), but in the hands of institutional shareholders (Hawley and Williams, 1997). The importance of understanding fiduciary capitalism arises as institutional shareholders own substantial stakes of equity on behalf of members, in the case of pension funds, to whom they owe a fiduciary responsibility (Hawley, and Williams, 1997). It is through this lens, where fiduciary responsibilities require institutional shareholders to ‘vigorously promote- and only promote- their beneficiaries interests’ (Hawley and Williams., 1997, p. 207) that the importance of active ownership and governance come to into focus. For Clarke and Hebb (2005), Hawley and Williams (1997), and Monk (2014) active ownership takes on the form of meaningful engagement due to the ability of pension funds to assume a consistent and cohesive voice to influence corporate decision making. Richardson (2010) adds a further dimension to this understanding of active ownership and its relationship to the promotion of the best interests of pension fund members. He tackles the difficulty in the ability of trustees to surface a unified opinion on the best interests of beneficiaries, specifically derived from the beneficiaries themselves (Richardson, 2010). The concept of fiduciary capitalism thus framed is well-established internationally (Monks, 2007). However, little is explored on the same theme from a South African perspective, other than what is seen as a general trend of disregard in the industry wide reports on RI in South Africa and from an active owner perspective (Ahee & Schulschenk, 2013; UNEPFI, 2007; and Crotty, 2012).

Corporate governance is a key feature and channel through which institutional investors can wield their influence within a fiduciary capitalist framework (Brennan 2003; and Hawley & Williams, 1997). Monk (2104) reminds the industry that in order for fiduciary capitalism to be effective, institutional owners need to recognise that they are indeed owners, with the ability to exert influence in accordance with their ownership rights and in doing so use corporate governance mechanisms. Others rely on this premise to ground their arguments with respect to

stakeholder engagement, active ownership and ensuring good governance (Hawley and Williams, 1997; Clarke and Hebb, 2005; Brennan 2003; Monks, 2007; and Hawley and Williams, 2004).

According to Vittas (1996) and Meng and Pfau (2010) pension funds play a significant role in influencing the corporate governance of the companies in which they are invested, and of course can also be significantly affected, positively or negatively by sound or poor corporate governance respectively. Although engagement from the perspective of active ownership and ensuring sound corporate governance are closely linked due to the separation of ownership and control of corporations inciting the agency problem (Romano, 1993; Hawley et al., 1997; Giamporcaro, 2011), ensuring sound corporate governance provides the platform for meaningful engagement and the fulfilling of ones responsibilities as an owner. Therefore active owners engage on many issues to the benefit of, in this case, of the members of pension funds (or their beneficiaries).

Blackburne (2014) for example explains that active ownership is about creating better risk-adjusted returns over the long-term. Blackburne (2014) specifically readdresses the issue of stewardship over capital, calling for, in the words of Simon Howard (2014, as cited by Blackburne, 2014), chief executive of UK Sustainable Investment and Finance Association: “responsible stewards, not absentee landlords.” Aligned with Balckburne’s (2014) message of better returns; Dimson, Karakas and Li (2013) find, for a propriety dataset, that successful engagements do yield better returns for companies in the short term, while there is no price reaction for those companies with whom engagements have been unsuccessful. Dimson et al. (2013) acknowledge that these returns could be due to shareholder and market perception, perhaps overstating the value unlock through the engagements in the near term. Due to the time horizon it is difficult to test value unlock over longer periods of time, although some theories suggest that engaging management on ESG issues, focuses management attention on the long-term perspective, and sustainability of the company both from an operational perspective and earnings perspective (Kim, Park, and Wier, 2012). Dimson et al. (2013) note that the majority of engagements in the dataset dealt with corporate governance and climate change as engagement topics. Earlier research also finds corporate governance to be the central-sometimes only- theme (Hendry, Sanderson, Barker, & Roberts, 2004). This is perhaps unsurprising given most advice on initiating the active ownership journey begins with aspects

of corporate governance: proxy voting and attending annual general meetings (AGMs), for example (Leadbetter, 2013).

While Balckburne (2014) and others address the financial results of engagement and active ownership practices; Monk (2014) believes that active ownership from institutional fiduciaries has the ability to place capitalism on a more sustainable trajectory, thus building a framework for tackling other long-term fundamental challenges presented both to society and to the specific members and beneficiaries of pension funds. This of course is often the rallying call with respect to responsible investment; the need for capital across the board, from banks and life offices, to pension funds and insurers to find practices which create a sustainable environment in which both business and living conditions may continue at their optimum (Richardson, 2008).

The fiduciary duties of pension fund trustees, to act in the best interests of beneficiaries, places further importance on the need to actively engage with companies to the benefit of beneficiaries under the auspices of active ownership. This is understood to be generally difficult, from ascertaining the will of beneficiaries, to taking instruction, and acting impartially (Richardson, 2010; Richardson, 2011). Although, acting on the will and in the best interests of beneficiaries is perhaps a complex landscape to navigate, the complexity does not justify a lack of action (Richardson, 2011). Intent in this regard, is therefore important not only because it ultimately leads to engagement with corporations with the purpose of inciting change, eliciting further information, or fostering relationships, but perhaps is even more important in that it presses upon trustees the need for engagement with pension funds' very own members. From a South African perspective active ownership or active engagement refers typically to engagement with company management on general ESG issues, and not necessarily on issues relating directly to beneficiaries. This is due to the fact that these engagements are asset manager and not institutional investor initiated and led, and tend to be corporate governance biased (Viviers, 2009; Giamporcaro and Pretorious, 2012). It is in this context that Clark et al. (2014) assert that the next step in the evolution of active ownership and engagement is the inclusion of customers of investee companies, as well as the ultimate beneficiaries of pension funds.

3.3 Fiduciary Duties

No research or discussion on responsible investment is complete without an exploration of the fiduciary responsibilities of pension funds and their trustees. Although referenced in earlier

sections of this literature review as a fundamental concept to many of the previous topics, it is important to provide space for the topic to be explored in its own right. The interaction of the two: responsible investing and fiduciary duties is an integral component when considering the role and actions of pension funds particularly as ‘fiduciary duties’ is cited as a leading barrier to responsible investment (Herringer et al., 2009; Siavanen, 2014).

It is, of course, the work by law firm Freshfield Bruckhaus Deringer known as the Freshfield Report (2005), which is typically cited as the main piece of literature which supports ESG within the context of fiduciary responsibilities. The report covers nine jurisdictions of both common and civil law to explore whether responsible investment is compatible with the fiduciary duties of trustees. The phrase most touted by proponents of responsible investment from the Freshfield Report is:

“...integrating ESG consideration into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions.” (Freshfields Bruckhaus Deringer, 2005, p.13).

Arguably of greater interest, and perhaps deliberately ignored by many is, as Sanderbg (2010) points out, that the main thrust of the Freshfield Report is that profit maximisation has never been and is not a key component of the fiduciary duties of institutional investors. The wording of the preamble to Regulation 28 of the Pension Funds acts suggests a similar notion (The Public of South Africa, 2011). Certainly, Hunter (2012), the current Financial Services Board Deputy Executive Officer of Retirement Funds, articulates an argument by citing Gillesse (1995), which proposes that the responses required of pension fund trustees with respect to their fiduciary duty of prudence is to ensure that process is proper, well thought through and executed, and not to necessarily realise the highest financial performance.

The understanding and interpretation of fiduciary duties is therefore integral to the practice and demand for responsible investment. Many believe that society is at an inflection point with respect to the interpretation of fiduciary duties and the intersection thereof with RI (Hawley, Johnson, & Waitzer, 2011). Others, like Sandberg (2013), may be considered to have a narrower view in this regard, believing that fiduciary duty does not mandate RI for pension funds, and that the problem lies within the very concept of fiduciary duty. This does not mean, however, that as Hawley et al. (2011) state it is not possible to initiate the re-imagination of fiduciary duty to speak to contemporary issues which inevitably affect the beneficiaries of pension funds.

In this respect Lydenberg (2013) and Richardson (2011) propose interesting concepts within the ambit and framework of fiduciary duty. Lydenberg (2013) places on the table an opportunity for institutional investors to reassess the reasonable and rational aspects of fiduciary duty, arguing that rationality in terms of modern portfolio theory (MPT), with the goal of maximising portfolio returns, robs institutional investors of greater opportunities to meet their fiduciary duties. The view he presents asserts that rationality under MPT limits the ability of trustees of pension funds in three ways. The first, that rationality denies trustees the latitude to reasonably assess the objective and holistic well-being of beneficiaries. The second is that it impedes the scope, not only to recognise, but to act on alternate sources of investment return, and the third is that it hinders the ability of the trustees to fulfil the fiduciary duty of impartiality, consequently potentially treating current and future generations of beneficiaries unequally.

Richardson (2011), however, does not implore industry and academia to re-interpret fiduciary duty but rather to interrogate the central theme of fiduciary: to act in the best interest of beneficiaries. Richardson (2011) makes the point that while the trustees of pension funds are bound to act in the best interests of their members there is no requirement to inquire along those lines, which subsequently typically leaves obvious and deliberate breaches as the only events which initiate direct dialogue between trustees and beneficiaries. Richardson (2011) recognises that concluding the will of the beneficiaries may be difficult, and perhaps near impossible to achieve due the diverse nature of the group and perhaps their possible lack of knowledge and insight with respect to certain issues. However, Waitzer and Sarro (2014) suggest that trustees have a duty to consult and where it may be difficult to garner a consensus view of their beneficiaries, a board of trustees should appoint a trust advisor or the like. If anything, this will assist the fund in its demonstration of prudence, impartiality and commitment to executing decisions in the best interests of its beneficiaries (Waitzer & Sarro, 2014)

4 RESEARCH METHODOLOGY

4.1 Research Approach and Strategy

This research aims to understand why South African pension funds demonstrate little action with respect to RI. Given that the Amended Regulation 28 promulgated in 2011 calls for the consideration of RI within the scope of the pension fund's fiduciary duties, it becomes an important question as it speaks to both their fundamental role as well as to legislative requirements. Typically RI progress is most notable in other parts of the investment value chain, such as asset managers (UNEPFI, 2007; CRISA, 2013, Ernst & young, 2013). In addition, RI research in South Africa tends to have an investment or broad industry focus. As such RI research which uses pension funds as the focus of analysis offers the opportunity to provide unique insight into the RI landscape in South Africa. Additionally, given that pension funds in SA have approximately R4.2 trillion under their control (ASISA, 2014), with prudential requirements which allow up to 75% of the fund to be invested in South African listed equity (The Republic of South Africa, 2011) and the average value of the JSE All Share Index in 2014 at R5.7 trillion (Bloomberg, 2015), they are in a unique position to shape and influence the market and investment outcomes broadly. This begs further understanding around philosophy of pension funds particularly as it relates to RI.

Zhang and Wildemuth (2009) state that qualitative content analysis uncovers patterns, themes and categories significant to a particular social reality. Certainly within the responsible investment literature qualitative methods are popular approaches for this very reason. Much of RI research is focused on attitudes and changes in investment practices. Therefore qualitative methods, due to their intrinsic ability to take into account context as appropriate and deal with dynamic structures and paradigms, are typical research approaches (Strauss & Corbin, 1990, Locke 2001).

Hence a qualitative research approach is adopted in this dissertation, where primary data is collected through qualitative semi-structured interviews with key professionals who interact in varying capacities with pension funds and pension fund trustees. A variety of views on the topic of responsible investment in the context of South African pension funds have been sought and as such a cross section of individuals are interviewed.

In particular primary data, through semi-structured interviews, has been generated by way of content analysis techniques and the use of certain grounded theory principles and techniques. Grounded theory is particularly useful methodologically where little is known or where academic interrogation has been previously lacking (Goulding, 1999). It is in this context, that content analysis surfaces as a further useful tool. Neuendorf (2002) makes the case that research using content analysis techniques is moulded as the researcher deems necessary. Additionally content analysis also provides useful practical guides and perspectives which assist in navigating a grounded theory approach

4.2 Data Collection, Frequency and Choice of Data

Giamporcaro and Pretorious (2012) explain in their research on the adoption of environmental criteria in SRI in South Africa that interviewing is often necessary in this field due to a lack of media or academic sources. The same can be said of the topic of this research.

Therefore, semi-structured interviews have been deliberately chosen as the preferred data generation and collection method. By constraining the conversation loosely, the interviewer has the liberty to draw out unique and relevant perspectives depending on the role of the interviewee and additionally has the opportunity to guide the conversation depending on the interviewee's responses (Hove, S. and Bente, A, 2005)

The semi-structured interviews comprise ten parts, six of which cover the central themes underpinning the topic at hand. Part 1 is conducted as per Saunders, Lewis and Thornhill's (2007) guide to opening semi-structured interviews. Typically, semi structured interviews are non-standardised, which is the case in this research. However, while the interviews have been conducted in a non-standardised manner, a pre-prepared set of questions for each of the parts indicated below has been composed and can be found in Appendix Two. These questions were not adhered to religiously, but served as conversation pegs to guide the interview process as necessary. As Saunders et al (2007) explain, interviewers in semi structured interviews guide the conversation as necessary, changing the order of sections and questions where appropriate as well as adding and neglecting certain questions as appropriate. While Appendix Two provides the standard list of questions, the transcribed interviews, as seen in Appendix Three: The Interview Transcripts, provide evidence of the deviations one would expect to observe in a semi-structured interview environment.

Table 3 below shows the structure of the interviews. While the set of pre-prepared questions was not adhered to strictly, the structure of the interviews was held consistent across each interview. Having received ethics approval from the university, the necessary information was provided to interviewees in an interview brief circulated prior to the interviews and informed consent obtained verbally, in the first part of the interview.

Outline of interview structure

Part 1: Contextualising the interview
Part 2: Professional information gathered on each respondent
Part 3: Gathering of either organisation specific information or role of the type of organisation within the pension fund landscape
Part 4: Role of pension funds
Part 5: Fiduciary Responsibilities of Pension Funds
Part 6: Responsible Investment
Part 7: Corporate Governance and Stewardship
Part 8: Activity and trends in the industry on parts 5 -7
Part 9: Recommendations
Part 10: Closing comments

Table 3: Semi-structured interview outline

Each of the interviews took between 45minutes and one hour, and was recorded and transcribed for analysis purposes as suggested by Saunders et al. (2007). All interviews were one-on-one, with the majority conducted telephonically.

4.3 Sampling

The sampling method adopted is that of purposive sampling as explained by Jankowicz (2005). In particular, such a method is appropriate as it makes use of the key informant technique (Tremblay 1982, as cited by Jankowicz, 2005). For the purposes of this research, key professionals in the industry who have particular insight by way of interaction in specific capacities with pension funds and their trustees were selected to interview. As expected, an element of snowball sampling surfaced as a result of the interview process. In the case where some of the original interviewee candidates were unable to participate the suggestions of other interviewees were welcomed.

The appropriate number of interviewees in a sample depends on the nature of the research question (Jankowicz, 2005). Therefore, the sample size for this research was limited so as not to dilute the findings with the voices of potential interviewees who would not have had appropriate insight. This is not uncommon in research in this field where interviewing people with the appropriate knowledge and insight is key, often due to limited or specialised knowledge. By way of example Herringer et al. (2009) interviewed seven respondents when investigating challenges to RI in South Africa. This research follows a similar line of action in terms of sample size, resulting in a total of eight participants.

Although small and non-random, the sample of interviewees is able to provide a sufficiently representative industry view on the topic of RI. In order to obtain a broader view on the concepts at hand (RI in particular), the industry as a whole, and of pension funds and their trustees, the voices of those who interact in varying capacities with a range of pension funds and their trustees has been garnered. In this way a cross section of views of and on the industry and pension funds has been captured. This sampling pool includes people in key or executive positions of organisations and bodies which interact directly with pension funds and their trustees. The sketch of the participants below, including descriptions of role and organisation, evidences the desired characteristics. For the purpose of preserving confidentiality, in the interest of gathering views which were more frank (and not simply marketing or public relations blurbs) anonymity was assured.

Interviewee	Organisation Description	Role Description
1.	A professional body which promotes the interests of the retirement fund fiduciaries, including the boards of trustees and principal officers. Employees of retirement funds may join the body as affiliate members.	Chief executive officer: execute the mandate and objectives as set by the directors. Responsible for the operation and management of the organisation. Fulfils the role of the secretariat.
2.	An organisation which represents the interests of all stakeholders in the retirement fund industry, from members and beneficiaries of retirement funds to trustees,	Chairperson of the research sub-committee: steer and direct the

	asset managers and government. The main objectives are: to aggregate information across various stakeholder groups, influence and drive policy where appropriate, and comment publically regarding matters which involve the retirement fund industry, particularly around government publications and announcements. The organisation is made up of various sub committees commissioned by the board, constituted by various stakeholders.	aggregation of selected topics and information.
3.	A global initiative, based in the United Kingdom, but with regional representation, it acts as conduit which facilitates institutional investors to integrate ESG through the sharing of best practices, mentoring, the provision of materials and the hosting of conferences.	Regional network manager: represent the organisation in the region. This includes raising awareness and lending support.
4.	The research institute of a leading retirement funds consulting and administration provider and corporate health consulting business in South Africa. The institute looks at the full spectrum of issues which confront savings and investment issues for South Africa.	Senior research analyst: Authored and responsible for the majority of publications on topics regarding employee benefits. The work includes collaborating with the various investment teams
5.	Independent consultant on the pension fund industry, investment, and sustainability reporting. Work includes publications used by the industry, and previous experience includes sitting the board of trustees of retirement fund.	Strategic Consultant: Advise bodies involved with pension fund work, RI, and otherwise

6.	The organisation is an industry body which represents the majority of South Africa’s asset managers, collective investment scheme and management companies, linked service providers and life insurance companies. The organisation’s mandate includes partnering with stakeholders in the financial services industry to proactively engage on policy, regulation, and other important issues of common concern	Senior Policy Advisor: Advise the organisation on policy recommendations. Make and oversee any proposals regarding regulation, such as Regulations 28.
7.	A full suite African focused law firm with multiple branches throughout Africa, originating in South Africa. The firm does everything from corporate transaction work, through to litigation and employment law. The firm has the largest and most established pension law practice which deals with pension fund governance, advisory services including training and application advice, as well as litigation.	Senior Associate: directly involved in advising, training, and litigation on behalf of pension funds.
8.	Previous: A large, established defined benefits pension fund Current: a leading South African asset manager	Previous: Chief investment officer Current: Investment strategist and ESG analyst

Table 4: Interviewee descriptions

As Table 4 illustrates the interviewees cover industry relatively well from a pension fund and investment industry bodies’ perspective to RI experts and independent advisors.

4.4 Data Analysis Methods

Similar to other research in this field the transcribed interviews have been analysed through a process of grounded theory and content analysis. Acknowledging that grounded theory can

allow for an iterative interview process, the guide of procedures provided by Saunders et al. (2007) according to Strauss and Cobin (1998, as cited in Saunders et al. 2007) has been followed loosely, while the philosophy of the theory of grounded theory as a strategy rather than a rigid set of procedures has been maintained.

The set of procedures as described by Strauss and Cobin (1998, as cited in Saunders et al. 2007) includes three primary steps before the summarising and discussion of conclusions. The first step, open coding, simply refers to the consistent categorisation or unitisation of the data gathered by way of interviews and generated simultaneously through content analysis techniques. The second step, axial coding, depends on the first and specifically looks for relationships and interactions between any of the categories of data established in the first step. The third and final step, selective coding, involves the selection of principle categories around which other categories and relationships emerge. It is at this point that findings and the subsequent discussion regarding findings features.

4.5 Research Reliability and Validity

Reliability

Concerns around reliability are inherent in the nature of non-standardised interviews or questioning. However, as Saunders et al (2007) point out, typically research using such techniques is not necessarily meant to be repeatable. This is the case with the research at hand, as it reflects the views and environment regarding a particular topic during a particular period in time. For the purposes of this research, the fact that the research findings may not be replicable during another time period simply supports the need for the research question. The qualitative nature and non-standardised interviews allow for the flexible approach needed when engaging with complex and dynamic topics and questions (Marshall and Rossman, 1999, as cited by Saunders et al., 2007). That being said, appropriate steps are taken, as suggested by Saunders et al. (2007), to ensure sufficient rigour to the interview process. Elements such as the provision of an interview brief explaining the nature and purpose of the research, the inclusion of the structure of the interview prior to the interview, sound organisation with respect to the setting up and conducting of the interview (the majority of the interviews were conducted telephonically), and the electronic recording of the interviews all contributed to the necessary rigour. Lastly, assurances of anonymity provided greater transparency.

Validity

Semi-structured interviews provide the interviewer with the opportunity to clarify and probe interviewees with respect to certain responses. In essence, such a process allows for the calibration and validation of the interviewees responses during the course of the interview. By the very nature of the grounded theory approach, and content analysis techniques, refinement of facts and ideas allows for the crystallisation of themes. More importantly though, the iterative nature and emphasis on cross checking, introduce appropriate validation by way of fact checking where participants have based views on certain predetermined ideas. Again, assurances of anonymity contribute to the accuracy and openness of responses, which support the validity of the information gathered.

5 RESEARCH FINDINGS

The following section presents the findings drawn from the interviews. The results are presented together with preliminary comment ahead of the discussion section so as to contextualise other findings. The results are presented under five topics: first, the role of pension funds; second, the fiduciary duties of pension fund trustees; third, accountability; fourth, trustee competency; and lastly fund characteristics. Findings are presented in a dual fashion where applicable; presenting the opinions of the interviewees as well as presenting the perspective of the interviewees in terms of their view on the progress and perspectives of pension funds.

5.1 The role of pension funds

The interviewees identified four roles of pension funds: institutions for savings for income on retirement of members, allocators of capital, part-owners of companies, and providers of social security. The bar charts in Figure 5 and Figure 4 provide a view of the personal and respective institutional views of the interviewees in this regard, as well as the interviewees’ opinions with respect to the perspective of pension fund trustees. ‘Yes’ indicates that the interviewee believes that the category in question is a role of pension funds. ‘No’ indicates the opposite view, while ‘Maybe’ indicates that there is some ambiguity or caveat.

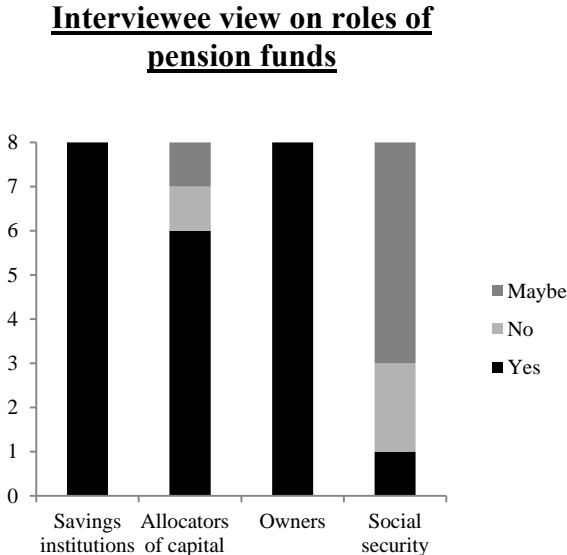


Figure 5: Bar chart showing the count of interviewees’ views on the roles of pension funds

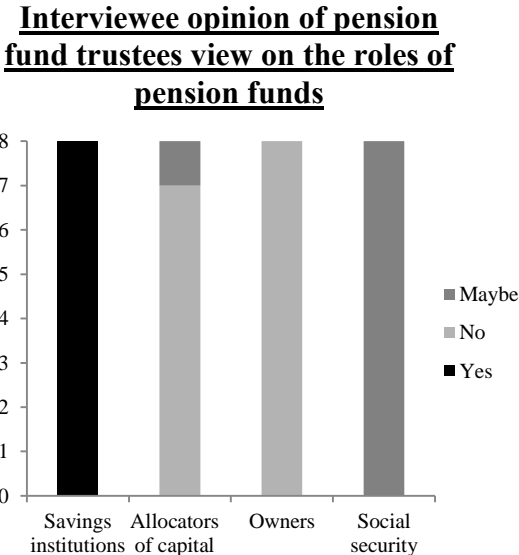


Figure 4: Bar chart showing the count of interviewees’ views on the opinions of pension fund trustees on the roles of pension funds

A caveat which is worth mentioning is that due to the nature of the question posed (see Appendix Two for interview questions), interviewees on occasion did not respond fully with

respect to the role of pension funds; sometimes conflating the role of the pension fund with the function of the board of trustees. For the purposes of analysis, this is not necessarily problematic as the justifications for the roles identified rather than the number of interviewees explicitly in support of certain roles are more important. In addition, through responses to other questions, interviewees’ perspectives could also be established to a certain degree.

Results and rationale for each of the roles are set out below. In addition, further results are presented on why the role as allocators of capital role can be considered valid and why some interviewees were hesitant to acknowledge it.

5.1.1 The role of pension funds as savings institution for income on retirement

All interviewees acknowledged the primary role of pension funds as savings institutions in order to provide an income on retirement for members, benefitting both members and beneficiaries.

5.1.2 The role of pension funds as allocators of capital

All interviewees acknowledged that pension funds are in a unique position due to the capital under their control. This view however was consistently emphasised by all interviewees as a secondary consideration to the role of pension funds as savings institutions, albeit an important one. While the views of the interviewees are generally positive with respect to this role, the interviewees generally did not have the impression that the pension fund trustees understand that pension funds have a role as allocators of capital.

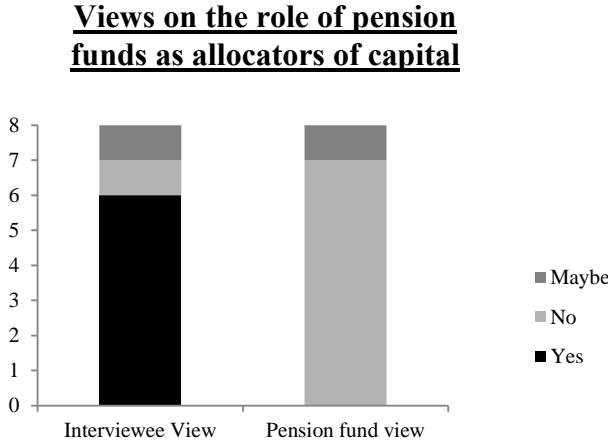


Figure 6: Bar chart showing the interviewees’ views as well as their views on the perspective of pension fund trustees on the role of pension funds as allocators of capital

The views of the interviewees are grouped into three categories. Where interviewees did not commit fully to the notion that pension funds have a role as providers of capital (seen in Figure 6 as ‘No’ and ‘Maybe’ responses), the interviewees’ primary concern centres around the need to focus on what they consider to be the sole purpose of the fund- namely, that of a savings facilitator. The long term nature of pension funds and the nature of the institution are the two reasons provided by interviewees who felt that pension funds should acknowledge their roles as capital allocators. Each of these three positions is explored below.

5.1.2.1 Focus on sole requirement

Two respondents were hesitant in committing to any role pension funds may have in the allocation of capital. The first respondent repeatedly emphasised the sole role of pension funds as related to income on retirement, although did address investing in such a way that the optimal environment is created for members and beneficiaries. This could be interpreted as a contradiction. This interviewee stated that trustees should pose the following question: ‘is this good for our members, is this good for our society at large?’ The second respondent focused on their interpretation of what the South African Pension Funds Act mandates (preserving and growing members’ funds), and therefore felt extrapolation should not be encouraged.

5.1.2.2 Long term nature of the capital pool

Three respondents highlighted the unique nature of pension funds, in that the liabilities of pension funds are of a long term nature. This consequently provides the opportunity to invest in longer dated assets. A typical example of longer dated assets is investment in infrastructure development. Due to the longer time horizon their rationale is that pension funds should recognise the ability to influence and drive the economy in certain areas. One respondent commented that due to the obligation of pension funds to benefit the member, the pension fund has a derived obligation in the allocation of its capital to at least assist in the development of the South African economy to the benefit of its members. This view is explored further in section 5.2 on Fiduciary duties of pension fund trustees.

5.1.2.3 Nature of the institution

A further three respondents believed that pension funds have a responsibility with respect to the deployment of capital due to the nature of the legal entity. The first aspect noted is that pension funds are juristic persons, and as such the South African constitution applies horizontally to funds and the funds are therefore bound by the Bill of Rights. Consequently this makes pension funds more of a social entity as compared to pension funds in the United States of America, which have a more capitalist imperative. As a non-profit entity, which disallows for profit hunting and rent seeking, and as an entity which should possess a social conscience, the allocation of capital should be an important aspect of the decision making of pension funds.

The second aspect relates partly to the long term nature of the obligations of pension funds. The long term nature of the liabilities necessitates the allocation of capital so as to ensure the sustainability of continued returns and income in retirement for the individual member at some point in the future.

The third aspect presented by interviewees in this camp relates simply to the fact that pension funds are typically the key stakeholder in the investment chain, because they are the owners of the assets of which they are custodians on behalf their beneficiaries. By virtue of this position, the power pension funds hold is accompanied by a responsibility with respect to allocation of capital.

Interestingly all interviewees who supported the roles of pension funds as allocators of capital, as well as the entities referenced in their responses, framed the concept of pension funds as allocators of capital in terms of development capital or infrastructure spend. One interviewee did posit that capital can be used positively for society (from an environmental or social impact perspective) more broadly than what is simply understood by development capital. None of the interviewees articulated any view with respect to the deployment of capital which directly affects members positively or negatively today, or in the near future. There was no recognition that capital could or perhaps could not be deployed in a way that is aligned to the desires of the members of the fund, from a practical perspective.

All interviewees barring one expressed the opinion that pension funds have little understanding or demonstrate limited recognition that they have or can have a role with respect to the allocation and deployment of capital to whatever end. The GEPF and Eskom Employee

Provident and Pension Fund (EPPF) are typically cited as the only pension funds whose behaviour demonstrates acknowledgment. One interviewee recognised that union funds are usually reasonably connected to the community that they serve and, from time to time, these funds exhibit behaviour which demonstrates an understanding of the influence the funds have with respect to where the fund’s capital is allocated. Most interviewees attributed this result to mind-set and, in the case of considering longer dated assets, liquidity concerns. In addition, the fact that a trustee may only sit on a board for a term of two years and therefore will not see the fruit of a longer dated asset under his or her watch does not necessarily encourage such thinking. Lastly interviewees commented that boards of trustees often transfer responsibility for a range of issues to their service providers. This distances the trustees from investment decisions as well diminishes the opportunity for trustees to fully realise and understand the position and influence of the fund.

5.1.3 The role of pension funds as part- owners of companies

All eight interviewees responded positively with respect to pension funds as part-owners of companies, although most acknowledged that this is not an area which has attracted much interrogation by them personally, or by their organisations. The results below reflect the industry perspectives on whether pension funds do or do not have a role as part-owners of companies. Establishing industry and trustee perspectives on this is important as it informs the degree to which engagement takes place in the context of active ownership as discussed in the background section 2.5 on responsible investment strategies

Views on role of pension funds as part-owners of companies

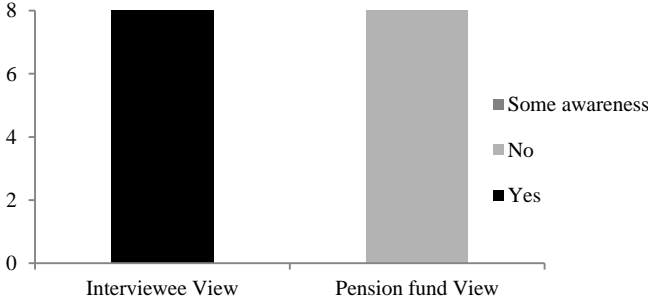


Figure 7: Bar chart showing the interviewees’ views as well as their views on the perspective of pension fund trustees on the role of pension funds as owners of companies

Figure 7 shows the results are binary in that all the interviewees think that pension funds should assume the responsibilities of asset owners, and in particular, of as part-owners of companies. Yet, all interviewees are of the opinion that pension fund trustees do not view one of the roles of pension funds as part-owners of assets and companies. The reasons provided for this disjuncture have been identified as: problems with trustee competency, difficulties with resource allocation, and the length of the value and the spatial construct of the industry. While of these reasons are addressed as issues in sections (5.2.1.3, 5.2.1.5, 0, 0), they are briefly addressed here as well as interviewees linked these topics to the role of pension funds as part-owners of companies.

The varying levels of education and experience of the trustees may dampen discussion as well as possibly decelerate any progress on acknowledging and implementing policies in this respect. Section 0 provides more detail on how lack of education and experience of trustees detracts from the full functioning of the fund. In addition, the resources needed and cost to behave as owners, in staying well-acquainted with what is owned, may be too onerous for a pension fund to carry. However, since this hasn't necessarily been explored by the funds themselves, this could be seen as conjecture. Thirdly, the length of the value chain often results in trustees feeling far removed from the ownership or investment decision making. While this may serve as an explanation, it is not necessarily legally valid due to the responsibilities of trustees and funds. Lastly, when considering funds' relationships with asset managers, structural issues within the industry can shift the balance of power away from pension funds. Due to the size of some funds and the need for diversification it is not always possible for each pension fund to hold segregated mandates with asset managers and thus pension funds may only be able to invest through pooled-vehicles. The result of which is that, the assets are not held in the name of the pension fund at the custodian level, but rather the asset manager. Again, while this may be an explanation it is not necessarily justified, as interviewees reiterated that legal responsibility lies with the board of trustees, and asset managers should perhaps be persuaded to change and align with newly identified needs.

5.1.4 Social Security

**Views on the role of pension funds
in the social security system**



Figure 8: Bar chart showing the interviewees’ views as well as their views on the perspective of pension fund trustees on the role of pension funds with respect to social security

The interview questions did not address the topic of social security explicitly. However, a number of interviewees addressed it of their own accord in their response to the role of pension funds. The interviewees’ responses are shown in Figure 8 in the following categories: ‘core focus’, ‘non-core focus’, and ‘ambiguous’. ‘Core focus’ speaks to the notion that social security is core to the role of pension funds and has equal importance to and interactive relevance with other components of the country’s social security programme. ‘Non-core focus’ emphasises the view that pension funds should be viewed separately to other social security measures in that they exist in their own right and for their own purposes. The interviewees who expressed this view were of the opinion that pension funds should not be used to bulk up other factors or act as proxies for other social security needs. The final category represents those views where either the interviewee did not address social security directly (this does not necessarily mean that he or she does not believe it to be a component) or where the interviewee stated that pension funds have an important role to play in the security system, just not a primary one.

Most interviewees (those in the ‘ambiguous’ category) had relatively agnostic views or did not share their views. All, however, addressed the fact that through their primary function pension funds do address a distinct component of the social security system that being the provision of income on retirement and old age for those citizens previously employed.

5.2 Fiduciary duties of pension fund trustees

Fiduciary duties are core to the role and function of the trustees (as discussed in section 2.4). It is therefore important to understand the position of trustees regarding fiduciary duties with respect to three key areas: first, awareness and understanding; second, interpretation; and third, the relationship to the preamble to Regulation 28. These aspects can be considered as drivers of trustee behaviour with respect to RI. Underlying reasons in the case of the lack of awareness and understanding, understandings in the case of interpretation of fiduciary duties, and possible causes for the lack of digestion of the preamble to Regulation 28 are unpacked.

5.2.1 Awareness and understanding

All interviewees felt there was awareness on the part of trustees that they assume fiduciary duties on fulfilling the office of trustee. However, not all interviewees felt that the significance of these duties is adequately understood by the trustee.

Views on trustee awareness and understanding of their fiduciary duties

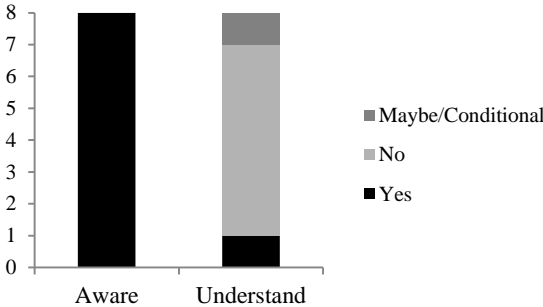


Figure 9: Bar chart showing the interviewees’ views on whether they believe trustees are aware of and understand their fiduciary duties.

Six of the interviewees are of the opinion that there is insufficient depth of knowledge and understanding on the part of trustees with respect to their fiduciary duties. The remaining two interviewees were divided. The first expressed the view that experienced trustees have a comprehensive view and understanding of fiduciary duties, although practical implementation of this enhanced understanding is not always evident. The second is of the opinion that trustees do have a sufficient understanding of their duties according to the interviewee’s understanding of what those duties include; in particular that fiduciary duties are restricted to maximising returns and as such is categorised as ‘Yes’ in Figure 9 with respect to understanding. Six common underlying reasons were identified as to why understanding may be lacking. This

dissenting view is included in the analysis below and is represented in the categories ‘legal and legacy interpretations by the industry,’ as the interviewees are of the opinion that the legal interpretation is to maximise returns only. Figure 10 shows the count of interviewees who indicated that the particular reason referenced explains the lack of understanding.

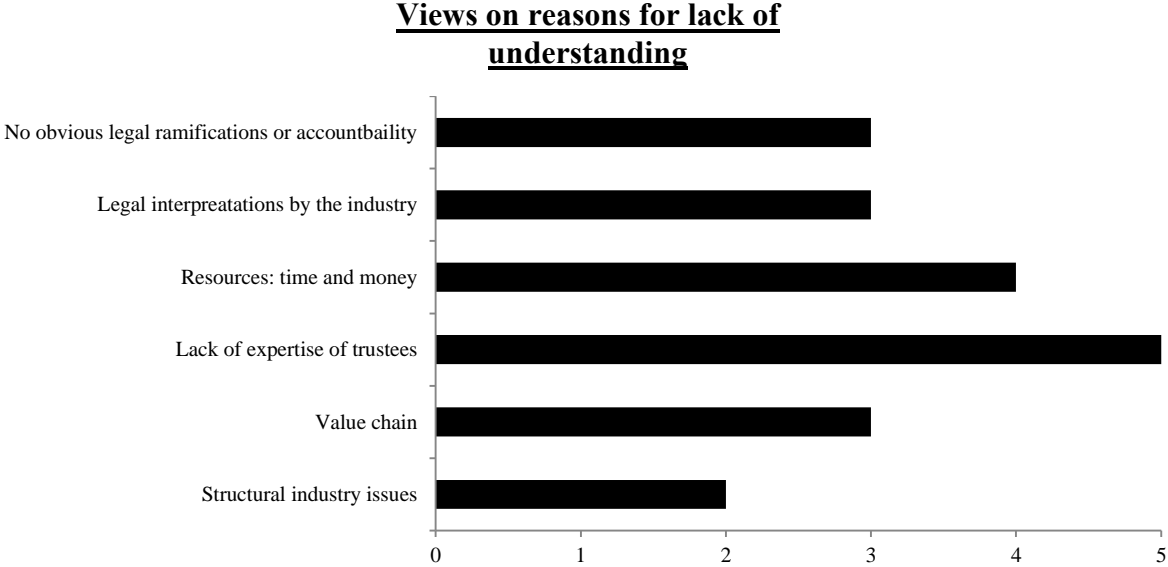


Figure 10: Bar chart showing the interviewees’ views on why trustees lack understanding with respect to their fiduciary duties.

5.2.1.1 Reason one: No obvious legal ramifications or accountability

Interviewees highlighted that the industry is a heavily regulated one, with legacy behaviour which seeks to meet legal requirements. The three interviewees purport that unless there is a legal imperative accompanied by an accountability factor on any issues which fall within the ambit of fiduciary duties, trustees would not identify the need for interrogation of the issue.

5.2.1.2 Reason two: Legal interpretations by the industry

Here interviewees referred to three areas: legacy issues, belief that fiduciary duties only include maximising returns, and what the Pension Funds Acts mandates. From a legacy perspective the previous Regulation 28 of the South African Pension Funds Act spoke only to parameters with respect to investing in certain asset classes. The recent amendment, including the new preamble, remains a guideline with respect to parameters. The mentality therefore remains one of compliance with these guidelines and a degree of ignorance regarding the preamble. The mind-set that fiduciary duties extend only to maximising returns limits any potential opportunity for interrogation of either consolidating or amending this view. The interpretation of the mandate

by the Pension Funds Act was also felt to restrict any interrogation (see results in section 5.1.2.1).

5.2.1.3 Reason three: Resource allocation (time and money)

Many interviewees felt that the lack of understanding and interrogation can be attributed to an insufficient allocation of time and resources on the part of the trustees. With respect to time, interviewees felt that even though the typical meeting agenda holds many issues which need to be addressed, all items relating to decisions which need to be made from a fiduciary duties perspective should be given an adequate and appropriate platform. Apart from time constraints, four interviewees also expressed concern that the trustees and consultants do not always manage the time available well and prioritise agenda items poorly. Although interviewees acknowledge that trustees often have to attend to other duties, particularly with respect to issues surfaced by the pension fund reform, trustees set their own time parameters and have the authority to allocate more time, whether through additional meetings or within already scheduled meetings, to issues they feel are important. While some interviewees offered time constraints as an excuse, others felt that if time is not allocated to certain issues, breaches of fiduciary duties could occur. Furthermore if trustees are not fully aware of what potentially falls within the ambit of their fiduciary duties breaches are more probable. Similar issues arise with respect to cost and money. However, almost all interviewees drew a distinction between DB and DC funds, as well as larger and smaller funds, explaining that in each pair, the former is more likely to have room in their budget to attend to issues such as understanding fiduciary duties.

5.2.1.4 Reason four: Lack of trustee expertise

The five interviewees who highlighted lack of expertise pointed to three issues. The first being the employee representation on the board of trustees. The second, a lack of professional trustees, and the third, the general level of expertise in a specialised area. Interviewees provided anecdotal evidence of many situations where employee-elected trustees have had low levels of education and potentially lacked the sophistication to apply their minds to concepts like fiduciary duties. This is not necessarily because of lack of capacity, but can be attributed to the bombardment of unfamiliar information accompanied, perhaps, by a deficiency in the tools and skills necessary to understand the industry. Even for those representatives on the board, employee or employer elected, who are professionals and have higher levels of education, the industry is a complicated one with many nuances, and much to absorb, learn and interpret. Typically South Africa does not have professional trustees, who are well-versed in their duties

as a trustee and who hold and transfer institutional knowledge as appropriate. Given this, interviewees also thought that the turnover of trustees on a board does not ensure development of understanding, philosophies, and processes. Rather it perpetuates a vacuum in areas which need attention resulting in the need for continuous education of trustees on basic issues which can detract from trustees' time and attention to the business of the fund.

5.2.1.5 Reason Five: Value Chain

The length of the value chain and confusion with regard to where responsibilities lie, may contribute to the neglect of the interrogation of responsibilities. Generally, interviewees vacillated between placing greater responsibility and reliance on asset consultants or asset managers. Or in some instances interviewees simply acknowledged that due to the length and intricacies of the value chain, many trustees feel removed and distant from consequences and responsibility. However, as mentioned in section 5.1.2.3, interviewees reiterated that legal responsibility regarding fiduciary duties lies with the trustees.

5.2.1.6 Reason Six: Structural industry issues

Interviewees emphasised that the number of issues pension funds are currently attempting to tackle, crowd out resources which would potentially be used to place more focus on the interrogation and understanding of fiduciary duties. These issues often relate to the pension fund reform.

5.2.2 Interpretation of fiduciary duties

Of the eight interviewees, seven feel strongly that the interpretation of fiduciary duties of a trustee is broader than simply maximising investment returns. However, in their representation of the views of pension funds, all interviewees indicated that they are of the opinion that pension fund trustees view their fiduciary duties as only maximising returns (as seen in Figure 11) and while they may acknowledge other responsibilities held by the trustees, they do not necessarily place these within the ambit of their fiduciary duties. This supports the results in section 5.2.1 on awareness and understanding of fiduciary duties by trustees, where interviewees feel that trustees do not have a good understanding of fiduciary duties.

The analysis below sets out the prominent views the interviewees hold in this regard. It is important to note, that of those interviewees who believe that fiduciary duties are broader than maximising returns, not all provided clear articulation as to why they feel it is broader or what

argument could be presented to justify this position. Therefore when considering the views described below and as seen in Figure 12, it is important to consider that there may be other views and that there may also be stronger support for the various categories of views presented. This does not necessarily dilute the validity of the theories presented below in justification of a broader view of fiduciary duties than simply maximising returns.

Interviewee views on scope of fiduciary duties

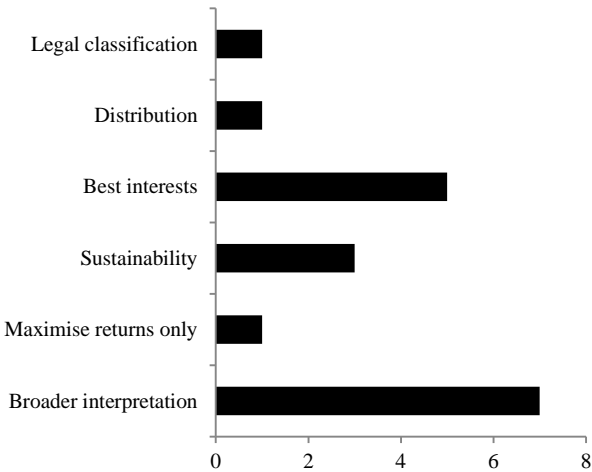


Figure 12: Bar chart showing the interviewees’ own views on themes within the scope of fiduciary duties

Interviewee perspectives of trustee views on scope of fiduciary duties

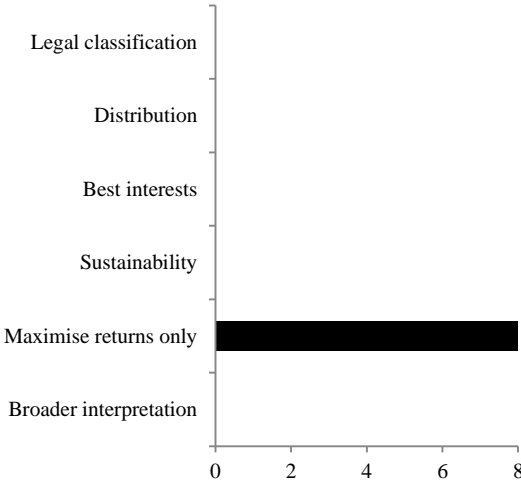


Figure 11: Bar chart showing the interviewees’ perspectives of what trustees understand fiduciary duties to encompass

The four most well- developed theories provided to justify broader interpretations of fiduciary duties relate to: sustainability, the best interest of the members and their beneficiaries, issues around distribution, and the legal classification of pension funds. The rationale pertaining to each justification are presented in turn.

5.2.2.1 Theory one: Sustainability

The case presented by interviewees for support regarding sustainability with respect to companies as a justification pivots around the requirement for sustainable returns on the capital invested by pension funds. Due to the long term nature of the liabilities of current members (as discussed in previous results section 5.1.2.2 and 5.1.2.3) sustainability becomes an important consideration. Furthermore sustainability is also important because of the aspect of impartiality embedded within fiduciary duties of pension fund trustees, since trustees need to act in the best interest of both current and future members and beneficiaries. Hence all three interviewees address two main issues regarding investing within a sustainable framework. Firstly, investing

in this manner would ideally ensure that corporations address the ESG issues within their companies and operating environments, such that they remain on-going concerns, which are able to operate and produce returns as their environments change. The second aspect would be to ensure that companies address ESG issues such that they contribute to the existence of operating environments which make business and therefore investment generally possible in the present as well as into the future. This typically speaks to the curbing of negative externalities, for example, as well as the addressing of areas of society and the economy where there is a deficiency and therefore lack of support for economic growth and well-being.

5.2.2.2 Theory two: Best interests of members and beneficiaries

The phrase used to capture the fullness of the fiduciary duties of pension funds is that trustees need to ‘act in the best interests of their members’. The five interviewees all agreed that best interests refers to more than simply maximising returns. While two interviewees’ responses were simply to agree that broader social and other issues be included, the remaining three interviewees articulated their perspectives more fully. Their premise being that ‘best interests’ as a term is not restricted to one thing only, and that in the full scope of fiduciary duties, no mention is made of maximising returns as a necessity or as the fulfilment of ‘acting in the best interests of’. Furthermore recognising that the capital in pension funds is the capital of the ordinary man and woman on the street who have real needs and desires, best interests can also refer to the understanding and, where appropriate and possible, the meeting of some of those needs and desires.

Interestingly the interviewee who believes that fiduciary duties relate only to maximising returns did raise the issue that trustees should ask questions around what type of society and environment should be created for the people whose money is being invested (discussed in section 5.1.2.1).

5.2.2.3 Theory three: Distribution of benefits to members

Only one interviewee raised the distribution of benefits to members within the interpretation of fiduciary duties. However, providing income to members on retirement is essential to the pension fund fulfilling its primary role. In ranking importance of items to address within fiduciary duties the interviewee therefore listed optimal returns as the top priority followed by the correct distribution of the benefits to the pension fund’s members and beneficiaries where appropriate.

5.2.2.4 Theory four: Legal classification

Many of the views expressed relate to the legal standing of a pension funds. This idea is also presented relating to the role of pension funds in section 5.1.2.3. However, in this case, one interviewee expressly articulated the view that pension funds are non-profit entities, and are, like companies, considered juristic persons. This is significant in that as a non-profit entity a pension fund need not be derailed with activities which enhance profit hunting for example. In addition, as a juristic person, the bill of rights applies horizontally. This implies that pension funds have far more of a social responsibility than society might recognise. Interestingly, the interviewee whose views are categorised ‘maximising returns’ as the epitome of fiduciary duties added a caveat that care should also be taken as to where the funds are invested and the subsequent larger societal affects (as seen in sections 5.1.2.1 and 5.2.2.2).

5.2.3 Preamble to Regulation 28

The Preamble to Regulation 28 of the South African Pension Funds Act specifically addresses RI in relation to the fiduciary duties of the fund and its trustees, with respect to acting in the best interests of those for whose assets they are responsible (The Republic of South Africa, 2011). In this regard none of the interviewees were of the opinion that pension funds have acknowledged, processed and incorporated Regulation 28. All interviewees provided a variety of reasons to support their view.

Figure 13 and the analysis below presents the interviewee’s reasons given for why they thought there was a lack of acknowledgement and application by pension funds of RI as found in Regulation 28. They fall into nine categories and in no particular order they are: one, lack of understanding of RI; two, legacy understanding of Regulation 28; three, the crowding out of RI due to other issues; four, the lack of engagement by asset consultants; five, lack of understanding of fiduciary duties; six, lack of guidance from the FSB; seven, lack of demand from members; eight, lack of reporting requirements; and nine, lack of innovative solutions from asset managers. It is important to note that the reasons are not necessarily mutually exclusive

Interviewee views on reasons for lack of acknowledgement and application of RI in Regulation 28



Figure 13: Bar chart showing the interviewees' reasons for the lack of acknowledgement and application of RI as found in Regulation 28

5.2.3.1 Lack of understanding of RI

Most interviewees acknowledged a deficit in the understanding of RI as described in Regulation 28. This speaks more broadly to a lack of understanding of RI in general. One interviewee differentiated between the understanding of principal officers and other trustees, noting that many principal officers have an adequate understanding of Regulation 28 and RI even if there may be uncertainty with respect to implementation. Some interviewees expressed the view that the market has an implicit understanding that RI means forgoing investment returns. They purport that this understanding consequently leads to hesitancy on the part of trustees to further explore the topic of RI. In addition there is a limited understanding of RI approaches and strategies. Interviewees cited that typically trustees still think that negative screening is the only approach. Many interviewees cited the guide published by the Sustainable Returns Project: Responsible Investment and Ownership as a critical document in promoting RI within pension funds as set out in Regulation 28.

5.2.3.2 Legacy understanding of Regulation 28

Many trustees and consultants still view Regulation 28 as a set of rules regarding investment limits on categories of asset types with which to comply. Similar to the comments around legal interpretations by the industry with respect to awareness and understanding of fiduciary duties

(section 5.2.1.2), the legacy interpretation of Regulation 28 hinders interrogation of what the preamble prescribes.

5.2.3.3 Crowding out of RI due to other issues

The pension fund and its trustees experience continuous pressure resulting from the number of issues that need to be addressed. Often this results in what may appear to be less pressing issues being relegated to lower positions on the agenda of pension funds, for example RI. While this may be the case, one interviewee countered this notion, highlighting the fact that trustees have a duty to attend to all issues which fall within the ambit of their fiduciary duties. As Regulation 28 makes specific mention of fiduciary duties and the relation to RI, the trustee therefore has no excuse not to address RI and the preamble, despite the potential plethora of other issues which demand attention.

5.2.3.4 Lack of engagement by asset consultants

Interviewees had somewhat conflicting views in this case. While almost all interviewees agreed that more engagement by asset consultants on the topic of RI would certainly encourage and assist trustees in processing and assimilating the RI requirement, the ultimate responsibility lies with the trustees of the pension fund. Those interviewees who disagree with placing the responsibility on the consultants are generally of the opinion that the demand and request needs to originate from the board of trustees. Two interviewees, whose opinions are counted as positive for this response, likened the situation to a ‘chicken and egg’ conundrum. Another interviewee remarked that although the ultimate responsibility lies with the board of trustees, , in their role as advisors consultants do have some, even if limited, responsibility to address the preamble to Regulation 28. At the very least they should make the board aware of its contents. Due to some of the other factors explored, including lack of trustee expertise accompanied by turnover (see section 5.4), some interviewees advocated for consultants to bring the RI agenda to the table, and direct the focus of trustees. However there was consensus with regard to the current experience generally that if the RI agenda was not raised by the trustees the consultants would not pursue the topic.

5.2.3.5 Lack of understanding of fiduciary duties

This links to the earlier results section on fiduciary duties (section 5.2.1). Given a lack of understanding of fiduciary duties and that the preamble is framed within the context of fiduciary

duties, it is natural that there would be a hindrance to the assimilation of the preamble Regulation 28.

5.2.3.6 Lack of guidance from FSB

Interviewees tended to frame their responses as suggestions. The first interviewee suggested that a FSB notice, requesting that pension funds demonstrate what they've done to address the aspects the preamble presents to the pension fund, should be published. In a similar vein the second interviewee suggested that a requirement to articulate an investment philosophy which includes RI be included in a revised PF 130 Circular (see section 2.1). The remaining two interviewees preferred a guidance note from the registrar as opposed to stringent reporting requirements. Reporting on RI is addressed later (in section 5.3.1) as a key theme extracted from the interviews.

5.2.3.7 Lack of demand from members

The two interviewees who highlighted this reason, specifically dealt with a lack of empowerment of the end beneficiary and actual member to galvanise the entire investment chain. One interviewee recommended that a change in the reporting of the activities, decisions and position of the pension fund to the FSB and to the members themselves, could assist in such empowerment and thereby encourage the demand for RI. This is also addressed in section Reasons for on reasons for support of reporting.

5.2.3.8 Lack of reporting requirements

Although reporting is addressed in a dedicated section (section 5.3.1.1), it is worthwhile noting that most interviewees thought that the lack of reporting requirements contributes towards the deficiency in addressing what is set out in the preamble. However, most saw some sort of reporting requirement as a proxy for accountability rather than a necessity in and of itself.

5.2.3.9 Lack of innovative solutions from assets management

Although not a common response, the idea that asset managers can assist pension funds in the fulfilment of the preamble is not contrary to what is currently observed in the market, as discussed in the background and literature review sections (sections 2 and 3). The interviewee who offered this as a reason presented what could be considered an example of a novel. One possible solution or product would be the provision of funds which specialise in particular areas of environmental or social concerns. Governance is more overarching and thus should be

applied to all companies regardless of the fund. Specialised funds would perhaps allow for the opportunity for pension funds to select asset managers and funds within which to invest using a building block approach. These specialised funds would be treated much like specific asset class funds in the sense of creating balanced or multi-asset funds.

5.3 Accountability: reporting and spatial structure of the industry

The following section deals with interviewee responses to accountability, firstly with respect to reporting and regulation and secondly with respect to asset managers and asset consultants. The first covers the potential method of increasing accountability through reporting, presenting views for and against this course of action. The second addresses accountability through the value chain, looking particularly at advisory services, legal responsibility, education and independent accountability.

5.3.1 Reporting and Regulation

Most references to accountability by the interviewees were focused on either changing regulation or regulating reporting requirements. As seen in Figure 14 the majority of interviewees were in favour of reviewing and possibly changing current regulation or reporting requirements. While six interviewees were in favour, it must be noted that many of the reasons in support of change were accompanied by caveats which are covered in these results. One interviewee felt strongly that current regulation is adequate and that further regulation around reporting would not be constructive. The remaining interviewee (represented in the ‘no comment’ category) did not give a definitive indication of their view.

It is worth highlighting that many of the interviewees reiterated the fact that the preamble to Regulation 28 is articulated intentionally to introduce principles thinking and an element of following the spirit of the law rather than the prescriptive ‘tick box’ approach.

Interviewee views on whether regulation should be changed to enforce more RI action

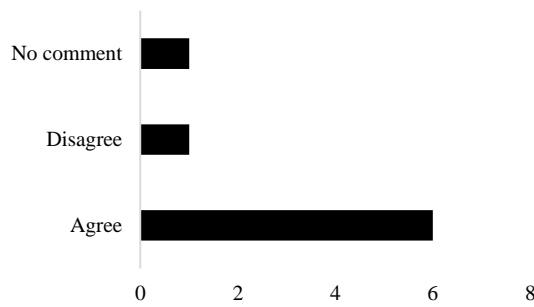


Figure 14: Bar chart showing the interviewees’ views on whether they agreed or disagreed with further regulation in respect of RI to advance action

Three primary reasons were presented by interviewees for more stringent regulation or reporting requirements, support for which can be seen in Figure 15. Three main reasons against more stringent regulation or reporting requirements were also put forward as seen in Figure 16. Many interviewees who indicated that they were in support of change with respect to more stringent regulation or reporting requirements acknowledged the reasons cited for resistance to change, but maintained that the reasons for change offset those against change.

Interviewee reasons for support of increased regulation on RI

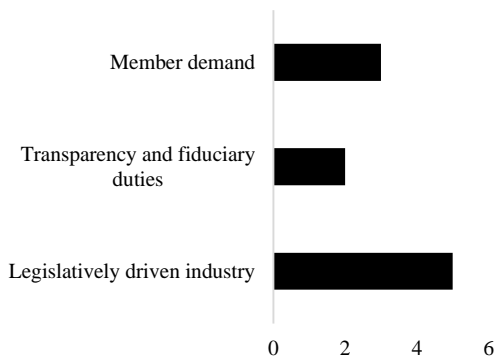


Figure 15: Bar chart showing the count for interviewees’ reasons for support of increased regulation in RI

Interviewee reasons against increased regulation on RI

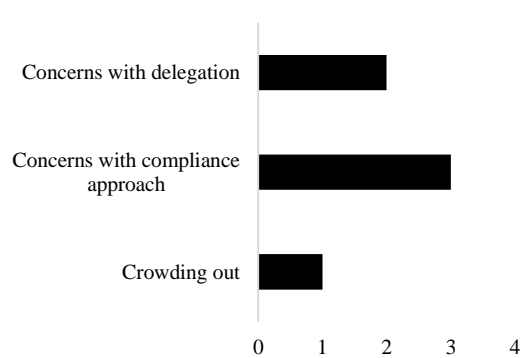


Figure 16: Bar chart showing the count for interviewees’ reasons against increased RI regulation

5.3.1.1 Reasons for increased regulation

The three primary reasons identified for increased regulation on RI could be grouped as follows: one, legislative driven industry; two, transparency and fiduciary duties; and three, member demand. Figure 15 shows the count of interviewees who indicated each of the three primary reasons in support of greater regulation. One interviewee did not provide views on regulation

or reporting. The count therefore should be considered as six out of seven for this particular section. Each unique reason is described below

Legislatively driven industry

All interviewees in favour of further regulation situated their responses in the context of the nature of the industry and the typical behaviour of pension funds. Their responses speak to an industry which has been highly regulated historically, resulting in a mentality on the part of pension funds' trustees that if something is not legislated clearly it need not be acted upon. In the case of RI, the preamble to Regulation 28 does not specifically provide criteria which need to be met or, the most common phrase used by interviewees, 'boxes to be ticked'. Similarly, CRISA does not provide clear reporting lines, although it outlines five principles which can be reported against.

Interviewees emphasised that the focus of pension funds tends to be on hard breaches. Therefore, if a requirement is not specifically stated in regulation or is untested in law, pension funds tend to be slow to respond. While most interviewees actually preferred the notion of following principles, they did not provide much guidance on what they thought could be further included in regulation.

With respect to regulation, interviewees, however, voiced ideas regarding regulating reporting to help drive action. For example, a simple requirement set out by the FSB through a board notice, directive or through revision of the PF 130 circular, calling pension funds to report on RI would help expedite action. There was support for a reporting requirement which wasn't prescriptive, but rather one which simply called pension funds to report on their view and approach to RI, followed by reporting on action and progress in that regard. Concerns were raised around the potential fickleness of self-reporting, but it was still felt that any reporting was better than none, and, at the very least, serves as a point of engagement.

Transparency and fiduciary duties

Two interviewees noted that the trustees of pension funds have a fiduciary duty in terms of open communication and disclosure to their members. Therefore, apart from transparency serving to support RI within the pension fund space, it also supports a

general requirement that may not presently be fulfilled by pension funds; The CRISA report (2013) certainly indicates that this is the case.

Member Demand

When thinking about regulating reporting often only reporting to the regulator is what surfaces. However, three interviewees noted that improved reporting to members would facilitate greater demand for RI and therefore apply more pressure on pension funds and their trustees to improve on action. Interviewees noted that in the case of members not being aware of what the fund is invested in, it is almost impossible to hold funds accountable. Limited reporting to members hinders the addressing of pertinent issues, RI related and otherwise.

5.3.1.2 Reasons against increased regulation

Three primary reasons were identified against increased regulation on RI: one, concerns regarding a compliance approach; two, inappropriate delegation; and three, crowding out. Figure 16 shows the count of interviewees who indicated each of the three primary reasons against greater regulation. One interviewee did not provide views on regulation or reporting. The count therefore should be considered as one out of seven for this particular section. Each unique reason is described below.

Compliance approach

There interviewee against further regulation thinks that there is a danger of skewing trustee behaviour to meet prescriptive reporting requirements rather than sincerely engaging with RI, particularly in light of the industry as a whole not having standard RI criteria. The other interviewees who were for increased regulation also acknowledged a compliance mentality as a concern offered much the same explanation. Their recommendations were to ensure that reporting is not prescriptive, but rather descriptive and in the spirit of the principles approach.

Inappropriate Delegation

A further concern is that pension funds and their trustees will not own any reporting requirements brought upon them but rather transfer the responsibility to the consultant or asset manager. All interviewees who addressed this feel that this would defeat the

purpose of reporting, particularly as ownership and responsibility for fiduciary duties should be assumed by the trustees and not by other parties.

Crowding out

This reason was provided by the only interviewee who was against further regulation and reporting requirements. It specifically refers to the time the interviewee thought trustees would spend attempting to unpack further regulation or reporting requirements. This additional obligation would crowd out other important issues which need addressing. To the interviewee using time in a board of trustees meeting to address RI reporting instead of topics like preservation and contribution rates was unacceptable. This assumes that addressing RI reporting would take a significant amount of time, and given that trustee meetings are already considerably time constrained, would pose a problem. Most interviewees state that trustees meet on average four times a year and meetings at each sitting take a combined total of 8 hours.

Other interviewees acknowledged the issue of time and potential crowding out. However, some thought that the topic of RI was sufficiently important to address and detract from time spent on other issues. Others noted that the pension fund trustees themselves set the rules regarding how often they meet, how much time they spend on issues, and how decisions can be made. A potential solution to addressing the time-constraint problem was presented. A rule which allows certain solutions to be made by round robin, for example, could be instituted.

5.3.2 Consultants and Asset Managers

This section deals with the spatial structure of the market as it relates to accountability of pension funds, consultants, and asset managers which includes accountability to each other and accountability to regulators. Many of the items are addressed in conjunction with other topics as indicated earlier in this results section. Due to the nature of the interviews, the results regarding these findings are presented only as themes substantiated by views elicited during the interview process and not necessarily by count of interviewees as in previous sections. Four themes are presented: one, advisory services; two, responsibility; three, education; and four, independent accountability.

5.3.2.1 Advisory services

The common understanding presented by interviewees regarding the role of the consultants is that of a typical advisory role. As such emphasis on the obligation of the consultant to provide advice to the pension fund is generally understood and accepted. This establishes an element of accountability to the pension fund and its trustees. That being said, the interviewees also acknowledged that information provided by the consultant on RI matters would potentially be additional to the services agreed upon by the consultant and pension fund manager in the service contract, and therefore such advice would be at an additional charge. Accountability would therefore only be instituted on payment for the additional service. A counter to this point is that at least the consultant has the duty to inform the pension fund trustees that they should be seeking advice in this regard. However, interviewees thought that this does not occur as the consultants themselves do not have the requisite expertise or knowledge.

Another element which was addressed falls in the ambit of advice consultants provide to pension funds and speaks to the role asset managers potentially need to play. Often it is difficult for consultants to provide advice to pension fund trustees because there are an insufficient number of asset managers which are engaged with RI. As a result consultants do not have a large enough pool of asset managers to assess and therefore cannot provide advice on asset manager selection in this regard. A deficit of asset managers with robust ESG or RI systems is compounded by a value investment style bias in the South African market.

5.3.2.2 Responsibility

Interviewee views on whether there is a high reliance on asset consultants in trustees fulfilling of their fiduciary duties

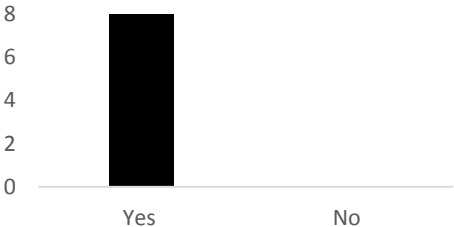


Figure 17: Bar chart showing the interviewees' views on whether there is a high reliance on asset consultants by pension fund trustees in the fulfilling of their fiduciary duties

While fiduciary duties establish pension fund trustees as ultimately responsible for the fund, all interviewees thought there is a heavy reliance on consultants as Figure 17 shows. This is

broadly acknowledged by the industry which according to some interviewees places an added derived obligation on consultants to be more active. Acknowledging the tension between service providers and pension funds, other comments encouraged funds to be more assertive, particularly as there is a danger with outsourcing completely because trustees hold personal liability.

No direct comment on asset manager responsibility was made, other than what was noted in the advisory services section (5.3.2.1). In addition to assisting consultants in providing advice, more active asset managers, particularly in the specialised product space, may also help consultants adopt a building block approach.

5.3.2.3 Education

Trustee competency is a strong theme within the results, and thus has a dedicated section (Interviewees noted that pension funds are accountable to the registrar of pension funds at the FSB. Most of the formal monitoring takes place by way of annual reporting to the registrar, generally in line with the requirements as set out by the PF 130 Circular. However, some interviewees noted that there appears to be a lack of interrogation by the FSB into the pension funds' activities and reporting, possibly due to the pension funds department being overburdened particularly in light of the pension fund reform and some of its unintended consequences.

The second point of concern with respect to independent accountability lies with the consultant. While consultants should operate according to the parameters set out in the Financial Advisory and Intermediary Services Act 37 of 2002, some issues from the perspective of the interviewees are problematic. One example offered, with respect to investment returns, suggests that consultants take credit for asset manager selection and advice when returns and investment performance has been good, but shift the blame to asset managers when investment performance is poor. This is not to say that asset managers are not to be held accountable for poor investment performance, but rather was raised to highlight inconsistency in accountability. With RI related matters there does not seem to be any obligation for consultants to provide pension funds with advice and there is thus no independent accountability with respect to quality or provision of advice.

Trustee competency: selection, tenure, training and education). Notwithstanding, some of the issues with respect to the provision of education to all parties are addressed here. Firstly, one

interviewee raised the concern that in some cases it appears that consultants themselves lack depth of knowledge and understanding of RI issues. This of course affects the consultants' ability to advise and to educate trustees which builds a potential bottle neck in the system as many trustees receive their education through their consultant.

Secondly, there was very little mention of the responsibility of asset managers with respect to RI education or any problems associated with potential lack of understanding from an education perspective.

5.3.2.4 Independent accountability

Interviewees noted that pension funds are accountable to the registrar of pension funds at the FSB. Most of the formal monitoring takes place by way of annual reporting to the registrar, generally in line with the requirements as set out by the PF 130 Circular. However, some interviewees noted that there appears to be a lack of interrogation by the FSB into the pension funds' activities and reporting, possibly due to the pension funds department being overburdened particularly in light of the pension fund reform and some of its unintended consequences.

The second point of concern with respect to independent accountability lies with the consultant. While consultants should operate according to the parameters set out in the Financial Advisory and Intermediary Services Act 37 of 2002, some issues from the perspective of the interviewees are problematic. One example offered, with respect to investment returns, suggests that consultants take credit for asset manager selection and advice when returns and investment performance has been good, but shift the blame to asset managers when investment performance is poor. This is not to say that asset managers are not to be held accountable for poor investment performance, but rather was raised to highlight inconsistency in accountability. With RI related matters there does not seem to be any obligation for consultants to provide pension funds with advice and there is thus no independent accountability with respect to quality or provision of advice.

5.4 Trustee competency: selection, tenure, training and education

This section presents results regarding the view of the interviewees with respect to the capacity of trustees in relation to competency and expertise to specifically address RI, but also other issues more broadly. The findings show that none of the interviewees thought that the

competency and expertise of the trustees, from a holistic perspective (not only on RI matters), are to the standards needed to fully perform the function of a board of trustees. Five interviewees directly acknowledged a deficiency in the capacity of trustees (as seen by ‘Yes’ in Figure 18). Of the remaining three, two implied a deficiency either through an emphasis on the need for holistic and basic training as well as RI training. The last interviewee made no mention of trustee skill at all.

Interviewee views on whether trustees are sufficiently skilled to carry out their duties

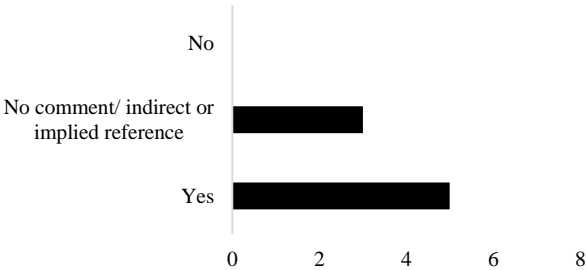


Figure 18: Bar chart showing the interviewees’ views on whether there is a deficiency in the capacity of trustees to carry out their duties.

Three themes were identified within the key attributors to deficiency in trustee competency and expertise. The first, the selection of trustees, notes their background and therefore initial competency. The second, training and education, speaks to the training offered to trustees. And the third speaks to the tenure of members of a board of trustees. Each of these is presented below, with interviewee support for each illustrated in Figure 19. In addition, training and education has further subsections on issues of concern.

Interviewee views on reasons for deficiency in trustee competency

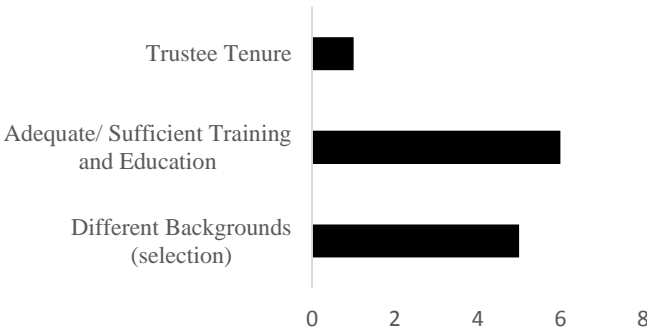


Figure 19: Bar chart showing the interviewees’ own views on reasons for deficiency in trustee competency

5.4.1 Background and selection of trustees:

As outlined in the background section (section 2), boards of trustees are constituted by an even split of employee elected trustees and employer elect trustees. Five interviewees addressed background and selection of trustees as a reason for the deficiency in trustee capacity. All of them noted that employee elected trustees tend to have lower levels of education, on average, than their employer elected counterparts. Many are ‘blue collared’ workers, without tertiary and sometimes even secondary education, and likely to be unfamiliar with the board room set up and the sophisticated world of investments. One interviewee cited an example of a trustee being unable to read, and while this may be an exception, it raises concerns regarding competency and ability to not only action RI, but to fulfil any basic fiduciary duty. Interviewees noted this as a particular concern given the personal liability which accompanies the office of trustee.

One interviewee highlighted that even employer elected trustees who may be professionals in other capacities sometimes lack the necessary aptitude or inclination needed for the role of a pension fund trustee. To combat this to some degree it was suggested that minimum qualifications for trustees be instituted, as in the case of non-executive directors of companies. Acknowledging the disadvantage the employee trustees often find themselves at, another interviewee emphasised the need for strong mentorship, empowerment and development should employee elected trustees remain a feature of the pension fund industry.

Training issues were also addressed with respect to different backgrounds and levels of education of employees. With the wide array of backgrounds and occupations of trustees, provision of training at the correct level becomes challenging. Some trustees may require the most basic of training in addition to more sophisticated training while more established and learned trustees may feel that they are above training on offer

5.4.2 Training and Education:

Problems with trustee training and education were identified as: one, quality of the training; two, level of the content of the training; three, the attendance requirements; four, how often training occurs; and five, how much is spent on training. These are described in greater detail below ending with comments on what is currently provided by way of training described by the interviewees.

Interviewee views on reasons which contribute to issues related to trustee training

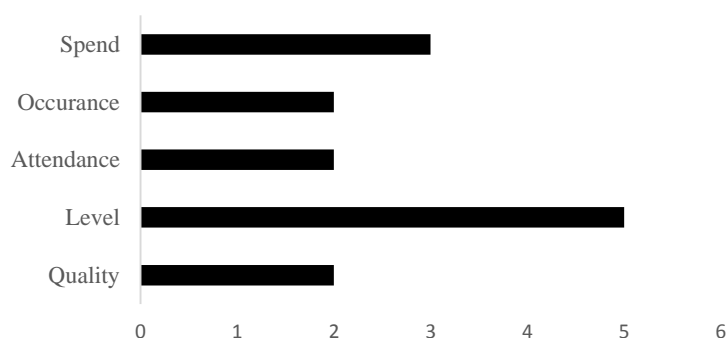


Figure 20: Bar chart showing the interviewees' views on reasons which contribute to inadequacy or insufficient training of trustees

5.4.2.1 Quality of training provided

Interviewees emphasised that quality of training is not guaranteed and varies significantly from one provider to another as a result of an absence of standard training curricula and assessment of training service providers.

5.4.2.2 Level of training material content

The level of the content which is provided is related to the quality of training offered. Again interviewees highlighted that since this is not assessed, it cannot be guaranteed that information imparted to trustees would be pitched at the level required to ensure that they are trained and equipped to fulfil their duties.

5.4.2.3 Attendance of training sessions

One interviewee mentioned that attendance at training sessions provided is not mandatory and this is highly significant when considering the need to develop trustee competency. The interviewee stated that a vast improvement in trustee competency and knowledge would be observed if more training became mandatory. A second interviewee emphasised that the introduction of mandatory training (on basic issues) for new trustees within 6 months of taking office has already made a marked difference and implied that further mandatory training may yield similar results.

5.4.2.4 Frequency of training

Two interviewees voiced concerns with respect to the occurrence of interviews. They made two different but related points. The first, simply being that all trustees need to undergo training with respect to RI and ESG, not simply new trustees. Interviewees indicated that more

experienced trustees do not attend training sessions due to the impression that much of the material may perhaps be familiar. The regularity of training in general was also raised. It was felt that all trustees should be refreshed of their duties and responsibilities regularly and thus receive mandatory training on a regular basis.

5.4.2.5 Spend on training

One interviewee was of the opinion that trustee competency, specifically around RI, is low due in part to a lack of resources directed towards addressing areas of deficiency. The interviewee was of the opinion that the industry has been lulled into complacency as it has accepted low levels of competency and has been unwilling to spend the necessary resources to address problem areas. Therefore resources can make a substantial difference in addressing trustee competency with respect to RI and otherwise.

5.4.2.6 Current state of training

This section covers some of the commentary made by the interviewees with respect to what is currently offered in terms of training and what is in the pipeline. The FSB has attempted to address some of the competency issues through training, for example, by instituting the requirement that all trustees undergo training within 6 months of appointment. In addition, Batseta, a newly established organisation which serves the interests and needs of principle officers and trustees, is working with many industry bodies to establish an industry wide standard of training for trustees. This is being done together with the Insurance Sector Education and Training Authority (INSETA). One suggestion which arose is that training offered within this framework should allow for attendees to achieve the relevant continuing professional development points (CDP).

5.4.3 Trustee Tenure

Although only one interviewee addressed trustee tenure as issue, the theme influences and is influenced by training and education. Most trustees serve on their board for a two-year duration, after which the intellectual capacity and institutional knowledge developed within that time leaves the pension fund with them. This potentially affects the funds' ability to mature in certain areas, including RI, and also affects the resources and energy dedicated to training and interrogating particular issues, which again affects RI development within the fund.

5.5 Fund Characteristics: Fund size and fund type

Other more miscellaneous themes which surfaced related to implications around fund size and therefore available resources, as well as fund type, namely, defined benefit or defined contribution.

With respect to fund size four issues arose. The first related to influence over asset managers. One interviewee noted that larger funds are able to meet diversification needs as well as request segregated mandates from asset managers. Many asset managers have relatively high floors with respect to segregated mandates. The interviewee noted that it is far more challenging for pension fund trustees to press RI issues in pooled funds as opposed to a segregated fund. Typically pension funds would need to accept most of the terms of the pooled fund as it stands with few tailoring options. This limits the potential for the pension fund to demand that RI be addressed in particular manner. Also, with respect to influence over asset managers, those pension funds with larger pools of capitals tend to be more desirable or important clients and, hence, asset managers will deliver on unusual or new requests more readily.

The second issue relates to the influence the pension fund may have on the market or on a particular company, specifically with respect to engagement and active ownership. Pension funds in pooled vehicles may, in fact, not have companies registered in their name or may not own a sufficient percentage of the company to be considered a real concern. In these cases the role of the asset manager is important as a collaborator and facilitator of engagement.

The third issue relates simply to the advantages of size. Larger funds, due to economies of scale, tend to have larger pools of funding from which to resource the governance and operations of the fund. This would include funding training for trustees, compensating asset consultants for work done and employing dedicated resources for specific tasks and areas. All three are areas which have been identified as aspects which potentially need to be bolstered in order for pension funds to implement RI more actively.

The fourth issue links to concerns regarding defined benefit (DB) funds compared to defined contribution (DC) funds. When looking at DB funds compared to DC funds the most important distinction noted is the difference in the liabilities of the funds. In DB funds members and their beneficiaries have set expectations with respect to income on retirement. Therefore sound management of investment and fund governance can see DB funds with surplus funds which can be used to fund initiatives, including RI. In DC funds members expect income directly

correlated to investment performance, therefore what pension funds use to resource other fund activities, directly erodes retirement income. Interviewees typically referred to DB funds as having ‘excess fat’ or ‘surplus’ with which the fund could ‘play’ in order to meet RI outcomes.

6 Discussion

The results highlight five main subjects of concern with respect to why pension funds and their trustees have taken little action with respect to RI in general and as outlined in the preamble to Regulation 28 and CRISA. They are: one, the role of pension funds; two, fiduciary duties of pension fund trustees; three, accountability within the spatial structure of the pension fund industry; four, trustee competency; and five, the specific characteristics of funds. Each of these is discussed below. The background, literature review, and results sections paint a picture of the South African pension funds industry with respect to conditions, industry structure, conduct, and performance.

Figure 21 presents a synthesis of this information. It maps the links between the relevant areas of the discussion and puts the various agents in the spatial structure of the industry as seen in *Figure 1: Pension fund investment management: institutions and services (Clarke, 2001)* and in interviewee responses into context. The perspectives of the various stakeholders on the roles of pension funds inform the basic conditions and therefore play a significant part in understanding behaviour and performance related (but not limited) to RI as outlined in the preamble to Regulation 28 and otherwise. Similarly interpretations and understanding of fiduciary duties inform conduct and performance, as does trustee competency (although trustee election is a function of the industry structure). Much of the discussion on accountability speaks to specific areas of conduct relating to agency and the outsourcing of responsibilities, and performance relating to disclosure

Basic Conditions		
Constitution <ul style="list-style-type: none"> • Social protection • Social Responsibility 	Social Security Mandate <ul style="list-style-type: none"> • Constitutional imperative • National Development Plan (NDP) 	Social and Economic Dynamics <ul style="list-style-type: none"> • Aging Population • Wealth and income inequality • Poor savings culture



Industry Structures- South African Pension system	
Non-Contributory, means-tested public benefit program <ul style="list-style-type: none"> • State Old Age Pension Grant • Main source of income for 75 per cent of the elderly population 	Employer- based Pension Funds, governed by Pensions Act of 1956 <ul style="list-style-type: none"> • Fiduciary duties of Pension fund trustees • C. 50/50 split between privately administered and underwritten (umbrella) funds (FSB 2012 Annual Report, 2014) • A change towards defined contribution from defined benefit funds over the last decade • 6581 pension funds (FSB 2012 Annual Report, 2014) • Aggregate assets of pension funds in South Africa R 2 750 billion (FSB 2012 Annual Report, 2014) • Pension fund reform



Policies and Regulatory Environment			Objectives and Incentives			
CRISA <ul style="list-style-type: none"> • Voluntary code on RI 	Reporting Requirements to FSB <ul style="list-style-type: none"> • PF130 Circular 	Regulation 28 <ul style="list-style-type: none"> • Including prudential requirements 	Income on retirement <ul style="list-style-type: none"> • Replacement Ratio 	Investment <ul style="list-style-type: none"> • Returns • Quality of environment 	Distribution <ul style="list-style-type: none"> • On retirement • To beneficiaries 	Contribution and savings rates



Conduct			
Rules of the Fund <ul style="list-style-type: none"> • Set by the board 	Outsourcing to service providers <ul style="list-style-type: none"> • Agency, responsibility and accountability (asset consultants and managers) 	Training and Upskilling of trustees <ul style="list-style-type: none"> • Irregular • Basic • Non-mandatory • Non-standardised 	Responsible Investment <ul style="list-style-type: none"> • Philosophies • Processes • Incorporation • Collaboration/affiliation with industry bodies

Performance		
Reporting <ul style="list-style-type: none"> • To the FSB • To members • Voluntary reports to industry 	Philosophy of Performance Metrics <ul style="list-style-type: none"> • Returns maximization 	RI <ul style="list-style-type: none"> • Poor reporting and disclosure

Figure 21: Conditions, Structure, Conduct and Performance of South African Pension Funds

6.1 Role of Pension Funds

The conditions under which pension funds operate (informing industry structure and stakeholder conduct) are shaped to a large degree by the views and perspectives on the role of pension funds. The results identify four dominant roles: one, savings institutions; two, allocators of capital; three, part-owners of companies; and four, constituents of the country's social security system. Each role is discussed below, with a final concluding paragraph on the overall role of pension funds.

Although the results show that all interviewees regard the primary role of pension funds as savings institutions, an interesting picture emerges as the roles identified display interdependent characteristics. Typically, the view that pension funds are only savings institutions, is one which cannot be divorced from over-arching or intersecting and derived responsibilities. The results allow a new picture to emerge, one which creates the opportunity to view each of the four roles as part of a virtuous cycle, reinforcing each other.

6.1.1 The role of pension funds as savings institutions and constituents of the social security system

While most interviewees did not completely address the social security aspect of the role of pension funds, it is important to note as a matter of fact that pension funds form part of the South African social security system as outlined in the literature review (section 3.2.1). While pension funds should not necessarily and unreservedly serve very broad social security goals, their very purpose in providing retirement income is a social security goal in and of itself. As such, all subsequent roles are situated within this overarching structure. In this regard a pension fund's role of a savings institution is its expression of its social security purpose. Similarly pension funds' roles as allocators of capital and part-owners of companies are derived due to their roles as savings institutions.

Before considering how these derived roles support the overall societal goals, as outlined by National Treasury and discussed in the literature review (section 3.2.1) it is important to note further legal imperatives. Importantly, emphasised by the interviewees, the nature of the institution as a juristic person, to whom the constitution and Bill of Rights applies, and as a non-profit organisation, places social responsibilities on pension funds from which they should not simply be excused due to other obligations. The remaining two roles are considered with this in mind.

6.1.2 The role of pension funds as allocators of capital

Firstly, as constituents of the social security system pension funds should not conduct their ‘business,’ which includes capital allocation, in a manner which jeopardises or is opposed to other goals of the social security system. It is possible that an approach which follows Pareto improvement (actions which harm no entity, but helps at least one) should be explored and adopted in some form. This would need to be held in tension with a fund’s fiduciary duties of acting in the best interest of the funds beneficiaries.

Secondly, as a social entity and subject to the constitution, allocation of capital becomes an important expression of the funds’ social responsibility. Pension funds should therefore be aware of how their capital allocation empowers or cripples societal imperatives.

Thirdly, as the allocation of capital is an obvious and direct expression of addressing the best interests of the fund’s beneficiaries, the results suggest that it should be considered more fully. Not only does allocation of capital realise certain investment returns, it also realises development and economic outcomes which can have a negative or positive impact on beneficiaries. This overlaps with the interpretation of fiduciary duties discussed in section 6.2.1.

The fourth factor hinges on the long-term nature of pension funds’ liabilities. Conventional actuarial thinking suggests that assets and liabilities should match in duration. Therefore, the allocation of capital is important in that time horizons ought to be harmonious. This creates a derived responsibility to ensure the development of environments in which longer dated assets can thrive, in addition to the sustainability of earnings over time, both in current and prospective investments. This aspect alone makes RI compatible with the aims of pension funds.

6.1.3 The role of pension funds as part-owners of companies

The last role, as part-owners of companies, is also derived. As investors in equity, pension funds become part-owners of companies and assume shareholder rights. There are no explicit legal obligations on the part of shareholders to act on certain issues. However, when considering pension funds as social entities in the context of a greater social security system, the societal impact of companies and their decisions, engagement on the part of owners and the exercising of ownership rights become imperative. In addition, the same is true from a fiduciary perspective, both from the perspective of holistic best interests of pension funds’ beneficiaries (discussed in section 6.2.1.2) and with respect to ensuring sound financial returns. Assuming

ownership responsibilities therefore provides tools and mechanisms through which a number of goals and concerns can be addressed.

In summary, pension funds fulfil or should fulfil each of the four roles. Social security being the institutions' ultimate purpose, while their role as a savings institution is an expression thereof. It must be noted, however, that arguably, while pension funds should not work against the goals of the greater social security system they themselves are not responsible for addressing those goals and should not necessarily be distracted in that regard. The other two roles (that of allocating capital and as part-owners of companies) are derived roles but are congruent with both the nature of a pension fund as a social entity and with the fiduciary duties of trustees. It would appear that the constitution and Pension Funds Act do not prohibit pension funds from assuming these roles. It is rather the broader industry and stakeholders who write-off or conflate these roles with other issues.

6.2 Fiduciary duties of pension fund trustees

Fiduciary duties are often a primary consideration in the discussion around the assimilation of RI concepts into the investment practices of pension funds. The fiduciary duties of the trustees of pension funds are a prominent component of both the structure of the industry as well as of the ultimate conduct of the stakeholders within the industry. The results highlight three dominant topics: one, awareness and understanding of fiduciary duties; two, interpretation of fiduciary duties; and three, the relationship between fiduciary duties and the Preamble to Regulation 28. To better discuss the topic of fiduciary duties, the interpretation of fiduciary duties is addressed first, followed by awareness and understanding, and lastly the Preamble to Regulation 28, as each subsequent topic could be considered to be nested in the previous one.

6.2.1 Interpretation of fiduciary duties

The interpretation of fiduciary duties is important as a point of departure as it guides the thinking of pension funds, trustees and other stakeholders, and therefore either facilitates or negates the need to engage or interrogate certain topics, including RI. In addition, the literature (section 3.3) often emphasises fiduciary duties as a leading obstacle to pension funds adopting RI, despite the fact that RI is explicitly addressed in the Preamble to Regulation 28 in the context of fiduciary duties.

It is therefore significant that the interpretation of fiduciary duties from an interviewee perspective differs considerably from what the interviewees thought pension fund trustees understand is included in the scope of fiduciary duties. Only one interviewee indicated that the fiduciary duties of pension fund trustees is to only maximise returns, while the remaining seven argued that there is scope for broader interpretations. However, all interviewees were of the opinion that pension fund trustees view their fiduciary duties as only maximising returns. There is therefore a disjuncture between what is and what potentially should be.

When considering the justifications for broader interpretations of fiduciary duties the four most well-developed theories presented by interviewees - sustainability, best interests of members and beneficiaries, legal classification, and distribution of funds - can arguably pass scrutiny and are congruent with the understanding of the roles of pension funds developed earlier in section 6.1. In addition, of the four theories provided to support a broader interpretation, three are either compatible with, have very close links with or are at their very core an RI approach.

6.2.1.1 Sustainability: ensuring companies adapt appropriately and operating environments remain viable into the future

Sustainability within fiduciary duties was justified by interviewees by the need for sustainable returns on capital due to the long term nature of the liabilities and the explicit fiduciary duty of impartiality between current and future members. Implicitly this means that all decisions and actions need to be made in such a manner that the fund itself is sustainable. Therefore its investments and their returns should be sustainable. In addition, the operating environment in which investments are situated should be sustainable to ensure the longevity of the funds. This places a necessary burden on pension fund trustees to ensure that corporations address ESG considerations such that they individually remain on-going concerns, and therefore can continue to offer investors returns as they adapt to meet the challenges of their operating environments. Additionally, apart from addressing company specific issues, pension funds should also ideally assume some responsibility in the creation of sustainable operating environments for business in general such that an investment opportunity set continues to exist. This would be in the context of the assets the funds own and therefore have a degree of influence over. Should externalities affect the system negatively, this would jeopardize current and future investment returns and, in some cases, the economy.

Therefore while sustainability might appear to be a secondary consideration, it could be considered core to pension funds trustees' fiduciary duties of adequate investment returns and impartiality. Additionally, sustainability can be applied directly to all four roles of pension fund previously identified.

6.2.1.2 Best interests of members and beneficiaries:

Maximisation of returns is strongly emphasised with respect to fiduciary duties and RI in the pension funds industry. However, the results show that the central tenet of these duties- for trustees 'to act in the best interest of members'- is not fully appreciated. Interviewees generally agreed that a fuller appreciation of the scope of best interests needs to be had by the industry and by trustees. The phrase itself is not restrictive, and thus restricting its interpretation to only maximizing returns displays a limited appreciation of the role of pension funds (as discussed in section 6.1) and responsibilities of trustees.

In general the results indicate that meeting this duty includes broader social issues. More specifically it should include an understanding of the desires and needs of the beneficiaries and, an attempt to meet them. As discussed in the literature review (section 3.3 on fiduciary duties), at times this can be a complicated process, nonetheless it does not negate the necessity for the trustees to pursue action along these lines.

It is important for pension funds trustees to begin to understand the relationship between the roles (discussed in section 6.1) and their fiduciary duties. In this case the pension fund holds power as an allocator of capital, as well as a part-owner of companies. In this respect capital can be directed more thoughtfully toward investments which have direct and positive repercussions for members and their beneficiaries, where appropriate. Similarly, as part owners, meaningful engagement (as explained in section 2.4) with companies can assist in addressing issues of relevance to members and beneficiaries.

6.2.1.3 Legal classification of pension funds: implications

It is in considering the legal classification of pension funds that a schism between the nature of the entity and the notion that fiduciary duties means only seeking to maximise returns appears. In a South African context pension funds are both non-profit organisations and juristic persons, to whom the Bill of Rights applies. Therefore constraining the duties of the trustees to simply maximising returns can contradict the social responsibilities which accompany all juristic

persons and non-profit entities. Therefore while not strictly a part of fiduciary duties, the legal classification of funds presents to trustees further cause to consider RI.

6.2.1.4 Distribution of benefits to members and beneficiaries

While only one interviewee explicitly mentioned the distribution of benefits at the appropriate time, it is important to include in the fold of fiduciary duties. Naturally if benefits are not distributed appropriately maximising returns would be moot. As a concept it is not directly correlated to RI, but is certainly important as a component of fiduciary duties.

The results on the interpretation of fiduciary duties show is that there is a significant area which may not be diligently addressed, due to a lack of appreciation or knowledge of their position within the scope of fiduciary duties. From these findings one can assert that indeed aspects of RI critical to the honouring of fiduciary duties. Unfortunately, the deficiency with respect to interpretation of fiduciary duties is perpetuated as the following sections on awareness and understanding, and fiduciary duties within the context of the Preamble to Regulation 28 address.

6.2.2 Awareness and understanding of fiduciary duties

All interviewees believe that trustees are aware that they have fiduciary duties. However most interviewees feel that understanding is lacking and attribute six reasons for this: one, no legal ramifications or accountability; two, interpretations of fiduciary duties by the industry; three, difficulties with resources; four, lack of trustee expertise; five, the nature of the value chain, and six, structural industry issues.

The reasons attributed fall into three main categories: accountability, trustee competency, and resources. Trustee competency and accountability are addressed more thoroughly later in their own distinct sections (sections 6.3 and 6.4). Many of these reasons are not mutually exclusive but rather intersect with one another, thereby compounding issues.

From a resources perspective, the lack of accountability or ramifications discourages resource allocation (time and money) to the interrogation of fiduciary duties and the implementation of any findings. A lack of general expertise accompanied by a plethora of other structural industry issues further discourages resource allocation in the direction of fiduciary duties as the return on investment per se may not be as great had the trustee body been better qualified and other issues did not need addressing.

6.2.3 Preamble to Regulation 28

The Preamble to Regulation 28 of the South African Pension Funds Act specifically addresses RI in relation to the fiduciary duties of the fund and its trustees. Therefore while it may be possible to explain away broader interpretations of fiduciary duties to include RI, it becomes more difficult to provide legitimate justification for the lack of assimilation of RI, when Regulation 28 explicitly links RI, fiduciary duties and other duties of the trustees.

The results of the interviews show that none of the interviewees believe that pension fund trustees have digested the Preamble to Regulation 28. Nine reasons are presented for this lack of assimilation. These nine reasons can be roughly divided into four categories, not dissimilar to those observed when looking at the previous section (6.2.2) on awareness and understanding. The four categories: understanding, accountability, resources, and value chain recur as themes explaining why there has been limited action on the part of pension fund trustees with respect to RI.

6.2.3.1 Understanding

Three main reasons are identified in this category. The first acknowledges a simple deficit in the understanding of RI in general. The second reason acknowledges the legacy understanding and interpretations of Regulation 28, while the third acknowledges a lack of understanding of the full scope of fiduciary duties as discussed earlier in section 6.2.1

The literature review (section 3.1.1) details confusion around RI definitions, particularly the assumption that RI means forgoing returns, as one of the obstacles to implementing RI. The results show that due to a lack of understanding of RI, concerns around forgoing returns explain why many trustees have not invested time and effort in understanding what RI entails and what its purposes are. Therefore a lack of clarity in the industry as a whole around the definition of RI in different contexts creates a significant hindrance to the progress of RI.

Traditionally Regulation 28 has simply been a list of guides and limits on investment decisions. The industry therefore understands Regulation 28 to literally be a list of check boxes with which pension funds need to comply. Therefore the spirit of the law approach of the preamble is an entirely new concept with which to contend. Given that RI should not be a compliance based approach to investing, this does introduce added complexities around the understanding and implementation thereof. However, the Responsible Investment and Ownership Guide published

by the Sustainable Returns Project goes some way to setting out how pension funds can begin to assimilate RI into their processes. It is noted that the guide does not necessarily fully unpack RI in all its forms, and therefore understanding the full scope, benefits and purposes of RI may remain lacking to some degree.

The last reason within the ‘understanding’ ambit pertains to the understanding of fiduciary duties. As discussed earlier in section 6.2.1 a narrow understanding of fiduciary duties can limit pension funds and their trustees in the full implementation of RI. The earlier discussion does not fully address the fact that the preamble specifically presents RI in relation to the fiduciary duties of the fund. Therefore the lack of understanding of fiduciary duties by trustees and the industry as a whole can be seen to be compounded when not fully appreciated in the light of the preamble.

6.2.3.2 Accountability

In the context of accountability three themes surface. The first, identifies a lack of guidance from the FSB. In an industry which is regulatory focused, a lack of guidance and regulatory emphasis implies that a relaxed approach to RI is acceptable. Even without stringent requirements with respect to implementation or reporting, guidance from the regulator brings the need for a philosophy and formal approach to RI. A guidance note would serve a double purpose in that it would also assist pension funds and their trustees in the assimilation of RI in the funds’ activities and decisions making. Suggestions as noted in section 5.2.3.6 regarding guidance were presented as a guidance note, a revised PF 130 Circular, or a board notice.

Secondly, accountability is better realised when there is an element of reporting so as to reveal any progress and activity. For RI there is currently no requirement to report. CRISA encourages transparent disclosure, but as a voluntary code it remains difficult to assess what progress, if any has been made and there is no explicit accountability. Not all interviewees are supportive of reporting requirements, mainly due to potentially increasing workloads and fears around the obligation being passed onto consultants rather than being owned by the pension fund trustees. One other dominant fear is that reporting requirements would introduce a tick box mentality with respect to RI. Most interviewees however, are supportive of a non-prescriptive reporting requirement which is demonstrative, simply to encourage disclosure and introduce some element of accountability. As noted in the results section (5.2.3.8), most interviewees view reporting as a proxy for accountability, rather than a necessity in and of itself.

The third theme from an accountability perspective relates to a lack of demand, specifically on the part of members and beneficiaries. This is also noted in the 2007 UNEPFI report on the State of Responsible Investment in South Africa. Interviewee sentiment indicates that without ‘customer’ demand there lacks an element of natural accountability one would typically observe in a system where there is a ‘buyer’ of a service or product. In this case, interviewees highlighted that members and beneficiaries are not knowledgeable enough so as to be empowered to galvanize pension fund trustees. Due to the wide array of people who are members and beneficiaries, without thorough and transparent disclosure, members and beneficiaries are not always aware of what they are able to hold pension funds and trustees accountable for. This does present a conundrum, as interviewees indicate that demand incites accountability, and adequate reporting. However, without reporting as an initiator, accountability derived from demand with respect to RI could lie latent for some time.

6.2.3.3 Resources: allocation of time and money

While the allocation of resources towards other issues has been cited by interviewees as a justification for the lack of interrogation around understanding fiduciary duties thoroughly, it also appears when considering the lack of assimilation of RI according to the preamble. It could be said of all the other obligations and issues that pension funds trustees face (particularly with respect to the pressures the pension fund reform has placed on pension funds), that they ‘crowd out’ other issues which may be deemed not as urgent or not as important. As mentioned before this is understandable to some degree, but Regulation 28 frames RI in the context of fiduciary duties it can be argued that RI is fundamentally core to these duties, and that the burden of other issues and responsibilities cannot be offered as a fully legitimate excuse. And while many interviewees did express the view that they believe RI is on the agenda of pension funds, it is far down on the list of priorities.

6.2.3.4 Value Chain: complexity and spatial dynamics

The spatial structure of the pension funds industry as seen in the background section (2.1), is complex with many players. As such, one of the recurring themes which hinders RI is the issues the complexity of the value chain presents. While in some cases the reasons for lack of engagement on certain issues has been attributed to the distance between trustees and related parties, in this case two of the reasons provided are not trustee focused, but rather speak to the responsibilities of asset consultants and asset managers. Interviewees emphasise that this is not to say however, that the primary responsibility of RI assimilation does not lie with the pension

fund trustees as the discussion on fiduciary duties highlights, rather that asset consultants and asset managers can play increasingly more influential roles.

The opinions of interviewees on the lack of engagement on RI issues by consultants is important as although pension fund trustees hold primary responsibility, they rely on consultants for advice. While pension funds should ideally approach asset consultants for advice, interviewees expressed that by virtue of the length of and complexity of the value chain, in addition to some of the other issues which will be discussed relating to trustees (section 6.4) guidance from asset consultants is crucial in the promotion of RI. That being said interviewees also raise consultant competency and expertise regarding RI as a concern.

Interviewees also cite a lack of innovative RI solutions from asset managers as a reason for poor guidance from asset consultants. Consultants often offer advice based on the assessment of the performance or offering of an array of asset managers. In this case the argument would be that the absence of advice is simply a function of an insufficient number of asset managers applying RI principles. This once gain presents somewhat of a conundrum as there is no legislative requirement on the part of asset managers to provide such solutions. Most asset managers provide to the market what is commercially viable and as such look to clients to guide service offerings.

What therefore appears to be lacking in the investment value chain is a clear sense of responsibility and accountability for each stakeholder with respect to the relationships between the preamble to Regulation 28, RI, and fiduciary duties.

6.3 Accountability: reporting and spatial structure of the industry

Both elements of accountability discussed here – reporting and value chain or structure of the industry - have been discussed in the previous section. Section 6.2.3 discussed accountability in relation to fiduciary duties, with a particular emphasis on reporting and the role of the FSB in the form of the Registrar of Retirement Funds. This discussion covers reporting and increased regulation as well as the roles of the asset manager and asset consultant in the value chain. With respect to the value chain it brings into focus the need for an industry wide discussion and understanding of the responsibilities of all stakeholders in the value chain with respect to RI. Therefore, both elements are expounded upon as they apply more generally below.

6.3.1 Reporting and Regulation

Most interviewees agreed that regulations should be changed to enforce greater action with respect to RI. In addition most interviewees felt that the optimal regulatory solution would take the form of introducing reporting requirements. Interviewees presented three reasons in support of such directives as well as three reasons against. While reporting has been covered within other topics this section provides a comprehensive discussion.

The three reasons cited in support of a reporting requirement are: one, a legislatively driven industry; two, the need for transparency, particularly when one considers the fiduciary responsibility to disclose (see background section 2.4); and three, the opportunity to promote demand and interest from members with respect to RI. To date the industry, by its nature, has reared a mentality of legislative compliance and reliance. In other words, little or no action will be taken unless there is a real fear of hard breaches and corresponding damages. Interviewees touted that this has been observed in the case of RI and pension funds even though the Preamble to Regulation 28 states that RI should be considered. Therefore it was felt by most interviewees that a requirement for reporting in a non-prescriptive, demonstrative approach (versus a non-compliance or check box approach) would be a helpful step toward combatting the existing inertia. Rather than stipulating exact steps and requirements as to how RI should be implemented, which was deemed to be inappropriate by the interviewees in the context of RI and fiduciary duties, a limited requirement for reporting appears to be the least intrusive measure to ensure accountability and action.

One of the concerns cited against the introduction of reporting requirements is the fear of introducing a compliance approach. While interviewees noted this as a valid fear given the compliance centric nature of the industry, they generally felt that a reporting requirement which is not prescriptive but rather requests of pension funds to describe and explain philosophy and process, supported by evidence or demonstration of attempts to implement may ease some of those issues. In the same vein concerns around inappropriate delegation of the reporting tasks to other stakeholders was presented as a reason to not enforce reporting requirements. Again, while this is a valid concern, it addresses a broader industry issue around the correct allocation of tasks and responsibilities to the relevant stakeholders. It suggests that it may in fact be more appropriate to question the blurring of responsibilities of consultants and pension fund trustees more broadly, and not simply with respect to RI or reporting issues. If this is indeed a concern, it can be argued that there is a deeper, more systemic issue relating to the performance of

trustees in their duties and the outsourcing thereof. A later section (6.4) on trustee competency explores this concept a little further.

Other reasons in support of reporting are the need for transparency and inciting member demand and interest discussed in some detail previously (sections 5.2.3.7 and 5.2.3.8). From a member demand and transparency perspective, it is important to appreciate that the suggested increase in reporting is not only to the relevant authorities but also to members. This is born out of a fiduciary duty (as discussed in section 2.4) as well as the belief that improved reporting to members would facilitate greater demand for RI and therefore apply more pressure on pension funds trustees to assimilate RI as appropriate.

The last reason against reporting is that of the problem of resource allocation and crowding out of other important issues which need addressing as mentioned in section 6.2.3.3. However, a counter to this is that in honouring the full scope of fiduciary duties and RI responsibilities, reporting would simply be a natural product of the efforts of trustees, rather than a concerted effort and time allocation to thinking about RI simply due to reporting requirements. In addition interviewees highlighted that trustees themselves make the rules of the fund which ultimately shape conduct. Therefore it is within their power to change the rules of the fund in order to meet the need of more meetings or to allow decisions to be made by round robin.

6.3.2 Consultants and Asset Managers

Four specific topics emerged with respect to accountability relating to pension funds, asset consultants and asset managers: one, advisory services; two, responsibility; three, education; and four, independent accountability. All interviewees emphasised that ultimate responsibility lies with the pension fund and its trustees.

As the provider of advisory services, consultants have a derived accountability to pension funds and their trustees. This takes the form of the consultant either providing agreed upon advice as per the contract or the consultant creating awareness of issues the trustees need to address. Therefore should trustees solicit additional RI related advice from consultants, payment for such advice can be negotiated or trustees can endeavour to tackle the issue independently. However, it was noted that conflicts of interest can potentially arise when consultant themselves are not equipped with the requisite expertise and cannot either provide adequate advice themselves or do not wish to highlight a deficiency in the services they can provide.

This brings to bear the importance of consultant education with respect to RI. It is possible that where consultants themselves are empowered to provide advice, greater RI activity in pension funds may be realised. In such circumstances, consultants may be able to readily provide RI advice to pension funds without prompting from the trustees themselves, or at least would not shy away from suggesting certain measures be introduced. While some interviewees cited additional costs which may arise as consultants bill for RI advice, they also felt that this may in fact encourage a greater quality of advice. Again, reasonable costs to fully pursue RI as applicable to Regulation 28 and trustees' fiduciary duties should not hinder the soliciting of needed advice in this field.

The lack of accountability with respect to consultants is also an issue. There is often an asymmetry of information with respect to consultants and pension fund trustees, which can make it difficult for trustees to hold consultants accountable. This is compounded by the fact that typically the body of pension funds is fragmented, while consultants are often consolidated organisations with large influence and established processes and systems.

Although asset managers are also not held accountable by authoritarian bodies with respect to RI, in a commercial sense they are held accountable to consultants and the pension funds trustees. Unlike consultants they do not primarily provide advice to pension funds trustees, but provide a service whose outcomes are measured. In so doing there is greater sense of accountability through the value chain. In the South African context, many asset managers have made themselves accountable to the likes of the UNPRI as signatories on RI related issues. And while becoming a signatory is voluntary it does offer a signal to the market and provides an element of transparency and comfort due to the accountability controls in place.

6.4 Trustee competency: selection, tenure, training, and education

Interrogating the competency and abilities of trustees is an integral component of assessing why there has been limited action in terms of assimilating RI into the decision making of pension funds. Understanding and ability on the part of trustees is a necessary condition for any action to be promulgated. It is therefore concerning that most interviewees felt that there is an inappropriate reliance on consultants due to a deficiency in trustee capacity from a competency and expertise perspective, not only on RI related matters, but on other matters related to fiduciary duties too. Considering that concerns regarding consultants' understanding of RI were also noted in section 6.3.2 this becomes more problematic. To further compound the issue, not

only does trustee competency have implications for the fund, but it has implications for trustees who are personally and jointly liable for breaches as discussed in the background section (section 2.4).

Of first concern is the capacity and competency with which trustees enter the office of trustee. Understanding that trustees are either employee or employer elected, there is significant variety of skill levels as well as qualification levels. Apart from trustees lacking the sufficient skill and know-how to execute their duties at the outset, the mismatch of skills creates further problems with respect to training, and resource allocation. It requires a great amount of effort, training and time to ensure that all trustees are suitably equipped for the office, which the following discussion explains is not the case.

Four problems surfaced with respect to training: one, no regulated minimum level; two, no quality control; three, training is not always mandatory; and four, there is an absence of regular training. Currently training is not standardised and those institutions who offer training are not necessarily vetted by institutions which understand the pressures and requirements of trustees. As such the quality and level of training is not guaranteed from one training session to another. In addition, training is not mandatory and due to the disparity in quality and levels of training as well as the disparity in the level of skill of trustees, many trustees are not motivated to attend. Apart from problems relating to the level and quality of training as well as the absence of compulsory training, regular training on a variety of relevant topics is not a common feature of pension funds educational efforts. As a result training on new and relevant topics, like RI, for example, is not guaranteed.

It appears, however, with the establishment of Batseta in the latter part of 2014, that there is an increased focus on the need for training. The FSB, recognising the need for improved training efforts, has instituted the requirement that training of trustees takes place within 6 months of appointment. While this can be considered an improvement it still does not necessarily address the issues of quality and level of content. Should standardised industry-wide training for trustees be approved by INSETA, a measure of accountability and comfort could be gained from the knowledge that trustees have at least been exposed to a set range of topics at a particular level, with quality material and trainers. This would not necessarily automatically solve all issues around the level and quality of training unless approving bodies draw up appropriate standards. Similarly, this would not guarantee that the full scope of fiduciary duties is explored, understood and assimilated. Neither would it guarantee that RI is sufficiently and

appropriately addressed, particularly if those creating standardised programmes themselves are not sufficiently familiar with the concepts and material. Given that, apart from the Sustainable Returns Project: Responsible Investment and Ownership Guide, little is available by way of RI frameworks, the creation of RI frameworks which promote and ease understanding are paramount importance.

Compounding the above issues is the typical two-year tenure of a trustee which results in a recurring loss of institutional knowledge and limited opportunity for the experience and knowledge of individual trustees to be built. Furthermore it results in very basic levels of trustee understanding and the need for basic training and concepts to be revisited periodically. Hence progress around issues such as RI are stunted and boards of trustees may find themselves circling back to issues which may have been previously solved. Ultimately trustee tenure and succession planning which do not facilitate continued growth and progress hinder RI development and assimilation. However, given that very few boards have any appraisal mechanisms in place, short tenures could also be viewed in a positive light, with the hope that trustees whose presence on the board is viewed as constructive are re-elected.

Improvements in training and changes in tenure and appraisal would go some way to promoting and supporting trustee competency and expertise. However, if the board is endowed with a generally low level of skill, it could be argued that at a board level little can be done to improve understanding and expertise. The problem of understanding with respect to RI and fiduciary duties (and perhaps other issues too), may therefore be more systemic in nature rather than simply a function of training. While the inclusion of employee elected trustees can be lauded as a positive step to ensuring that the interests and opinions of employees, in reality members, are heard, if trustees are insufficiently equipped it could ultimately do members a disservice. A suggestion offered in this regard is to ensure minimum qualifications of trustees similar to the approach of the Institute of Directors Southern Africa with respect to directors. This also provides trustees protection as they are adequately equipped against any potential personal or joint liabilities.

6.5 Fund Characteristics

The characteristics of a particular fund can also affect the degree to which pension funds implement RI strategies and, in particular, engagement as part owners of companies. The results show that the size of the fund as well as whether the fund is a DB or DC fund can have an

impact on the influence of the fund and the resources available, or at least the perception of the resources available, to explore RI matters.

Although the size of the fund may dilute some of the power the fund has with the asset manager, the fund and its trustees remain the clients of asset managers and still select asset managers with which to invest. Should more pension funds request greater RI capabilities within the funds they are invested in from a pooled-vehicle perspective, it is not unlikely that the commercial imperative will start to shape what asset managers offer to pension funds in this regard. As the responsibility falls with the asset owner, the pension fund, and not the asset manager, it becomes an even greater necessity for pension funds to request RI capabilities to ensure that the industry evolves to assimilate RI as appropriate.

In the South African context, DB funds are often larger, more established funds and are typically seen to have surplus resources due to size and scales of economy and due to the nature of the liabilities of the fund. While this may be true to some degree, as discussed earlier, limited resources cannot be provided as a legitimate excuse to not engaging and actively pursuing issues related to the fiduciary duties of the fund.

7 RESEARCH CONCLUSIONS AND RECOMMENDATIONS

The analysis in this dissertation has showed that a lack of understanding and accountability play major roles in the limited action on the part of pension funds trustees with respect to RI. However, the reasons for this are layered and more complex than they may first appear.

Firstly, it is not only simply an understanding of RI which is lacking, but what also appears to be an under appreciation for the full scope of fiduciary duties and how different elements of decision making and responsibilities interact with one another. A broader interpretation of fiduciary duties as justified in this dissertation by considering sustainability, the best interest of members, and the legal classification of pension funds, interacts harmoniously with the views presented on the roles of pension funds. These roles include savings institutions, integral players within the social security system, allocators of capital, and part-owners of companies.

This lack of understanding and appreciation is further attributed to concerns with respect to trustees, from a competency, training and tenure perspective, as well as from a perspective of allocation of resources (due to other responsibilities of the fund). Should industry wish to meaningfully address the limited action with respect to RI it is important that these underlying issues be addressed first.

Crucial to promoting understanding is the development of frameworks which map and explain RI in its various forms across asset classes. Equally important, from the perspective of the purpose of RI in pension funds, is an emphasis on the roles and fiduciary duties of pension funds and their trustees. This would not only assist pension fund trustees in assimilating RI as appropriate but would assist the industry and relevant stakeholders in addressing and creating an enabling environment for the assimilation of RI into the practices of pension funds, particularly regarding investment decisions and disclosure. In particular asset consultants also need to be adequately equipped to provide advice and guidance on RI.

In addition to improved articulation around the purposes of RI within the pension fund industry, the fiduciary duties of trustees also needs to be interrogated more closely. The concept of fiduciary duties is an integral component of the RI landscape. Therefore an underappreciated view of fiduciary duties does a disservice to the role pension funds can and should play in society.

Apart from building tools which promote, assist and create understanding in the industry, the interviewees exposed concerns around general trustee competency, not only with respect to RI, but across a broader range of issues. Should the fiduciary duties of trustees be upheld in earnest, including those of an RI nature, it would do the industry well to interrogate and assess the abilities of the trustees who are required to fulfil the related obligations. Acknowledging that such a discussion would be sensitive in nature, particularly as it appears that employee elected trustees tend to demonstrate the greater deficiency in appropriate skill, it still remains vital to the institution. There may not be a simple solution, but suggestions made regarding minimum qualifications for trustees, even as basic as a South African Grade 12 qualification, trustee appraisal, changes to tenure based on the value added by trustees, and appropriate, regular and mandatory training may start to close some of the visible gaps. These measures would not only enhance the conduct and performance of trustees but would also serve to protect trustees with respect to joint and personal liability. Some of the strides made with regard to training programmes and initiatives with respect to INSETA, BATSETA, and CPD points should be encouraged and supported by the industry in order that they may realise results. Particularly, quality, level, and regularity of training should be emphasised; along with mandatory attendance for training sessions.

Secondly, from an accountability perspective, the resounding message is that in fact there is minimal accountability with respect to RI and related issues, including those related to the fiduciary duties of the fund. Industry tends to operate and respond to rules based approaches, where penalties for hard breaches incentivise behaviour. It may therefore be useful to introduce mechanisms which introduce an element of accountability in the same manner. While the initial intention of the amended Regulation 28 was to encourage pension funds to act by the spirit of the law, the lack of action four years on may suggest that the industry is not yet mature enough and requires further guidance in this respect. While not wanting to regress, introducing measures of accountability which make reporting on responsible investment activity mandatory could be viewed as a positive first step. While there are concerns that this requirement would simply be passed to the asset consultant, this could potentially be avoided through an emphasis on the report including the philosophy, process, and demonstration of action. It could be done according to the CRISA principles, with no penalty (barring enquiry and assistance offered) for acknowledging that no action has been implemented with respect to certain principles.

The Registrar of Retirement Funds at the FSB would need to lead in this regard and encourage pension funds and their trustees to report. Given that the PF 130 Circular was last updated prior to the promulgation of the amended Regulation 28 in 2011, an update including a reference to a non-prescriptive report on the RI progress of the fund, may be timely. A secondary reporting requirement is that of reporting on RI to members and beneficiaries. In general the results indicate that industry believes that reporting to members can be improved upon substantially so that members can begin to hold pension funds accountable. Holdings over the reporting period, engagements with asset consultants and managers, important decisions made and of course progress on RI including reporting against CRISA and important engagements are a few ways in which reporting to members can be improved.

In order to assist reporting and accountability, a guidance note on the part of the FSB would go a long way. While it is acknowledged that there is much other work underway, the work done by the Sustainable Returns Project, most notably the Responsible Investment and Ownership Guide, serves as a solid foundation on which to base such work and can be better promoted by industry bodies.

While a lack of accountability and understanding, partly derived from weaknesses in trustee competency, indeed stand out as primary factors which can be attributed to the lack of action on the part of pension fund trustees, one further reason also surfaces. While perhaps not entirely legitimate in the eyes of the law, the practical nature of resource allocation, particularly in the form of time and money, means that it cannot be ignored as a factor. As the industry continues to press forward on many fronts, many issues vie for the attention of the board of trustees. While these other issues may be of great importance, it could be said that a lack of understanding of RI, and therefore of the potential positive outcomes and unintended consequences of leaving RI unattended, is what allows RI to remain low on the list of items to address. Perhaps if trustees fully understood how RI relates to the fund and not only its compatibility with their fiduciary duties, but its intrinsic link, more resources would be allocated as appropriate.

Research on RI in South Africa, with respect to pension funds could be said to suffer from a lack of industry response, making it difficult to ascertain the views on RI as well as RI activity directly from pension funds trustees and other representatives. Both reports referenced in the literature review on RI in South Africa report a lack of response from pension funds, and partially attribute it to the fact that no RI action is present as well as a lack of interest around RI.

Having established that indeed accountability and understanding are leading reasons for limited RI action, further research into unpacking the current levels of understanding around RI and fiduciary duties directly from pension funds trustees would be an important next step. By exploring the understanding of pension fund trustees, the industry would be better able to address areas which evidence deficiency.

In addition, it is of paramount importance that frameworks and systems of thinking be developed which articulate and define RI as appropriate to the pension fund industry, linking its purpose, mechanisms, and outcomes. Such research could provide standardised terminology and channels of communication, as well as a platform on which training on RI could be standardised.

That said, for true industry galvanisation as a result of further research, ideas and recommendations need to be implemented by competent boards of trustees. Further research therefore, with respect to the nature and functioning of boards of pension fund trustees, including trustee competency in South Africa, is crucial to spurring the industry forward.

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9 APPENDICES

9.1 Appendix One



Research undertaken towards Master of Commerce Development Finance at the University of Cape Town, Graduate School of Business- Ann-Maree Tippoo

This research has been approved by the Commerce Faculty of Ethics in Research Committee and requires informed consent of respondents.

As such, the first part of the interview will include stating such consent on record. In the research I will use a description of your organisation and role, but maintain your anonymity. Generally the research will not reference any concepts specifically to you, but will rather map concepts. In this regard the research will not use statements such as: “Interviewee A suggested that ...” If any specific reference is deemed necessary, your permission to include specific reference will be sought.

The interview should take between 45 minutes to an hour to complete. Your participation is voluntary, and you may choose to withdraw from the research at any time. Should you have any concerns or questions, please contact Ann-Maree Tippoo at tppann004@gsb.uct.ac.za.

Interview Brief

South African pension funds in the context of responsible investment (RI); perspectives on regulation, fiduciary duties and stewardship.

The promulgation of the amendments to Regulation 28 of the South African Pension Funds Act in 2011 serves as the justification for much of the responsible investment activity in South Africa.

Preamble to the Amended Regulation 28 of the Pension Funds Act of 1956:

A fund and its agents have a fiduciary duty to act in the best interest of those for whose assets they are responsible. This duty supports the adoption of a responsible investment approach to deploying capital into markets that will earn them adequate risk adjusted returns for the fund's member profile, liquidity needs and liabilities. Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long term performance of their investments, including those of an environmental, social and governance character. This applies across all asset classes and should promote the vested interest of the fund in a stable and transparent environment.

Much of the research in South Africa has centred on responsible investment (RI) from the perspective of investment managers, while much less of the literature has focused on the approach of asset owners, pension funds in particular, for whom much of the regulation is applicable. 'Concerns regarding fiduciary responsibilities' has been identified as a key barrier to responsible investment in South Africa (Viviers et al., 2008), and as such the research I wish to undertake wishes to explore the position and perspectives of pension funds regarding:

- i. the role of pension funds,
- ii. the interpretation of the fiduciary duties and responsibilities of trustees,
- iii. the interpretation of fiduciary responsibilities in the context of responsible investment,
- iv. the interpretation of Regulation 28 and the responsibilities of pension funds relation to the legislation's interpretation,
- v. the general position and activity of pension funds and their trustees in this regard, and with respect to various RI approaches/strategies,
- vi. trends in the industry,
- vii. the role of corporate governance , stewardship, and active ownership, and
- viii. recommendations.

Viviers et al. (2008) also noted perceptions regarding risk-adjusted returns of portfolios within RI strategies, and this theme will, due to the scope of the areas above, be woven into the conversation.

The desired output of this research piece is to contribute to a fuller picture of the RI landscape in South Africa, by exploring the position and opinions of pension funds, acknowledging the regulation and codes in place and the framework within in which pension funds operate given fiduciary responsibilities. Five to ten interviews will be conducted with a range of industry stakeholders, most of whom have a view of the industry as a whole, rather than the intimate knowledge specific pension funds. As such questions will be posed in a dual manner: firstly to garner the opinion of the individual being interviewed, and secondly to garner their view of the industry and the various players other than the pension funds. The interviews will be semi-structured and consist mainly of open ended questions.

The general structure of the interview will be as follows:

Part 1: Contextualising the interview
Part 2: Professional information gathered on each respondent
Part 3: Gathering of either organisation specific information or role of the type of organisation within the pension fund landscape
Part 4: Role of pension funds
Part 5: Fiduciary Responsibilities of Pension Funds
Part 6: Responsible Investment
Part 7: Corporate Governance and Stewardship
Part 8: Activity and trends in the industry on parts 5 -7
Part 9: Recommendations
Part 10: Closing comments

References

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9.2 Appendix Two

Interview Questions

South African pension funds in the context of responsible investment (RI); perspectives on regulation, fiduciary duties and stewardship.

Structure of the Interview

Part 1: Contextualising the interview
Part 2: Professional information gathered on each respondent
Part 3: Gathering of either organisation specific information or role of the type of organisation within the pension fund landscape
Part 4: Role of pension funds
Part 5: Fiduciary Responsibilities of Pension Funds
Part 6: Responsible Investment
Part 7: Corporate Governance and Stewardship
Part 8: Activity and trends in the industry on parts 5 -7
Part 9: Recommendations
Part 10: Closing comments

Interview Questions

Part 2 and 3:

- i. Please describe your organisation: its mandate and structure
- ii. What is your position in your organisation?
- iii. Please describe your position and the type of work it entails

Part 4:

- i. What is your view on the role of pension funds in society and the economy?
- ii. What is your perception of the view of pension funds and their trustees on the role of pension funds?

Depending on the depth and breadth response of the interviewee, the following questions could be asked:

- iii. Do you feel that pension funds have or could have a broader societal and/or economic role beyond providing income on retirement to members?
 - a. For example do they have a role as deployers of capital?
- iv. Do you think pension funds think they have or can have additional roles with respect to the societal and economic concerns of their members?
 - a. And of the broader societal and economic environment?

Part 5:

- i. What do you think the current understanding regarding fiduciary duties of pension fund trustees is:
 - a. from the perspective of the entire value chain of the pension fund industry
 - b. as well as from the perspective of a pension fund trustee?
- ii. Do you think pension fund trustees engage and grapple with their fiduciary responsibilities?
- iii. How do you understand the concept with respect to fiduciary duties that pension fund trustees should act in the best interests of their members or beneficiaries?
- iv. What do you think the general understanding of pension fund trustees is with respect to acting in the best interests of their members or beneficiaries?
- v. Does ‘best interests’ refer solely to best financial interests or optimal financial returns on retirement?
 - a. Is there the possibility for greater scope of interpretation?
 - b. And if so, what could this include?
- vi. If there is greater scope, are pension funds and their trustees engaged in this regard?

Part 6:

- i. Do you think pension funds and their trustees have digested their responsibilities with respect to responsible investment as set out in the preamble to the Amended Regulation 28 of the Pension Funds Act of 1956?
- ii. If yes or no why do you think that is the case?

- iii. Do you think pension funds and their trustees have an understanding of responsible investment?
 - b. Is this included in training for trustees?
- v. What is the approach or view with respect to CRISA?

Part 7:

- i. What is the view of pension funds and their trustees with respect to the fact that in the case of equity, they are in actual fact part owners of companies?
 - a. Have they digested this?
 - b. And how do they approach the responsibility of ownership
- ii. In the case where pension funds and their trustees are or are not engaged in active ownership, why do you think this is the case?
 - a. Is it a resources or capacity issue ?
 - b. Is it a capability issue?
 - c. Is it because they believe it is or not there place to engage as owners?
 - d. Is it because they think it will or will not have an impact?
 - e. Any other reasons
- iii. Is there an understanding of the function and mechanisms of corporate governance?
- iv. Are pension funds and their trustees using and engaging with the tools corporate governance and the likes of the King Code provide?
- v. Why and how is this the case?

Part 8:

- i. What do you the trends with respect to RI have been
- ii. What do you think we are likely to see going forward?
- iii. What can be done to engage pension funds and trustees with their RI responsibilities?
 - a. What can be done to drive more action?

If the following have not been explored in any previous questions:

- iv. What are your views on the following in ensuring action on the part of pension funds and their trustees with respect to RI:

- a. training and/or
- b. practice notes and/or
- c. reporting and/or
- d. other entities in the value chain: regulator, industry bodies, asset consultants and asset managers.

Part 9:

- i. What are your recommendations for addressing the lack of action and presence on the part of pension funds with respect to responsible investment?

Part 10:

- i. Do you have any closing comments?

9.3 Appendix Three: The Interview Transcripts

The transcripts below have been edited slightly to maintain anonymity as far as possible.

9.3.1 Interview 1

Interview: CEO

Introduction

Context

Informed Consent

Interviewer: Can you comment on your view on the role of pension funds in society and the economy?

Interviewee: They are the custodians of retirement savings and they have to make sure that that money is there for safe-keeping and that when the time comes that money is available for distribution as per the mandate of the various funds. They have to make sure that the money is invested prudently. They oversee that there is proper administration, and that all the issues around risk management have been attended to. And that the governance issues are intended to as well.

This is in line with what the pension funds act mandates them to do. You can't give them anything else. But what is important is that that particular role is very very important. They are in charge of billions of rand so they have to be competent and skilled to manage that responsibility.

Interviewer: So in your view the savings element is the priority and main focus?

Interviewee: Personally, I would like to add something which is my own view which I hope will take off. I hope that over and above their fiduciary duties and so on, I also think that it is important that the board take note of the financial wellness of their members. And if they take decisions to invest, or whatever they do with savings of their members they still need to have a good understanding of the impact on their members. If they can have an understating of that I think they will be even more prudent than what they are at the moment. Because you know a small change in a decision in a fund might have huge impact on the financial impact on the

members' financial wellness. And we don't always know where members find themselves on their own financial journey. Sometime this is what the mandate is, but there are things they need to take into consideration, and I am not always sure whether this understanding is really there.

Interviewer: Perhaps we can now move to your interpretation of fiduciary duties. Is the interpretation limiting at all? And is it limiting when one considers that the core of fiduciary duties is to act in the best interest of their members and beneficiaries?

Interviewee: I don't think it is limiting at all because, if you really understand what fiduciary duty means; I think if you speak to any trustee on any board that is the first quote they will give you: "It must be in the best interest of the member." So I think that as a concept is well embedded or internalised in various funds. I'm not always sure is that full understanding is there- I have done a training session or two on fiduciary duty- and that there is a common understanding that there should be no conflict of interest, and that you should take more care than you do than you do in your own finances. So the general understanding is there, but I'm not always convinced that they have always interrogated that to that particular level. Because you will still find some funds where it is debated: what is the role of the trustee, what is the role of the POA, of the service provide? So although all these concepts are out there you will still find that in some cases those roles are blurred. It's not a foreign concept they talk about it all the time. There is a genuine sense that they want to do things in the best interest of members.

Interviewer: Do you feel that trustees consider 'interests' to only be financial?

Interviewee: My personal opinion, I think the financial interest is top priority. I think a lot of time is spent on that. Obviously the second one is the distribution of benefits. Personally I think a lot of time is spent on the investment bit, if it's not by the IC committees themselves. My sense is that they talk about members first, they talk about investments and everything related to that.

Interviewer: What then is your perspective on the changes to Reg 28, in particular the preamble? I'm most interested in the second part- with respect to the duty support adoption of RI and pursue adequate risk adjusted returns. Do you think the pension fund community has digested this? What is your sense around the approach, the view?

Interviewee: We've done a lot of work around this Sustainable Returns Project work, where we have put together guidelines on how funds could go about integrating ESG, and it sets out a whole plan over a 3/4 year period. What funds should do depending on where they find themselves on their journey to ESG integration. The big reason we did this is that we found that asset owners are not necessarily taking responsibility, you know ownership of these considerations. Yes, Reg 28 says you 'might' consider this, but it is not clear that you must do that.

Consultants are very much important in guiding funds in this respect. Our sense in the very beginning was that if the fund does not ask, the consultant won't pursue. But I hope that that has changed over the last couple of years. Because initially it was just about what this animal is all about- what is the common understanding of sustainable returns, or ESG, or responsible investment- just getting to know what the terms are. What is the difference between this that and the other. So in the beginning it was about raising awareness around responsible investment, what it entails, how it can be achieved, the fact that it doesn't mean that the fund must lose money. There was quite a lot of confusion around CSR and RI in the way that you and understand it to be. But my sense is that that has changed and that people do understand what RI is, what it means by now, and they have an understanding that they should not lose money from it, and there are projects or is something that is viable to consider, and that they should have these kinds of policies in place. So my sense is that that awareness is there.

However, what I cannot see from this point in time from where I sit is that there is a real active drive around this. So then CRISA came and CRISA sort of brought a little bit of perspective. But also because CRISA does not require anybody to endorse somewhere, I put my hand to paper, it's almost like it's there, but to the extent that it is applied and that people are pursuing it actively is not that clear.

Interviewer: What do you think can be done to drive more action?

Interviewee: My personal opinion here is that it is a collective drive. The first thing is that everybody needs to say that this is necessary for us to do so. Whether it is the consultant, or asset owner, or service provider. And I think the way that we did the Sustainable Returns Project is where we had input from everybody, where we had a stakeholder steering committee. And that was quite a good way of introducing and getting everybody on board. But now that that committee is not active anymore and we have issued the guide, and nobody is actively driving

it, it's almost like wait and see to see who is taking the next step. What my organisation has said is that our next step is – we've developed phases- which consists of piloting the guide, having sort of support systems in place so that funds can come back and say please help me with this and that- so almost a mentoring system. But it has not materialised because of funding issue, and secondly, what we've tried to do is something that a fund needs to do. We cannot go to a fund and say pilot this and that. They actually need to be the drivers of this and invest in their own development around this. It became a big issue where how do you as an organisation say to a fund you should change your mandate or you should do this you should do that. The whole conceptualisation around that was maybe a little too quick, in terms of where funds find themselves. So then what we then said is that we will take the guide and convert it into a training session. So that we can say this is what it's really all about and this is how you go about implementation and then see how can we help or assist them and understand the implementation process. Who do they consult around that and what assistance is available should they want to roll out ESG integration into their funds. That is something we will do in 2015/16 from our side. We hope that that kind of understanding will nudge the fund to say it's not that difficult and to see how that integration can actually happen very effectively. But unless it is a collaboration between everybody in the industry, if only one party drives it, it will be difficult. At the end it's about the funds taking ownership of this. You can do whatever you like, but unless they do that, it will just be a document or discussion somewhere.

Interviewer: So then why do you think funds are not taking ownership of this? Understanding has improved, you have guidelines out, there is CRISA. There is a lot in the market, I know a lot of asset managers' talk about ESG and Responsible Investment. Why do you think there is this lack of ownership?

Interviewee: Absolutely no idea. I don't know whether they are waiting for somebody to say this is now the next step or maybe in terms of where they find themselves in terms of their own investment process. I don't know how mature some funds are. I don't know what kind of philosophies they are supporting. I assume that the kind of investment philosophies and the way they structure their portfolios and maybe they are making good money at the moment without applying the pressure of looking at ESG more closely. And whether there might be one or two with we're okay where we are. Sometimes I think people are just comfortable with where they are and whether they want to stir the pot when they're not really sure what that stir would result in- better the devil you know than the devil you don't know. This is my opinion on this from

talking. There are some funds that are actually quite active. If you look at Sentinels they apply their minds. Also I'm not sure what kind of resources these funds have available and the intellectual and other capacity to really pursue this actively is readily available. You know, how big must you be before this becomes a reality? Is it when you have R35 billion? Which is when you start looking at these things. I'm not sure if they link this to private equity as well. I think when you get to a fund of that size I think the conversation will more likely be there than a fund which just has R1bn in the bank and they're not 100% sure if it will really affect them that significantly.

Interviewer: So CRISA is not enforceable- what is the impact of no reporting requirements?

Interviewee: There are no reporting or evidencing requirements. And this industry is a very strange industry, in that unless it's driven by some sort of regulation and requirement nothing happens. I think it was quite a big win when Reg 28 refers to ESG integration, but it just left it hanging. So it's not clear what you have to do. But what I also realise is that the FSB is very much more aware of this particular issue, and that it will get more attention. If it's not in PF 130 maybe somewhere else. And I also think that King IV might also look at ESG issues and references to CRISA, which I think will be maybe an interesting thing to explore. Just to give it that little bit more of a punch that it may be lacking.

Interviewer: Aside from some sort of requirement or enforcement mechanism, who else or what else could change the asset owner behaviour in this regard?

Interviewee: The voice of the consultant is so important. Listen, they can say whatever they like. Our funds do listen to their consultants, they respect their opinions. So an active consultant will definitely make a difference. And you know as soon as the development and training of the trustees improves over the years, I think they will also be more exposed to these kind of discussion as part of their skills development and so on. Its early days, but as soon as there is a little more attention paid to this, my sense is that it will pick up again. I must say, that at a stage, maybe I'm wrong, but especially in the Sustainable Returns Project where we were very busy with the report and we consulted and there was a lot of activity, it was almost as though there was a little fatigue around the issue. You know, we heard about this, and we've heard about this. And it almost became like 'not another presentation please!'

Interviewer: So would you say that there was fatigue, but little action?

Interviewee: Yes, fatigue but little action. So it was almost like a little bit of information overload. But it's sad that we could also not get the action going as well. So I think we've achieved in terms of information sharing and dissemination, but you know that implementation phase, we really need to get together and say what does it mean? For example, for us it means let us have another round of training not necessarily about awareness training but about how do we take that next step? A little bit of an assessment on this is where you are, where do you want to be, what is achievable? But I also think that we should focus on the funds that have the size as a first point of call. If you have one or two or three or four funds that have sort of worked together. And I really think that might be where we bring together say top 10 funds in the country and we discuss with them: this is an issue, what is your position on this, how are you doing this? And we have champions. If you have you 5 or 10 champions over and above the DB funds- that's the other thing I also need to say is that when a DB fund like the GEPF or EPPF leads this it's a different perception. 'Agh they have the money, they can do lose a little bit, nobody is going to cry too much'. So yes they are good champions, of we've been there, done that, we can share our learning. But if we can get between 5 and 10 champions in the stand alone and other environments and say 'drive this process, lets learn, lets share, etc- be the champions.' You know once we have that commitment, and that is maybe what I will drive from our side, once we've done the training and this is taking off. Let us just say, let us find the champions of this and let us learn and share.

Interviewer: So are you saying that there is a difference between DB and DC funds?

Interviewee: Yes, and they're DB funds. So there is somewhere a guarantee from an employer that they will top up in case they make a little mistake here or there. So what we need are champions in DC funds, even if it's just 5. I don't know how many. Obviously they can work with the GEPFs and EPPFs, of this world, but if we can just manage that, I'm telling you that will make a difference

Interviewer: You mentioned that you would do training, and trustees undergo training over time. The training trustees receive, do you think that providers of trustee training do address RI adequately?

Interviewee: No, not at all, it's not on their agenda. Maybe it might have a very small portion. But I haven't seen a single service provider that has said I will train in this and this is what it entails. But with the development of the new trustee qualification, ESG is quite prominent in

there and if it's not yet, we will definitely make sure that it gets the attention that is required. So trustees will be formally trained on this. Then as part of the CDP curriculum we have to make sure that the FSB one way or another prescribes that there has to be some sort of exposure of that particular area as well. So what I'm doing at the moment, and I haven't looked at the curriculum of the ASISA course, because they have a trustee 101 investment course, there might a little bit that we can add to that one. Then obviously once our course has been developed, and I'm working with ASISA here, then it will be almost like a standalone. Once that is available and it much be part of a trustee training curriculum, I think things will change. I don't know whether people just don't know or whether they think someone else will take responsibility for that. But once these kind of things feature in training and development it becomes much more real than a sentence in Reg 28.

Interviewer: Stewardship and active ownership- do you think this is a sort of thinking that's starting to evolve in the SA pension fund industry?

Interviewee: I think in terms of the bigger pension fund they sort of share information. But how active they are to work together, I can't comment on that. I saw the other day where mergence pursued an issue around the remuneration of Shoprite CEO, and I wondered who else was involved. But you are right and this is an area where we need to think about- you know the clearing house that the UNPRI has. I just think that we need to promote that and get the guys to understand what is happening there. I don't that there is a South African clearing house kind of concept?

Interviewer: The UNPRI does host one, but most of the SA asset owners are not signatories.

Interviewee: Exactly, you know they're doing a good job, but our funds <sigh> are, I don't know why, maybe they think that CRISA will fulfil that role at some point. I'm not 100% sure. But yes, I agree with you, the minute that that can be done, and we have that kind of consolidation through a clearing house whether it's local or whatever. I don't know, I know too little about how theses thing work at this point in time, but I will learn. So hopefully as soon as I have a better understanding, we can have a chat again. But when I speak to funds it seems to me that this is definitely an area for development. And an area that we can look into. How big or how small or how we start this, I am not 100% sure, but I do know that some funds are talking to each other, the EPPFs, GEPFs and Sasols, but I'm not too much aware of most of the others how they go about it. I'm not sure whether they rather leave that to their consultants, to

take responsibility and just report back. I'm not sure whether funds really sit down and say let's discuss what we're going to in the next period. I'm not aware of such consultations, but this could be because I'm not that close at this point in time. Believe you me that this is something that we will explore along with the training. And maybe we can work together and maybe in what you do to suggest that we do a bit of a survey around this and see what is the activity. But I don't know, that is not my area, I can't really comment. But that it is important, and that I have heard in the grapevines where I discuss that there is a need. That is something that can actually be very real.

Interviewer: A survey would be a good idea

Interviewee: Ya, you know we just drill down immediately, and not do you understand this and that. Just a very simple one around voting etc, because I don't think we have done one like that. We've done all sorts of other things, but not understanding what that is. And like I said, if there is a quick win, this is where it can happen.

Interviewer: All from my side. Any closing comments?

Interviewee: I think from my side and what we would like to do, is really to pursue the Sustainable Returns Project in terms of the phases that needs to follow which means the training and development, and assisting with implantation and getting like clearing house and voting systems in place an see how that that works. It is on our agenda, I think it is something that the funds have to pursue. I foresee that it is something that will be integrated that we don't think about it later, but there is a long way to go. I don't know in how much of hurry we should be. But it seems to me that it takes time for this industry to turn the wheel. But I don't think we should wait to long for this to happen. And let's work together. From our side it's more a funding issue and getting things going. But from the other side once the training and development happens, people get to know about it and see that maybe it's not so difficult- we might see results. And then let's find those champions, and I think that's what people can help us to do. Let's find them and with them let us then map a programme of action and share it as they develop and grow themselves.

Closing Comments

9.3.2 Interview 2

Interview: Chairperson of Research Committee

Introduction

Informed Consent

Context

Interviewer: To jump right in: very broadly, I've started these conversations with a discussion on the view of the role of pension funds in society and obviously in the economy.

Interviewee: A lot of what I'm going to say is going to either be influenced by conversations I've had with people or things I might have said in other forums. The first conversation, I don't know who you've spoken to, so the names, if you've spoken to them already, you'll know the story, you can say just move on. I think for me the primary focus of a pension fund is obviously to provide an income in retirement. For me that's really the thing. I've written about it, I've thought about it, and I'm really quite vocal about it. In South Africa at the moment, pension funds are a proxy for a whole lot of other benefits. And I think this goes right through to Cosatu's view on social security. For me pension funds are not unemployment insurance benefits, which they are a proxy for in many cases. They are not necessarily a proxy for survivor benefits, you know funding mechanisms. Which you know is another obvious thing they do at the moment. And that leads into a whole lot of other things. When it's a proxy, when I talk about pension funds being a proxy for many other things I refer to talk about the pension fund and the proxy that it represents: everything from housing to literacy, to education. So there is that view and that for me is a very realistic view in the current south African context, saying well, this is what we have and this is what have to work with let's use this creature the way it is. I don't necessarily think that that's a long term solution. But that's one of the views that has been put out there. And then probably something like Alex van der Heefa's view although he focused on medical aid funds in the past or medical care. He's also been very vocal as a macro economist on the impact of funding and where it's saved and when you access the money. So I think the solution I the South African context, even though you're not talking about the solution, is that for me the optimal solution would probably be somewhere in-between.

Interviewer: Yes, that makes a lot of sense. And part of why I ask that question is because it leads into my next question with respect to the interpretation of fiduciary duties and responsibilities of trustees. And obviously the main element there is ensuring that everything is done in ‘the best interests’ of members and beneficiaries. When you’ve been in conversations around fiduciary duties and that phrase ‘best interests’, do you think it has solely been focused on optimal returns? Is there any feel for something broader?

Interviewee: I think there has been a narrow focus on investment returns rather than broader issues. But then again that takes you right back to what is a pension fund? And what is the function of a pension fund. So I think the conversations are informed by that and there are also obviously strictly legal interpretations. This is the fund and this is what you need to do. These are the guidelines and what you need to do to stay within those guidelines or the law so to speak. So it becomes a little more fuzzy when people or boards of trustees start taking on considerations of financial literacy as an example. Again, a fund acting as a proxy for something else. It then also comes to the further conversation about what is the nature of the fund, if it’s a defined contribution fund, which most are, it’s quite simple. Then it is this investment focus and it is this obsession with the highest possible investment return with a strong consideration of risk depending on how big your board of trustees is. But I think the conversation is quite different when it comes to DB funds.

Interviewer: And you would say that conversation is different, why?

Interviewee: I think because of the liability focus of DB funds and I think a lot of DC funds thinking and a lot of thinking out there at the moment if we focus on investments purely, is becoming a more liability driven focus rather than an investment focus. So I think in earlier DC days the idea of a board of trustees was just to maximise returns, so you can maximise benefit. Whereas I think the realisation and with maturity, some of the older DB concepts, some of the liability driven models are definitely coming back. But that doesn’t really answer your question.

Interviewer: Well, it certainly provides a perspective. But to quickly move on. Given your comments around the purpose of a pension fund: to provide income on retirement; I would like to bring in RI which has proliferated the market to greater or lesser extents in different areas. Internationally it’s gained traction in the UK and the European markets. Obviously, South Africa is quite unique because we have this preamble in Reg 28 and then we have CRISA etc. What

do you think the understanding around RI is in the pension fund industry at the moment and then particularly of trustees.

Interviewee: Sho- I think just a perception for many trustees is that you have to give up investment returns to be able to RI. That's a general remark- throwing out there. I think there isn't a proper understanding of what it means and in the broader sense...here again the conversation will be informed by the size of the fund or the size of the assets that you control. I think that, not that this is the same context exactly, but the PIC's decision is very different from a R10m fund decision. I think that it needs to be a bigger conversation. I think the RI needs to be understood differently. And I think the use of the term RI is probably wrong where a better name would have been sustainable investing or investing for a sustainable future. Or something along those lines, which I think falls very much in line with the responsibilities of a pension fund.

Interviewer: Just to go back to your comment on size of funds, if you had to give a few reasons why this would play out differently for bigger versus smaller funds what would some of those reasons be?

Interviewee: I think it would probably start off with something as simple as asset allocation. Where the PIC can look at something like infrastructure development, very differently from a smaller fund, where the smaller fund would need to look at some sort of pooled vehicle if that's what they were looking for where as a bigger fund you could probably invest directly along those lines

Interviewer: So you think there is an argument to be made regarding segregated and pooled funds in this respect? Specifically regarding leverage an influence?

Interviewee: I understand that argument. For me that's not the focus though, because even if you enter into a pooled fund, as a trustee, in my mind, and I think Reg 28 also requires you to have a policy on shareholder or voting rights. So I think, if we had to be very technical, that's something the trustees need to understand.

Interviewer: So if you say that understanding is minimal or if in existence at all, or maybe a bit skewed, what would you say, or how would we be going to promote or create better understanding? Where is the gap?

Interviewee: I always think it comes back to the question, which is maybe not entirely within in this context: The society you want to live in and the society you want to create. As a person who has control over capital you have influence over society, however you want that society to look. Do you want to invest in companies that purely focus on short term profits without dealing with the consequence, corporate governance, and all those good things? You know, simple ESG things. I don't know if you've looked at reports done by a stock broking company called Legae Securities.

Interviewer: Yes I have

Interviewee: So when you have a look at their corporate governance research, is that the sort of society you want to encourage?

Interviewer: And do you think that sort of thing is trickling down to the trustees of the pension funds so that they can become more learned in this area?

Interviewee: I think it's really important.

Interviewer: But currently you don't think that sort of thing is happening?

Interviewee: I don't think it's done enough, to be quite honest with you.

Interviewer: And how do you think we can go about educating trustees in this way?

Interviewee: I don't think trustees are people who live in a vacuum. It's probably a more societal discussion than a trustee only discussion.

Interviewer: And the role of the consultant in this space?

Interviewee: The role of the consultant for me, and seeing that I have sold advice in my life as well, is to assist whoever they are consulting on, whatever the subject may be to make an informed decision.

Interviewer: And so you think consultants are wrapping their heads around RI in order to do that at all?

Interviewee: I can't say that I have had enough exposure to that. Some of the bigger ones, asset consultants included, but I don't think there is the enthusiasm or the bigger picture thinking.

Interviewer: Maybe just to go back to the fact that we have that preamble in Reg 28. How do think people are interpreting the fact that now there is this mention of RI within legislation? And do they feel a sense of accountability or is it just there and we don't know what to do with it?

Interviewee: I think it is a tick box. I think that's probably the general view.

Interviewer: And are people ticking the box? Do they know how?

Interviewee: They don't. And I think that it goes back to all those other things: what's the meaning, why are we doing this, what society do we want to create? Is this good for our members, is this good for society at large?

Interviewer: Moving on to one of the last sections I would like to cover: the idea of stewardship and ownership. And this also fits into some of theories which are out there around fiduciary capitalism. You know that the concentration of ownership of companies is found within pension funds or within institutional investors. Do you think pension funds and people along the value chain understand this idea of ownership of a particular or part of a particular company?

Interviewee: Again, I think that's probably the exception rather than the rule. And what I mean by that is, and I think you probably have conscientised boards of management where that is something that is discussed and raised. I think it's not part of the general conversation, in my experience. And be that at board of trustee meetings and even general information sessions.

Interviewer: You would say that there isn't even, or rather there is a lack of conversation around the fact that pension funds are part of owners of particular entities?

Interviewee: The only person I can think of is maybe, I'm sure you've looked at, who's that guy who is or was the PoA of the GEPP...

Interviewer: John Oliphant

Interviewee: Yes, John did a paper a few years ago which talked to a whole lot of that stuff. But that's the only big example that I can think of.

Interviewer: And you think that response to that sort of thing has been minimal? Or people haven't been invigorated or encouraged?

Interviewee: Ya, no, not at all. Even if you think about CRISA; people right these articles and I can't see very different behaviour.

Interviewer: And what do you think could potentially start to drive different behaviour? Do we need further regulation or reporting requirements?

Interviewee: Yes, I think the biggest driver for that would be empowering the ultimate beneficiaries of these funds. As the owner of the assets, those are the people who should really have their voices heard. For me, it goes much lower down the value chain than regulators and stuff like that. Because I think, once members are aware of these issues, once members care about this, the people managing the assets, the boards of trustees would start caring.

Interviewer: Is it quite difficult for members to say anything at this point because of the type of reporting that they receive?

Interviewee: Exactly. So you know that's really the question. Do I as the member of my fund go to the trustees and do I know we control a certain amount of assets and this is the world I want to see... I mean some of the big pension funds around the world really do that. Not that it's a pension fund but the Swedish Sovereign Fund and CalPERS maybe. They have very clear visions of what they want. But they're so big.

Interviewer: Do you think it would make a difference if pension funds reported to their members what they were invested in on an annual basis?

Interviewee: Yes, I think that's definitely part of it. Or explain at least the logic in choosing asset class and then the underlying holdings for that asset class.

Interviewer: And do you think that we see trends in that direction going into the future? Or is it unlikely that there is going to be change without something dramatic happening.

Interviewee: I think it's unlikely. And again, I echo what other people have said as far as regulation and all that sort of stuff is concerned. I think trustees have a focus on two things: what's their investment return and are we ticking all the boxes. Without having the freedom to think about the broader issues. For many reasons.

Interviewer: Is there simply a lack of appreciation of the fact that pension funds are part owners of some companies?

Interviewee: I think that's definitely the situation. If you think of the person who is not familiar with the board room for an example. Or who may be someone who doesn't necessarily have tertiary education, just as another example. Some of these concepts are very difficult concepts to understand. They're just very difficult concepts in general.

Interviewer: Are you saying that the level of sophistication, capacity and resources within pension funds may be a limiting factor to some of these things?

Interviewee: I think that's fair. I'm not saying it's the capacity. I think most people have the capacity to appreciate. But its resources in the sense of time and the ability to share this.

Interviewer: Do you think conversation of this nature are taking place within your organisation?

Interviewee: There is some conversation going on. I don't think it's focused enough. There are probably other question being asked in addition to this and I'm going to answer this in two ways. So are pension funds the most efficient ways to secure what we're trying to achieve, this retirement income. Which just comes right back to my idea of should you have a pension fund. And then secondly well if you do have them and they are what we need to work with at the moment, the conversations I think are limited because I think the majority of influencers either choose not to deal with it or maybe lack capacity in maybe understanding it themselves. So it's difficult to share this with other people to make informed decisions if you're the bearer or sharer of knowledge.

Interviewer: And actually you've sort of answered two of my next questions in that response so that's great. I'm going to wrap up and just ask if there is anything else you would like to add as a sort of closing comment or recommendations within this space even.

Interviewee: Within this space... It's just very interesting as I've been having this conversation quite a bit in the last day or two. You know what RI is trying to achieve is something you need to define before you get there. So for me: what is the society we are trying to create? If these are the assets or the resources we have and they can influence the way that society looks, what do we need to do. And as pension funds do control a whole lot of assets they definitely can influence the way companies act or at least what they own act.

Closing Comments

9.3.3 Interview 3

Interview: Regional Network manager

Introduction

Informed Consent

Context

Interviewer: The first question is around how you view, and how you think pension funds view their role...So their role in society, their role in the economy.

Interviewee: Maybe let me start with what I think they think their role is. And quite often the rhetoric is around I need to save as much, or give my members enough returns and maximise those returns in such a way that they retire comfortably. And quite often when trustees speak about their fiduciary duty, they normally equate it to getting the highest returns possible. One almost feels like the rest of the sentence missing, but we know you want to maximise the returns but in sustainable manner. But you don't get that rhetoric. The main focus is that I need to run this pension fund, we need to run it in such a way that the savings that are invested on behalf of our members or returns thereof are maximised. And that's where the mind-set is.

And I think my view of what pension funds exist for is broader than that in terms of yes, you need to maximise returns but you also need to take into account that the monies you invest and the capital that you allocate has an environmental or social impact and can be used to actually change society or move society in a way that is more beneficial than just getting a whole lot of money for that particular member. So sometimes I give examples to say that you actually maximise returns and have a pension member who retires with a whole lot of money but they have to use that money to be in an environment where they have to pay a lot more for medical costs because the companies that they invested in have not taken into account the environmental impacts that they have on these members or the health effects they have on these members. Or, for example, if you investing in companies where there is collusion around price-fixing, yes you want to have inflation beating returns, but what is driving that inflation? If you have suppliers of goods who are colluding and deliberately making things very expensive perhaps you wouldn't have to reach for the stars in terms of returns if you actually managed that type of exposure that your members have. Because if you are investing in a bread company and that

bread company charges an exorbitant amount for bread that would mean that the return you would need is much higher to actually afford that bread. But perhaps you might only need to reach for CPI +3 and make sure that these companies are operating in an ethical way and not colluding. And use your influence to make sure that they're also sustainable because this is also something that has a negative impact on how they are viewed in society. So if news does come out that they have been colluding what does it do for their share price? So basically the idea is to have them do the maximising, but the context and thinking has to be much bigger than what it is currently.

Interviewer: Thanks for that perspective, and your response leads into my question on fiduciary duties. What is the view of pension funds on fiduciary duties? So obviously the main thrust of that is as that as a trustee I have to ensure that I look after the best interest of my members. And obviously there are other factors which accompany that: due diligence, due care, prudence etc. How to pension fund trustees digest this? Do you think they have a good understanding of what fiduciary duties are? Is it at the forefront of conversation? What do they understand by that term?

Interviewee: This goes back my first point: looking out for the best interests is automatically equated to the highest returns possible. Because they feel that if you attain the highest returns possible you would have acted with due care, you would have acted as you were supposed to as a board of trustees. And I think that that's where things are. I can't say that every board of trustees thinks like this, but you find that the rhetoric, when you speak to trustees that there is always resistance or some kind of antagonistic approach towards ESG is 'yes, I hear all that, but I must maximise returns for my members'. So there is a disconnect in terms of understanding how ESG actually fits into the fiduciary duty where they almost see it as opposing as opposed to complimentary where in fact you actually acting within your fiduciary duty by considering these things.

Interviewer: And you would say that they would be acting within their fiduciary duties by considering these things, because best interests are not only best financial interests once you get paid out. So do you think there is any conversation within the industry from other trustees, or other bodies, saying that best interests may not only be optimal returns on distribution?

Interviewee: the irony is that when you actually look at the definition of fiduciary duty, there isn't anything about maximising returns. It literally says that you need to look after the best

interests of you members. So it's basically up to whoever the fiduciary is to breakdown what 'interest' is. Is 'interest' based only on financial return? No not necessarily. It's arguably other things. Like I said, you can retire with a lot of money, but if you retire in an unhealthy environment which requires you to now use all that money to pay exorbitant medical fees is that the best interest of that member? No it's not.

Interviewer: And do you think there are any voices, other than perhaps your organisation in the industry that are saying that?

Interviewee: Well I suppose that Regulation 28 was a good start- with the preamble. Because even when you break it down- and its misinterpreted to almost be legislative, but when you look at Reg 28 its rules based, but that particular aspect around considering ESG is more around principles. And when you look at it, the way it's written, it highlights the fact that ESG issues are not the only issues, but you need to consider the sustainability of the returns, including ESG issues. So it's actually even broader, what we look at from an RI perspective when we say ESG. But you as a fiduciary, it says, that as part of your fiduciary duty you need to consider the things that might affect the sustainability of your financial performance.

Interviewer: So coming back to my question... So we have Reg 28, but if you go to conference tomorrow with a large group of pension fund trustees, Batseta, IRF, other people who represent pension funds, PoAs etc would that type of conversation take place - that best interest could equate to something more than optimal returns.

Interviewee: No, not at the moment. That is not at all what I find. Because even today, as much as there have been so many articles and rulings around fiduciary duty, it still comes down to: am I maximising the returns for my members? That's what my duty is.

Interviewer: And do you have any idea where this comes from?

Interviewee: I would argue it's also the behaviour of the members themselves. Where, for example, the reason why they want to maximise returns all the time is because the only time trustees communicate with the member regarding their pensions assets is once a year when you get that statement. And if you look from one year to another they want to have seen that number grow, and grow substantially, because they will compare that number if they are form difference pension funds or different mining companies or different engineering companies, they'll be

like: actually my fund returned 10%, but your fund returned 12%, what is my trustee doing wrong, that you're getting more than I am?

Interviewer: So that brings us to an interesting point. So obviously regulation stipulates that pension funds have to report to their members annually, and that's all they have to report?

Interviewee: Yes, just these are your figures. This is where your pension stood last year and this is what it looks like now. So if you're not presenting a substantially different amount between that start and the end that comes back to the trustees saying you're not doing what you're supposed to do.

Interviewer: So would you say that if reporting to members was different we may see different behaviour with respect to chasing optimal returns?

Interviewee: I think I need to change the question because I feel that you can still get optimal returns, but what they're chasing is the highest returns possible which is not always optimal. That's where the difference is. Because of the level or even maybe the quality of what is reported, or the depth of what is reported, it's literally one point in time and it's reduced to a number. But there is no context behind that number. Where even the reporting of returns is still not done from a risk adjusted point of view. So yes we've achieved 20% but at what risk. And this even goes back to fundamentals of portfolio theory, because the idea is to say that you want to be rewarded for the risk that you took. But right now the reporting is only on the return. But what risk was taken, how did you get to the risk, and is it risk adjusted and what risk has been presented in order for me to achieve this return. Because you could have achieved 20%, and the risk was great, that 20% could have been a dismal return on a risk adjusted basis.

Interviewer: Am I correct in saying that pension funds don't need to disclose what they're invested in to their members?

Interviewee: The way the pension funds work is that should a member want to get to know what's happening, they have the right to ask the board of trustees where their money is invested, who are the investment managers etc. But you don't have that kind of active demand from members. So they do just get what they get from trustees. So you find in some instances reporting is so thin around these investments where they simply say you were in these portfolios and these were the returns. But it's almost like smoke and mirrors and you have very few who

are deemed as sophisticated types of members who will want to know am I with Alan Gray which Allan Gray portfolio, am I with Coronation- which one?- and how do they compare?

So I think the level of detail in reporting is still very poor and I think you also don't have it... you know we talked about the demand side being the pension fund trustees, but they also have a demand side, which is the member, so we don't have members demanding things from their boards of trustees to prompt them.

Interviewer: That's very interesting. So members wouldn't necessarily know if they are invested in the company which they work? Do you feel that there is a missing link there? Especially when you think about mining companies for example?

Interviewee: again, if you only have reporting coming to you once a year with just a number. You note your figure 31 Dec 2013 and this is what it is 31 Dec 2014, its bigger now, okay I've had a return. Sometimes I even wonder if they look at the quantum of the return or if they just note the absolute amount.

Interviewer: Do you think that's just because members don't know what investing is, and that in some cases you're actually buying shares in a company?

Interviewee: Yes, I don't think they understand where their money is going because they don't have that level of detail to start interrogating. So for those who look its moving in a direction that I like and that's where it ends and that's why they won't question any further. So you won't find them asking where money is my invested. And that's the sad part because you find that even boards of trustees are not asking these questions. And it really is that. You know, I made that example about not wanting to invest in a company who is fixing prices. Where boards of trustees are not even taking action should it be found that there is a company that they have exposure to that is fixing prices of goods that their members are spending their money on? So there is still a level of superficial understanding of returns and how they are driven. And for them to actually delve into where is this money being taken and what is it invested in, that requires trustees to do more research and more questioning. And then quite a lot of these issues are ESG issues because if you are looking at society, not even broadly, but simply going into the community that you are investing on behalf of you don't see it happening.

I don't see it a lot, but it could be the fact that they speak behind closed doors, which is something that we found with the work that we're doing in terms of engagements. We find that

a lot of engagements happen behind closed doors so you don't find these things being taken up publically. But you know you would sit through some trustee meetings where they raise certain issues, but you don't know how far they actually run with it or interrogate it.

Interviewer: so you would say that there may actually be instances, where trustees actually think about these things. Even though these issue are not addressed in open forums?

Interviewee: And I think that is one of the bigger issues around the quality of conversations taking place within board of trustee meetings. I've come from an environment where there are some funds where you have a whole day or two dedicated to a meeting. And within that trustee meeting they deal with claims, administration, and all that stuff, but you still find that they dedicated enough time to speak about their investments. But you also have another end of the spectrum where they meet 4 times a year, they do not have an investment committee and they have an entire trustee meeting in 2,5 hours.

Interviewer: And as trustees they decide that, correct? They decide the rules of the fund?

Interviewee: They decide on how long they will meet for, what the meetings will entail and how much time will be given to items on the agenda. So basically how they even prioritise boggles my mind. It boggled my mind while I was an investment consultant because I found myself in a situation where I thought how do you expect me to speak about your investments for 20 minutes, when you told me that your fiduciary is to maximise returns, but out of a 2.5 meeting, you've dedicated 20 minutes to investments? So 20% of your time is spent on what you deemed to be the most important thing. And you'll find that they spend hours deciding, if there is a death claim, which of the kids are going to get that. And that's a reality. That's what happens in a trustee meeting. Even when you then present on investments, they'll simply ask you to present what happened in the markets and with the portfolios. And I feel that they can read that in the meeting pack or investment report. They need to be discussing bigger things around strategy. For me to spend time telling you that the JSE All Share Index returned x... You can read that, why am I spending the little time that you've given me going over retrospective stuff, where we can discuss other issues. Let's discuss your top ten holdings for example and how is it that your equity manager and your bond manager disagree about the value of a company and you're still exposed to it. We don't have a good quality of conversation round investments, to actually understand where you find in some instances asset managers are pressurised to give very short term performance without the trustees actually understanding the

long term consequences of the returns or why is it that they invested in that particular company. They don't have those types of conversations. So someone will simply give them a top ten holdings list and this is how the holdings did over the quarter. And you might find that they say no we just invested in this that and the other and when you look at the broad portfolio on the corporate bond side, their corporate bond holdings are the same as the equity holdings you said you don't find attractive, so explain to me how you can say the same company is attractive from an equity perspective, but unattractive from a bond perspective. So things like that, they don't even have those conversations.

Interviewer: So even at that very simplistic level of 'if maximising returns is your game' at least there should be conversation at that level. And you're saying that at that level there is no quality conversations, or at least there is a lack of quality conversation?

X: Yes, I suppose it is quite subjective what you deem as quality, but that's typically the frustration. Actually you say investments, but you don't give it enough time, and when you do give it time you discuss things which are frivolous and beside the point.

Interviewer: okay, that's useful, very useful. Because that's also part of what I'm trying to get at. You know, people who have some view into that board room, what are some of the conversations that are going on there. With respect to the next question I have, you've touched on it substantially, but maybe for me just to ask the pointed question. So we've got Reg 28, we've got CRISA, is there an appreciation for what Reg 28 says? Is there any discussion or understanding of it? Or is there any attempt to tackle what Reg 28 presents to the trustees? And if there is anything what do you feel that will typically look like?

X: Again, I don't sit in a lot of trustee meetings, but when you start having conversations with a lot of investment managers who are appointed by these trustees, you do see that now there are a whole lot more questions around RI. But the quality of the questions, whether or not they know what they're asking about leaves you thinking that perhaps they don't understand what it is that is required of them and they don't understand what to find so they just ask questions without a particular objective, to say I want an answer for this because of A, B and C.

Interviewer: Do consultants help in this regard or are they also struggling?.

X: Yes, I do feel that a lot of consultants don't know what they're doing, so even with the work that we're doing, we're trying to actually get consultants on board. They have no idea how to

approach it. Even the way they provide their service. So ideally they should be the area of expertise as far as advising the clients goes. And they need to advise that this is what you should be asking for and this why you need to be asking for it. So you find that they are still quite primitive here. They're quite happy to ask about risk adjusted returns, how your portfolio performed over, 1,3, 5 years. But they don't know how to deal with the information you give them from an ESG perspective. Because it's very, I think, in my view, it's very cloudy for them. They don't understand and yet they are in a positions as experts, but if they don't know anything they are not going to highlight the fact that they don't know. Instead of being honest with themselves it appears that they would rather downplay it and ask very simplistic and superficial questions. I can't argue with the fact that Reg 28 has started that questioning and prompting questions to be asked. But I think it's almost like an evolution, to say we'll ask the questions, we don't exactly what we're looking for, but we'll just aske because that is what is expected of us. And then later on to say, okay we have this information, what's useful, what's not useful. But I think, once you move from that position where nothing was done before to at least one question ask, now we can move to improving the quality of questions. And I think the improvement of the quality of questions will come with understanding what you're asking and why you're asking it.

Interviewer: So that brings me then to the second part of this question. Where do you think the understanding of RI in the industry is at the moment? RI being the whole barney. Whether it is impact investing, whether it is ESG integration, whether it is ownership.

Interviewee: I think the understanding of the consultants, oi, I think their understanding is very far behind, I don't even know how to put it. Let's start with how RI has evolved and continues to evolve and I think that will present a huge challenge on its own, because once you start grasping a new challenge that's almost in vogue and you see how responsible investing evolved from just simple negative screening (you're a company supporting Apartheid we won't invest in you), to positive screening, or best in class. So while people are still trying to grasp a certain concept there is a new concept which is coming to the fore and I think that has been the Achilles heel of RI, and that's what lead to a lot of confusion. So as it's evolved, new terms have come into being. There are so many ways to look at impact investing for example. Being from a South African perspective, we had the TDI, targeted development investment, which arguably is impact investing. Because you targeted particular developmental areas. But because you have so many different terminologies for things which are similar and in some instances

something deemed as simple as simple screening has now three variants. Even integration, you can integrate right down to your valuation and say it's just an overlay, I'll do my normal numbers, but I'll integrate by looking at some ESG issues and seeing whether I need to adjust my risk inputs.

Interviewer: So you would say that the central response to my question is that understanding may be there in bits and pieces, but this thing keeps evolving and the understanding -one can't keep pace?

Interviewee: So it's basically trying to understand something that is not static. With portfolio theory for example, we now that R equals that, that, and that. That is a static concept. But when it comes to RI, you're trying to expand, but that expansion is now also just evolving on its own. And I think that's what presents an issue in terms of understanding for a lot of the boards of trustees. I have all these concepts... someone comes to me and says I'm an impact investor, someone else says they only do screening, and another says I have an SRI portfolio outside of my normal portfolio. So is RI not normal? So you have that adding to the confusion that is out there in the market. And then you have consultants who are now supposed to advise no this.

Interviewer: Are consultants required to get any sort of training?

Interviewee: And I think that's where the issue is. There is no visible accountability of the investment consultants. So if the investment strategy goes well, the consultants get a pat on the back with a 'well done you made us choose the right portfolios, you made us avoid the lemons'. You know that's a popular term: 'try to get the winners and avoid the lemons'. But if there is actually negative performance its place on the investment managers, not the consultants. They have an unfair island of safety which we can't explain. And I think that also makes them rest on their laurels, in that they think to themselves: I know how to calculate returns, and report on that and I can help you avoid the lemons. But as far as a better understanding of RI I don't think they are incentivised, or they stand a risk of being fired if they don't understand it. So from that perspective, I don't they're taking it as seriously as they should because they can get away with not taking it seriously, they can pass the buck very easily. And I know it's a bit unfair because you do find that there are now some consultants who are honest with themselves and are saying "we don't understand it but let's make an effort to understand, how we fit it into our consulting process, and how to we make sure that we do this". While others simply say it's a nice to have and when you ask them to show you how, you're meet with silence.

Interviewer: So consultants don't necessarily require training or CDP, or any of those things? Do you think trustees are getting enough training with respect to ESG or RI? And I ask that from the perspective that it is something that is present in legislation, and is there training around it and are they being exposed to it?

Interviewee: as far as training is concerned, I'm not sure. It's very difficult, because again they rely on consultants, or even service providers. Investment managers do training as well. But you still find that training is at very elementary levels to understand what equities and bonds are. So moving from that to something that is a more high-level concept, albeit a fundamental one – I don't think they're getting that.

Interviewer: So training for trustees is typically very basic?

Interviewee: It's difficult; it's a little bit of a chicken and egg situation. You know the board are actually employer and employee elected trustees. And the level of sophistication differs between employer and employee trustees. So someone who is drilling at the rock face won't necessarily understand what equity is so you need the training to teach him what that is. But you also have the opposite where you have someone who is a CFO sitting on the board, those are the kind of guys that are employer trustees. And I think they sometimes get arrogant about what they think they know. To the point where they ignore training, and you can't teach them anything, because they 'know' everything. And you have to teach the others to get the basics, and trying to marry the two, where both these parties need to make a decision or decide on an approach, it becomes quite difficult. So I guess that's why it becomes quite easy for investment consultants to say actually let's not even open that can of worms, we're doing fine and there are no complaints. We can maybe just mention ESG, but that's where it ends. We won't interrogate it further than that.

Interviewer: To move on, something that has been present in this conversation has been an emphasis on stewardship and ownership. My sense from our conversation is that you don't think that there is recognition, generally speaking, of the fact that pension funds own shares in companies and therefore are part owners? So do you think this would be a good point to drive for more enquiry and engagement? Or, the other side of the coin do pension fund trustees understand that pension funds are part owners, but they don't think that engagement, or actively participating in what they own is going to yield any positive results? So there are those two elements to why there is potentially a lack of engagement.

Interviewee: I think that is a structural problem we have in the South African market. Where you could almost empathise with the board of trustees around their understanding of ownership, and what is in their capacity to influence. And actually I blame the investment management industry as well. There are very few large enough pension funds that actually own assets, in the sense that you go to custodians and the assets are in their names. And those pension funds are actually quite vocal because they have a sense of ownership of their assets. But a bulk of the funds... you know you have a huge gap between the big big funds... you'll find that the top 10 are really huge, and then the next ten are a small fraction of what those huge ones are, and when you now go to the pragmatic way of looking at managing your pension fund, you can't invest your entire fund with one manager. You have to have that diversity. And then in order for you to have that diversity, you have small amounts you can invest with an Investec, Allan Gray, etc. And for you to go into a segregated mandate you have to the likes of the big asset managers telling you that you need to have R0.5 bn to have a segregated mandate, where you actually are the asset owner. There you have as say, it's a say that actually has tangible influence. But you don't have that anymore. And the investment management industry in the time that I was in investment consulting, you find segregated mandates have moved from R100k, to R200k, to R0.5 bn. So if you are half a billion fund, there is no way you would choose to get one segregated mandated, because then you are not diversified. So you are forced to go into pooled portfolios. And then your power is limited, as you don't own those assets, it's the investment managers insurance company that does. So trustees are understanding of that. So they may say I hear what you're saying about me being the theoretical owner, but I don't have power. The most that I can do as a trustee, in terms of power, is whether I assign money to that particular manager. And actually, I find it quite irritating, that a lot of investment managers don't want to recognise that. Where you find that there was quite a lot of rhetoric from them saying that they don't get enough guidance from the asset owners. But of course you won't as you as the manager keep raising the bar in terms of the segregated mandates which allows them to have the power.

Interviewer: That's a new perspective for me.

Interviewee: That's the thing. And I've taken the industry to task on this matter. And this goes right down to the way the contract is structured.

In 2013 there was one asset manager whose bar for a segregated mandate was R0.5 bn and that's the size of a medium sized pension fund. All of their assets. So for them to put all their

money into one segregated mandate, with one asset manager makes no sense. And they have to diversify. So as much as we're saying they have to take ownership, on paper they are restricted.

And now you have the added pressure of the regulators saying that the funds have to watch their costs. So a lot of the funds have said it makes more sense to go the umbrella route. Again, less ownership. The most you can do again is the decision around who you appoint as an umbrella fund administrator. And that's about it.

Interviewer: So would you say that potentially going forward, the people to target, even though RI is captured in pension fund legislation, but the groups and bodies to target are consultants, and the umbrella funds and the administration there? And if we want impetus around the RI movement and RI investing, those are the key stakeholders.

Interviewee: Yes, especially when you start looking into to active ownership. And you need the owner to actually have a say. When you look at the bigger funds, you actually do find that some funds vote their proxies. They have a vote. Some maybe don't attend AGMs and some maybe don't raise resolutions, but they have that ability and it's a matter of sensitising them to that.

Interviewer: This question leads into the next, which is around what do you see in trends going forward in RI from a pension fund perspective, active ownership and obviously I've mentioned now that if we want to see more activity, for want of a better word, targeting consultants and umbrella funds are maybe the groups to target going forward. But other than that what trends do you see? What do you think the landscape will look like in 5 years' time from a pension fund perspective? What do you think the bottlenecks are?

Interviewee: I think because the number of pension funds are technically behind the curve in terms of understanding RI, so I think you will see an evolution, where you move from asking questions just for the sake of asking questions, to actually asking questions which are meaningful.

Interviewer: And you think this will be because of training, or because of?

Interviewee: I think it's because of a better understanding.

Interviewer: And how is this better understanding going to happen?

Interviewee: So I suppose it its training, and actually being taken to task by regulators saying you need to understand this, what are you doing?

Interviewer: And do you think that will really happen?

Interviewee: It is going to happen, and that's why I say it's an evolution. Rome was not built in a day. The way I see it, the whole movement of RI is a revolutionary concept, but it's going to take place in an evolutionary environment. So that's why it's very difficult for people to grasp it. They hear you, you have a conversation explain why RI or ESG matters and the light bulb flickers, and then they go back to their working environment, their daily lives and its completely forgotten. Because it is something which will require behavioural change. And you are seeing the behavioural change from more questions being asked since 2011, to 2014 where every questionnaire has something. Whether it's a question on if you're a PRI signatory or are you a CRISA endorser or what do you do around ESG? Now it's a matter of we're getting this info on an annual basis, what does it mean. And I hope that now pension fund trustees will say: we get this information, what does it mean? As that will prompt the questions around elaborating on what was reported by the investment manager. Part of it will also be driven by training, and hopefully also the greater understanding of what the fiduciary duties of the trustees are and incorporating RI is not going against your fiduciary duty. So that's from the asset owners' side. And I'm thinking other trends you might start seeing, as far as having influence over markets, you'll find it very difficult for funds to have influence on a particular company or industry, but they could probably have more influence together, in terms of more systemic issues. You're starting to see it, for example, with climate change. In New York you had a huge march in the same week that the climate change conference was happening. And you had institutional investors, who are not directly engaging in the company ABC in what they're doing, but they're engaging with governments and policy makers. So you're seeing that the collaboration is starting to move towards more about addressing systemic issues. So maybe it will a top down thing, whereas we've expecting a bottom up approach.

So still a long way to go, and what I've learnt, and I remember when I first got into the work that I do now and I was expecting things to change quickly. But I actually had to sit back and reflect on the fact that we are advocating for investors to be long term investors, but we're not thinking long term in terms of our expectations. So we've also had to check ourselves, those of

us who are passionate or driving this. It is a huge behavioural change that needs to happen, so we need to be patient. Just as much as we're expecting investors to take time and look beyond 5, 10 years, you also need to look at this evolution, which is taking much longer than we thought. We advocate for sustainability, but we're not supposed to sustainable as an initiative. As ideally this should just be the way life is supposed to be. Why should you need an entire organisation trying to convince people. It is just the way it is.

Interviewer: So you'll know our job is done when you work ourselves out of a job.

Interviewee: You can never say it all when the job is still not done, but what I realise is that, again, we just need to be patient regarding what we expect. We need to have realistic expectation regarding how the industry will evolve. And I think we need to have bravery amongst a lot of people in the industry to call a thing a thing.

Interviewer: What do you mean by that?

Interviewee: Where as much as there is consensus on things such as investment consultants don't have any form of accountability in this. But no one is doing anything about it and people tip toe around it.

Interviewer: But whose responsibility is that at the end of the day, the FSB?

Interviewee: The members themselves as well, and the FSB to raise it. And it boils back to relationships which have been built over years and people don't want to step on other peoples toes. Because I also think investment managers actually are not brave at all. Whereas they want to have more clarity from asset owners regarding what they want done, but they'll never say to an asset owner, you're not telling me what needs to be done. And are rather happy to not do anything when nothing is required

Closing Comments

9.3.4 Interview 4

Interview: Senior Research Analyst

Introduction

Context

Informed Consent

Interviewer: Hopping right into my first question. What is your view and the view of your organisation on the role of pension funds in society and the economy?

Interviewee: So basically retirement funds, remembering that the typical pension and provident funds don't just do retirement savings- they also do things like life and disability insurance- other things which protect the family. So as a result, how we see that whole function of the pension fund in the economy is that it forms part of the social security system of South Africa. Now we know in South Africa, the constitution says that social security is the responsibility of the state and they have certain obligations around that. And in this case, for employed South Africans, the state has chosen to rather regulate the private sector to provide these things rather than do direct provision at this stage. So that's really how we see retirement funds- they fit into the social security system. And because they fit into the social security system they have to fulfil certain criteria. Because the reason you have a social security system in a country is for multiple reasons: for protection of household income, prevention of people falling into poverty, and preventing the creation of poverty traps. It's also about risk taking in a society and encouraging sufficient risk taking. So for example, will a household invest in education? Well if they have a little more protection and they know that if daddy gets disabled and may lose that income it will be replaced, then it's easier for them to say send the child to better school. So it improves the risk taking in society. So social security as a general function is a very broad function in society. So obviously in South Africa, we're a development state, so the state takes certain levels of responsibility for that around the grant system which provides a minimum for every South African. But the reality is that as soon as you're a working South African your income is higher and that is no longer sufficient, and that's where the private sector comes in to help fulfil that obligation of the state, to essentially ensure that people have a rising floor that is in some way related to their income. And so the way we see it is that

retirement funds need to fulfil that function at a society level and then at an individual level, they need to be a meaningful part of the individual's financial journey. And what we mean by that is that is if the rest of someone's funds are on shambles then fixing that person's retirement is not the priority. These long term things need to speak into people's lives as a whole.

Okay so those our perspectives of the role of the pension fund at a societal and at an individual level.

Interviewer: So at an individual level you would say that there should be more emphasis on the holistic financial well-being of the individual throughout the lifetime of the individual?

Interviewee: Absolutely. So one of our catch phrases is: "It's the journey not the destination." Which is a reversal of a lot of what you see around retirement funds in South Africa. A lot of the focus in retirement funds is: did you meet this target, did you meet this target etc. That's not how we see it. We have to look after the journey, and we have to fit into the individual's life as a whole.

Interviewer: So there is typically an emphasis that pension fund are not there to look after people, but just to provide income on retirement? And we can't blur those lines?

Interviewee: Yes

Interviewer: So it's very interesting, and obviously your view is in line with the whole package of the pension fund?

Interviewee: Exactly. So we often have a dispute with trustees, and this is not necessarily an RI issue. Where we say to them that you can't just look at maximising how much is going into the investment to make sure the retirement income is there, what you also need to consider are: the death and disability benefits if the family is left in a situation where the main bread winner is not there or is disabled. So our view of this role of the retirement fund is extremely holistic. It's to look after the beneficiary, it's to look after the employee, it's to look after the employees beneficiaries. And then to make sure, and this relates to RI, that the person has a retirement worth living. Having a retirement worth living is not the same as having a 75% income replacement ratio.

Interviewer: On the same question, what at this current time then, do you think is the view of the pension funds and their trustees on the role of pension funds? And maybe in direct reference to what you've outlined here.

Interviewee: A large part of trustees are focused on the 75% replacement ratio, which our research unit has not been able to find very much evidence for why that 75% exists. But they are very focused on retirement and maximising that income on retirement, and often in a very weird way, which is slightly divorced from reality, in the sense that they will look at projections and things like that and ignore behaviour. Which is strange because the people they're looking at- who these projections are for are likely not the type of people in their own fund. They have this view of the 75% ratio and then create this subsidiary obligation that they need to maximise investment returns from that. This seems to be the implicit ranking of how they see things. It's all about retirement and then implicit in that the focus is very much on investment returns. They treat investment returns as a proxy for the replacement ratio.

Interviewer: So again I'm interested in again your perspective, and then what you think the perspective of pension funds and their trustees is on the fact that pension funds sit on huge amounts of capital. This is capital of ordinary people, and as deployers of capital they have significant influence in the shaping of the economy, in the shaping of industries, in the shaping of their own lives. Do you think there is any discussion around the influence from that perspective?

Interviewee: In line with how I laid out where we are. There is a big thing for countries that private pension funds are actually a better way to make capital and development in country. Now there is a lot of disputed research about that. There is a lot of research (Nicholas Bar's work) which shows that it actually doesn't matter how you fund a pension system. There is also a lot of social security research coming out of the World Bank and the OECD says that the role pension funds play in capital has to be secondary to their role as a social security provider. So as much as states, when they introduce these things, and we've seen this in other African countries which are trying to build this up. The state often sees this as a way to develop infrastructure, the reality is that what the major multinationals are saying and we've aligned ourselves with is that social security is first and capital deployment is secondary, and a great nice to have. But you cannot maximise a system based on maximising money available for infrastructure. You have to structure around maximising the social protection of the individuals in society. That has to be its primary function. Having said that as I've said the way we see it

is that one of the first arguments we have with people is that maximising wealth is not the same as maximising income, the next layer of that is that maximising income is not the same as maximising standard of living. And standard of living is affected by a lot of environmental factors. So its affected by whether the air is worth breathing, its affected by how much you have to spend on security because your society is unequal, its affected by a lot of factors which ordinary pensioners will experience if the society is degraded. And of course a perfect example of this is Zimbabwe, in the 80s, as far as I understand this, although I would check this before I quote this, but my understand is that in the 80s their pension funds outperformed South African pension funds, but which would you rather be in. so in terms of capital deployment, it's not that we see the pension fund having a direct obligation in looking after the economy but because of the obligation to look after the individual, there is derived obligation, because pension fund members are normal South Africans, they are the majority in society, they are not the high income earners, then you have to look after the world in which they retire into. So it's a derived obligation, if that makes sense.

Interviewer: Do you think that there is an appreciation on the part of pension funds and their trustees with respect to this view?

Interviewee: The reality is that it's hugely variable. Your biggest funds and more professional trustees, your more engaged trustees etc can sit anywhere across the spectrum of views. The journey that a lot of providers has been on has been first to get people to understand that wealth and income are not the same and that maximising wealth and income are not the same. Then understanding that income and standard of living is not the same. That's a step that for some people makes perfect sense, but if they haven't made the wealth income connection, then that's why I said in the first question, a lot of people derive the 75% and then they turn it into investment returns, and that's a basic function of the fact that people don't understand that the structure of the liability is around income not wealth, so maximising returns can be essentially meaningless. But that's the kind of journey. Its first understanding it's not about wealth, it's about income and then once you understand that it's about what your income can buy- what does that life look like? And I think that that journey is very variable re where people are. I don't think there is a huge understanding of that and I think a lot of people back off from that and are frightened. Because how on earth do you model that, how do you measure that? And if everybody's doing that you will make no difference it's a classic prisoner's dilemma. If you as one pension fund, unless you're one of the bigger ones, you can say okay we're going

to do this, we're going to align our investment strategy with the National Development Plan, we're going to make that this is happening- but how much difference are you going to make to the South African inequality ratio, how much difference are you going to make to South African employment? Even if you completely decided that environment come before social, so we'll probably disinvest from anywhere in the core value chain, are you going to change anything? If you're one pension fund you're not. So it's very challenging. Because even if you get one pension fund to go yes, you're completely right, this is what pension funds could be doing, but you're saying that my pension fund is potentially funding this for the whole country, taking on excess risk, maybe cutting into my return- we do try to change that narrative- but everybody else isn't doing it so my pension fund members are paying for all the difference and maybe there just aren't enough of them. They can't- so it's a very challenging journey for them. I almost feel that at this stage of the game, there's a range of views in South African on these kind of things. That journey is a very hard one.

Interviewer: Do you think it would make a difference if there is some sort of requirement for pension funds to consider this and it's enforced and monitored in some way? So do you think that if there is some sort of requirement to report on this to members, to the FSB, that that will engender some more collaborative effort, so you don't get this lone pension fund example that you've touted here?

Interviewee: I think that regulation is not going to help. It is in Reg 28 already. The reality is that pension funds have a lot of obligations, backed by how the legislation works. There are so many things they have to get right. So simple things like are there members saving enough? You have to save enough in the first place. You know how many pension funds allow ridiculous things like a contribution rates of 5% of someone's pensionable salary of 60%, so the person is saving next to nothing. Issues around preservation. There are such massive issues that we have to get right for pension funds to even begin to serve its function that making this issue which is very important but very tricky a regulatory obligation- yah sure you'll change how much time you spend on this- but at what cost? We're just trying to get pension funds to undertake exercises to see what the preservation behaviour is doing to the pension fund, what the contribution behaviour is doing to the pension fund. What their pensionable pay is- simple structural things that you realise that there are structural things in the pension fund which are shooting you in the foot before you even get started. So there is so much that they need to get to grips with.

So you suddenly make ESG a reporting requirement, and what will happen is the consultants will suck up that obligation and make it as easy as possible for them, but it's not going to mean that these people- I mean is it realistic for them to sit for the 8 hours they sit and figure this stuff out, when it's so hard. And what do you report on? It's one of the things we're trying to do- help them, build reports for them so that they can look at. But what do you use? There are a multitude of ratings systems for companies so do I show them what their underlying companies are rated as by four different agencies, which are probably not in agreement on whether it's doing well and where its doing well and where its doing badly and how to balance the ES and G. Do I show them an assessment of the asset manager and their process? So do I do an assessment of the managers? So what does reporting do? We don't know what the solution is. In South Africa we make it seem like you can do E,S and G simultaneously and its super easy, and hey I've done this too. But sometimes you come up with huge conflicts like what do you do about the coal industry? It employs x amount of people in South Africa, we have a huge unemployment problem, yet on the other hand we have an environment issue. How do you balance these things? Not every pension fund is going to have the same view on these things. You try to get them to pay attention to maybe one issue at a time. You take a pension fund and you go, this is the kind of pension fund it is, these are the kind of members, so is there an ESG issue that we can use as a starting point. Also on our side it's also about how do we make this super easy for people. So rather than saying let's try and get the regulations changed, so that they have to spend 8 hours talking about this and then they ignore preservation and they ignore contribution rates and they ignore 'the widows and orphans'. So, you know, does regulation make sense? I don't know. I'm not sure. It's difficult, obviously reporting can help, but the other problem with this is that any kind of measurement or reporting skews behaviour towards meeting that. And the reality is that we don't know what the 'meeting that' answer is. And realistically the best version we have of what people should be doing, if we're talking in south African, democratic system is probably the National Development Plan, but 'Oh My Gosh' that thing is complicated!

Interviewer: You mention obviously that pension funds would look to the consultant if there was some sort of reporting requirement. But if there is not a requirement, do you think that there is a role that consultants can play in this arena? Because as you mentioned, RI can look very different for various groups of people. So do you think there is a role there for the consultant, or do you think it should be completely passed onto the asset manager, and if they do something, great, and if they don't do anything, its fine?

Interviewee: Well, you have to have every piece in the value chain engaging with these questions. It's too hard to solve in one place. There are two types of consultants: asset consultants, who will come in for a fee and will tell you this is who you could invest with and these are the pros and cons of these managers. And then the multimanager and they are an implementer consultant. So they go in and say these are our best house views on how you should do this if this is your objective as a fund, and then they give it to you packaged and you pay an asset managing fee. So you've got two very different types of consultants there. Is there a role for consultants? Absolutely! Probably not the same role, depending on what role the consultant plays for the fund. One of the challenges we have is that you can't just leave it with the asset manager to a large degree. Because the problem is that we have so few asset managers in this country who are really engaged with it. Then we have problems with the fact that this stuff is really hard to advise on, from a pure ESG perspective, because the reality is that we have so few asset managers that have robust ESG systems. Then on top of that they all tend to have the same investment style bias, which as a consultant makes it very hard. Like we don't have ESG managers that are further enough along, across the spectrum so that you can build a meaningful portfolio that covers your main styles: value, momentum, small cap, large cap, etc, fixed income, equity etc. You've got weird little biased pieces. So it's very difficult to do, and so obviously the consultants have a role to play in a) upskilling the trustees on the one hand, and b) on the other side get more asset managers to do this stuff well. To be honest, from our perspective, we need more asset managers doing this stuff well so that we can give meaningful advice. I can't put you in two equity managers, who have the exact same style bias, just because they're both RI.

Interviewee: Makes complete sense. What about the fact that the trustees of particular pension funds need to serve the best interests of those particular employees or members and their beneficiaries. And the work from an ESG perspective of an asset manager can be quite broad, they may not be speaking to a particular funds needs in an appropriate. So that could be a bit tricky to put together if you leave it with the asset manager?

Interviewer: The other thing we need in SA, from a consultant point of view is that it would be ideal if you had managers that were strong E managers, and different managers with strong S, and different managers with a G emphasis. So you start blending stuff. Because the reality is that if you leave it with the manager, it's sort of like the whole balanced/specialist debate in pension funds. So in a balanced fund you let the asset manager make the asset calls and that's

one way of doing it. And it's the same as if you give everything in ESG to a manager and you let them make the call on what's important in E, what's important in S, and what's important in G and how to play those things off against each other. And how to play those things off against the financial variables. [I'll leave that with you]. So that's one approach, and depending on the fund they may go that approach. But as consultants we need a much bigger universe than that. So in the specialist approach for instance, what we'll do is that a client will have a static asset allocation and then it will be allocated to equity managers, and to bond managers, and to money market managers, and to global market managers. And then the whole asset allocation is controlled at the consultant level and the managers are just dealing with their asset classes. And a similar thing with ESG, as consultant we also need to be able to that kind of thing with ESG. Based on what is important to the fund we allocate the money to this pack of asset managers which will give a high social return or a skew towards black economic empowerment, or high environmental skew towards climate change. Ideally in a consulting space you need to be able to either say these are the pros and cons of giving the decision to the asset manager and these are the pros and cons of us making the decision with you, these are the different layers that can be managed by us. On the multi-management side: style philosophy, what sorts of things should sit at the multi manager level and what sorts of things should sit at the manager level. The reality is that, well there are different views on this, but generally the consultant doesn't look at shares. The consultant looks at trends across the portfolio. So in an ideal world, where you have all the ESG pieces you want and all the portfolios you want then it's ideal. I can sit down and say, I know that this manager is always going to trade-off employment over biodiversity, always, always, always, except for when a company has very high dividends or something like that. Or they're a deep value manager so sometimes they do this or that. So the consultant absolutely has a role to play, but it will be different for different consultants, depending on the services they offer- it's going to be different. But absolutely there is a role there. And it's a role in two directions. It's a role to the trustees, often an educational role and tis a role down to the asset managers, to say that this is what we need guys.

Interviewer: That's very interesting, because that's the first time I've heard someone speak to the possibility of a building block approach, I suppose it is, with respect to ESG. So that's quite an interesting view.

Interviewee: Ya, it is only one way to do it, and it's not necessarily how we would do it. But obviously the consultant will want to be able to build towards something in as many ways as we can.

Interviewer: Maybe I can touch quickly, and I used the terminology briefly earlier, with respect to fiduciary duties of pension fund trustees do you think that there is a good understanding of what 'to act in the best interest of beneficiaries' means on the part of pension fund trustees, and what do you think it does mean?

You've obviously mentioned the role of pension funds from a social security point of view, which speaks quite well to this question, but if there is anything in addition to this emphasis on fiduciary duties, and them acting in the best interest of their members...

Interviewee: I think that trustees are very aware that they have one, but that they get very nervous about what that means. I gave you an example earlier, one of the questions is does their fiduciary duty extend to widows and orphans when someone dies, does it extend to a disabled member, what does it look like? The reality is, yes, pension funds are very aware of it. I think it's so huge, it's actually a huge thing. It extends to a lot of things, it covers so many issues. It's not a simple thing. So I think fiduciary duty is also about where do you base you time? So one of the things that we're constantly having conversations with pension funds at the moment, which I mentioned earlier is how much attention are you using trying to pick the best asset manager versus how much time are you spending looking at the structure of your pension fund and whether it even gives people the chance of saving the right amount? So fiduciary duty is there, they're aware of, and it's a very powerful language to use with which to speak to them, but there is a lot of nervousness. Because what if you tell me this is what it means and you're wrong! And that fiduciary duty covers so much. And obviously they can't control the behaviour of their members. But what are the options they're giving them, what is that doing? Are there ways they could influence behaviour more.

The struggle I have with this stuff, almost at a personal level, I believe deeply in RI, but when I look at the mistakes pension funds are making- and there are really huge staggering ones like preservation rates and contribution rates- you almost have to, at the moment, get them to first look at the structure and then hopefully once they get that bigger picture perspective, we can go 'let's look at investment again. But let's remember all the things we learnt about the bigger picture and bring it back to the investments. So they're very aware of it, but understanding what

it means, how far it extends, where it goes, where it doesn't, that's hard. That's hard, and it seems easier than it is. It's really hard. What do you do when you've gone okay this is the best structure, and this is the right investment strategy; it looks after South Africa in a long term way etc. and someone retires and one person in your fund retires and they decide, no they could have earned xyz and they're mad? So what does that mean? So the challenge for the pension funds, and I stand to be corrected, but legally that fiduciary duty is to the fund and its members. It doesn't necessarily tie it to its present members only. So there is a space for: what does that mean for beneficiaries, what does that mean for future members of the pension fund? Because it's DC you don't really get these problems anymore, but in terms of DB, what will that mean in an intergenerational context. Because one way I have to look after my members right now is to go completely bananas and give you loads of money, but then the fund won't exist next year. I think the awareness of this thing exists, the awareness is heavy, the importance is there in their minds, but understanding what that means and how to play off the gazillion things that play a role, is very hard.

Interviewer: You've highlighted to me the structure of pension funds, and almost the basic issues that we have to overcome before we take pension funds and fiduciary duties to the next level as it were. But would you say to a question on investment returns vs looking after the well-being, holistically, of a member or beneficiary. Academic literature tends to focus a lot that in the RI space. Is there, in the context of fiduciary duties, a recognition that 'best interests', that term, means more than just those optimal investment returns, and means, besides the structure of the pension fund, it means looking after other facets of the individual?

Interviewee: I mean it's difficult, because some of the things you're talking about, for instance the education vs retirement fund dilemma. We do say that there are some things that are more important than saving for retirement and that there are valid reasons not to save. You could put your money into your house as long as you're not overly capitalised and you put money into fund for your children's education if you live in a social environment where there is the expectation that they'll look after you in retirement. So we're not gung-ho retirement only. That's definitely not where we are as a house and in terms of how we approach investment specifically, within the context of investment, yes we try to get them to stop focusing on those little numbers on fact sheets and to actually look at how does this stuff actually work over forty years and what kind of risk is it exposed to and really try and have that kind of conversation with them, to get them to understand simple things like the wealth- income thing. Things like a

low risk strategy is not cash, a high risk strategy is not equity. A low risk and high risk strategy is relative to your liability, which is actually more like a bond. The literature, I know exactly what you're saying, it always talks about optimal risk returns and everyone's worried about this etc. And do ESG fund outperform or do they underperform or do they do this or do they do that, and is it a good risk return investment. To be honest in our narrative that's just really not important. Even when we look at risk return- we look at risk, we're very into risk, but we look at risk in a risk budgeting framework, which means we use gazillion different measures of what risk means. So, we try to facilitate different philosophies and we try to say to trustees don't just look at this as a 'check the numbers on the fact sheet'. Or even in our own investment surveys. There was an interview with our investment surveys head the other day on CNBC, and they clearly trying to get him to talk about performance and who's the best and he kept saying that's not why we do this, that's not supposed to be what you read this as. You're supposed to go- this is a manger, this is what a manager looks like and is he performing the way we expect him to perform. And that doesn't mean getting the best risk adjusted returns, because skill vs luck- luck is a big player in this game- is huge, it's massive. You're a hero if you get it right 60% of the time- you're like Warren Buffet if you get it right 60% of the time. We've spent the last 40 years trying to tell people that. Our focus is really not in making a comparison like that. The problem with those numbers is that they are really easy to put on the fact sheet, and so they're really easy for people to get fixated on. And as an industry we've done a huge disservice to ourselves- all financial players in focusing on fact sheets. We've spent way too much time distracting people with that stuff, and so what does it mean from an RI perspective? We're still grappling with that. It's difficult, but we've got to try.

Interviewer: What would push the conversation away from focusing on the number on the fact sheet?

Interviewee: I don't know, it sort of worries me a lot. We have to get rid of the short termism; we have to get rid of 'performance is everything'. It's difficult because the problem replicates itself at every level. I don't know if you've seen the latest Collective Insights magazine on goals based investing. So that's how some are trying to change that conversation, by getting people to focus on goals and how goals interact with each other. And so to try and change that narrative to a long term narrative, to an objective narrative, to a what does the end person actually want from this money kind of narrative. As much as I don't think the goals based articles ever look specifically at RI, I think it's a very compatible system with RI, in terms of the way of thinking.

But again it's very difficult. There's a lovely goal, where the author asks why did we end-up in this narrative of chasing performance? It is a very good article, and there is another one by Charles Ellis, the risk of performance investing. It was in the financial analyst's journal, I think the last edition. It looks at the theme again of why we have ended up in this narrative, and it boils down to the fact that at some point it was just really easy for sales people to do it this way. And the problem we have in this country, and we see this when we see the survey numbers is that managers like to chase performance- everyone in the industry does. And then you see people that break their style consistently because of it. And if people are breaking out of what they are supposed to be doing, it's very difficult. And the pressure is all the way through the value chain. So we just have to push through. I'm not sure what the golden bullet is, but I've given you some suggestions of what they might be.

Closing Comments

9.3.5 Interview 5

Independent Consultant

Introduction

Context

Informed Consent

Interviewer: The question I've started with is to frame the discussion-what is your view of the role of pension funds in society and the economy? How do you see the role of pension funds? Are there primary and secondary roles?

Interviewee: I think pension funds are the key stakeholder in the investment value chain. For the very reason that they are the sole owners of the assets they manage on behalf of their members. As a primary function -their key initiative is to drive returns and look at good investment strategies in line with responsible investment, in line with the different regulatory frameworks and the PF 130 circular requirements and to try and bring it all together under the overarching theme of responsible investing. So as an example, looking at the impact investing element: how does it impact their milestones for the coming year and their five year plan ahead? And I think with respect to their primary function as well, it's to uphold their fiduciary duties. Because at the end of the day they are very much responsible from a fiduciary perspective and they're very accountable in terms of how they run members assets etc.

From a secondary function, I would say their key responsibility is the accountability to members. It's around the communication, the transformation, the transparency in terms of what they're doing from a fund perspective. I think given that boards of trustees are very limited in the numbers of times they meet per annum, they don't get to address all the pertinent issues and through Sustainable Returns we've seen that although ESG and sustainability have been identified as a top 10 issue, with a lot of pension funds it's at the bottom of the top 10. It's just that they have so many other burning issues to deal with that this kind of gets side-lined. So those are the kind of things I'd say are from a secondary and primary perspective.

Interviewer: Later on in this interview, I think I'll come back to that point and talk about a little more on what some of those other 10 issues are. That's very interesting to touch on. And

then just from an almost broader societal and economic perspective- you've spoken quite closely to almost the functioning of the pension funds and the role of the trustees- but from a pension fund perspective do you think that there are broader economic and social roles for them to play? As asset owners is there anything in that space that you would think is worthwhile commenting on?

Interviewee: For me, I would say, your question is very valid. As much as pension fund trustees hold this power in the sense of choosing the investment structures that they want and investing in appropriate investment platforms, the challenge that we see is that a lot of reliance has been placed on the consultants. So in some boards you find that the area of investments kinds of gets abdicated to the service provider. And although, the boards of trustees hold their fiduciary duties, you find that there is a lot of reliance placed on the service provider in the sense that if the service provider tells them to invest in x, y, and z they would do it, because we find that in certain boards they feel very far removed from the topic, and they feel that they are not skilled enough to make the right decision in that sense. And that's a risk for me that we picked up. And as I said, going back to the fact that pension fund trustees meet so infrequently that they don't necessarily have the time and the skill set to actually execute that important decision and that is a worrying concern. And maybe if you don't mind, I just want to take you back to the opening question and maybe if I can add a little more context. In my previous role I was a trustee and principal officer of a large pension fund in South Africa, so that will just give you a little more understanding in terms of the answers I might be providing, will also be informed by experiences as an asset owner.

Interviewer: Then to dive right into fiduciary duties and you've obviously mentioned it quite a few times now- what is the current understanding regarding fiduciary duties from a pension fund perspective? Do you think trustees have a firm grasp of what fiduciary duties are? Do you think it's just something that is understood at a surface level- is it really interrogated by trustees?

Interviewee: I can answer it as a 'yes' and a 'no' in that the older trustees understand their fiduciary duties in terms of what is required from Section 7 of the Pension Funds Act. However, the new trustees don't know. And we find that trustees are often put into these positions with very little understanding of the risks that they hold. The FSB have since tried to bridge the gap by enforcing a rule that all trustees need to be trained within 6 months of the appointment. And what we're trying to do, together with Batseta. Batseta has recently kind of officialised the title

of the PoA. You know Batseta is now the officiating body for PoAs, very much the equivalent to a SAICA and a standard setter in industry. And this is a wonderful thing because it now sets apart being a normal trustee versus a professional and a POA. Because Batseta now offers membership to trustees as well.

The challenge that we often face is that trustees are not at the same level of understanding. They come from different backgrounds. The employer trustees are much more learned because they have the advantage of being in that space. But when it comes to the employee trustees, especially from the negotiated fund space, the blue collared workers, these are the likes of your shop stewards that are typically in these leadership type positions that are unable to grasp the concepts. And I would take the next step to say that training, mentoring, development, empowerment are all important factors in order to bridge the gap to make trustees to better understand their roles as fiduciaries. I think that is where we're falling short, but I know that Batseta, together with INSETA, are trying to look at that. For example, just to give you an idea, INSETA has approached a few industry experts, like myself and Batseta, to sit on a working committee of pension experts in the industry. And we're basically trying to scope the pensions industry to see what are the areas that need development from a skills point of view, how are the trustees unpacking the different changes from a regulatory point of view- because there are so many changes that trustees have to adhere to. And to be honest it's quite complicated, particularly now around the reform. And trustees are nervous because their jobs are becoming increasingly risky. And they're holding ten times the risk that they can actually relate to.

Interviewer: That makes sense. You mentioned that the FSB was trying to drive training for the new trustee within 6 months of appointment. Do you think that's happening? Do you think that's really being adhered to?

Interviewee: Absolutely. In certain funds it's definitely happening. The training and development is becoming a must. So for example how the pension fund industry works is that they pay a levy to INSETA on a monthly basis very similar to the way corporates and everybody pays. That levy is actually utilised for the upskilling and development of trustees, PoA, and senior management who may have the opportunity of sitting on these boards. So it's a win- win situation as it semi- funded by INSETA via the levy. So that's something they're using as well as tying it right in with the CPD points. So it's certainly taking place and the momentum has certainly started, but I don't think it's at the level where it should be.

Interviewer: Yes, that was my next question. What is the quality of the training like? And then are we seeing a significant and meaningful change in understanding and ability to uphold ones duty before and after training?

Interviewee: Yes, so they are very valid questions. For now the challenge in the industry is that there are so many different industry bodies offering training and it's difficult to try and quantify the type of training as well as the quality. And that's why it's important for the likes of INSETA to get involved because if they collaborate with BATSETA, which they are doing, they become the standard setter, almost to the point that BATSETA will peruse and say you have met the requirements of x, y, and z and now you can go out and issue an accreditation for the training that you're providing. So almost like a reinsuring the standard and quality that is offered to all trustees. The intention is that they would like to get all trustees to undergo the training. So irrespective of whether you're a new trustee or old trustee, in order to be on the same level it would be prudent for everyone to go on that journey. So whether it's an ESG 101 or 102, it's a good value add going forward. It's the only way you can start to track and check that system is working.

And then the other thing is that there is and FSB trustee toolkit available on the FSB website.

Interviewer: Do you know if that's really utilised?

Interviewee: So this is the thing. So if I look at stats from some of the projects, there were approximately 28 000 registered trustees in the country, both employer and employee. I'm not sure whether all of them are active or not, however only 2500 trustees were registered on the toolkit. I'm sure now there has been more uptake as a lot of consultants have also been driving trustees to complete it. As it's an online assessment and you can actually complete it as many times as you wish. So I've seen boards doing it. Certainly, there has been talks around it and certainly the messaging which has come from BATSETA, at their conference etc, trustees are wanting to become much more skilled. There will also be a pre-requirement as per their professionalization of the role of trustee.

Interviewer: Maybe just to go back to fiduciary duties as a central theme here. The core message in one's fiduciary duties is to act in the best interest of the beneficiaries, and so I would

like to pose an almost a three prong question from that core theme. Firstly, what is your understanding that fiduciary duty of the pension fund trustees? Secondly, what do you think the understanding of the actual trustees is of their duties in that regard? And lastly, and this ties in quite closely with RI, the advent of the modern portfolio theory in 1970s which has driven the message that one honours one's fiduciary duties, or rather the 'best interests' with respect to fiduciary duties, only refers to achieving optimal returns. In other words, best interest refers only to best financial bets interests. The term 'best interests' appears to be quite a broad term, and so where does that fit into the fiduciary duty construct. Is it still considered, and should it still be considered as best financial interests, or is there a broader reading of that?

Interviewee: I would certainly say a broader reading. However, I'm also going to jump back into the second part of your question, in the sense that it can only be a broader reading if you are exposed to this environment and you have a little bit of experience in being a trustee. Because for the new trustee coming in, they are so overwhelmed by all these different terminologies, all these different understandings, and if they are reading it, they will read it in isolation. But if the consultant actually takes the time to train and development them, which generally happens, within 6 months. So basically the consultant will do a pf 130 governance type training- just to say what the roles and responsibilities are as trustees, what are their fiduciary duties-things like financial statements. So if the fund has sub committees they will do a little training on the different types of sub committees- investment subcommittee, audit subcommittee, what are the roles and responsibilities of each. They would look at the skills of the current trustees and whether their skill set could add value to a specific subcommittee. There is also the communications and risk subcommittee. So these are some of the areas which speak to fiduciary duty, in addition to just worry about worrying about best interest of members at heart and looking at the financial landscape. All these are all really important burning issues trustees need to be cognisant of, because when they are running the board, they are doing so from a comprehensive view. So it's almost like taking a company and looking at the roles and responsibilities from a director's perspective and linking that back to trustee.

There is lots of overlap in terms of governance. Trustee remuneration, for example. So it's a matter of just getting that understanding right. And this why the training is so utterly important, because you have to go through the rules of the fund. You have to know the fund with which you are working. You've got to understand the legacy issues- where the fund comes from- what is the journey going forward. You've got to look at the risk matrix to see what some of the

highlights which have been problematic are. What has been done to resolve them. What are the indicators showing in terms of the risk elements? Look at your sustainability factors. So it's also about transparency and disclosure areas. So it can be as broad as the fund would like it to be. However, the fund also may say that for six months this is the areas you should be focusing on, just to get you up to that level. And the concern that we also find from an industry perspective is that the trustees rotate every two years. And it's like you're taking that intellectual capacity with you. Which necessarily is not a bad thing because more often than not, you are going from one board to another or you take that experience and you use it in terms of your own business ventures going forward.

So it's very big, broad spectrum, and it does also depend on your consultants and how they break up their fiduciary duty. But it is a must, otherwise you'll get it wrong from the very beginning. The trustees won't understand the landscape they're working in, the requirements in terms of the Act. They need to know that they are fit and proper. Which is also very important in terms of executing their duties? So again, it's about having the right trustees, but also understanding they hold the risk even from a personal liability perspective. The thing is that they could just have been sitting in the meeting and raised their hand just because they thought it was a good idea, but not understanding all the inputs into that decision.

Interviewer: And then just continuing from this best interest idea, do you think it is in this training or even just in conversations in the industry, the marrying of the idea that best interests fits quite well into particular RI approaches?

Interviewee: I would say yes. However, the conversation has been a very slow starter. Because as we've seen it, RI for the pensions sector has been a relatively new concept which has come into discussion, over the last four years. A lot of the funds are very nervous around RI, around unpacking the concept, the data matrixes and how it will impact the triple bottom line. And look at whether it will be a finance plus in terms of the model. And besides trying to digest this new concept, I spoke about the fund always having other burning issues to look at. And most of the other issues go back to unpacking the changes from a regulatory point of view, and stakeholder engagement, and mandates, using the right investment structures. So those are generally the type of issues that funds face. And I mean investments are at the top of the agenda. What I found is that the larger funds have been more active in this space, because they have the capacity, they have the financial means, they have the systems, they have the resources to

understand, to research, to execute and implement RI. The smaller funds don't necessarily have that, and this is where they are falling behind. And this is where the importance of the Sustainable Returns Project then comes to the fore because stage 4 was going to be the implementation of RI into policy. And the wonderful thing is that would have helped pension funds change the way they do things. So they would be streamlining their IPF to help with that and also there was open collaboration between pension funds, consultants, managers to better understand the landscape. So what is it that consultants could do to better help pension funds implement, and how could we actually, leverage off the investment value chain? And I think this is why it worked well, because we entered with the mind-set of what is it that you want given that we have x,y, and z legislation, as opposed to this is what you will be doing now. So the approach of the Sustainable Returns Project was very different. It was very much on and apply or explain basis, again linking it up to the PF 130, to CRISA, to the likes of the King III, impact investing, and even other areas.

Interviewer: But do you think that pension fund boards of trustees have even acknowledged that in the preamble to Reg 28 there is this talk of RI approaches- considering ESG? Is it correct to assume that trustees will acknowledge Regulation 28 but not know that RI is addressed therein, and further not know what ESG stands for?

So my question is, from your perspective, do you think there is even an acknowledgement that there is something in the preamble, something in the regulation on RI? And if yes, and understanding of why it's there, and how it is applicable?

Interviewee: The trustees are very far removed from this. What we've found is that by working with principal officers, specifically the POs from the top 100 pension funds, and the chairpersons, and the IC chairpersons. We didn't necessarily get to all of them, at every engagement, but we had at least a 60/70% representation at every event. Which was quite comforting. I find that the POs are much more hands on and have different fiduciary obligations, more from a strategic as well as an operational point of view, they are far more aware and have more of an understanding of the changes of the preamble, what it actually means to be prudent with the ESG component. The trustees at this point, I would say no, but in time it may be so. I still personally feel that they are very far removed, unless you speak to more of your professional trustees. And some of them may not be aware of it because the funds don't view it as something they need to do at this point in time. But I would say, certainly your POs and

chairpersons, and IC people, would be your first point of contact in terms of understanding and talking about what it actually means, working together with the consultants. Even if you look at it from a reporting point of view, funds are supposed to be reporting on ESG at the end of 2013. We were a bit optimistic, so FSB said fine, let's give them until the end of 2014 on an apply or explain basis, what it is that they've done in terms of ESG. Because in all honesty, Reg 28 has been around from quite some time, and very few pension funds are actually doing anything about it, if not nothing. Your best bet in terms of getting stats would be your auditors, and maybe going back to the FSB directly and saying you know what we would like to find out a little bit more about this; what is your feeling and what is the messaging that is coming through from a reporting perspective.

Interviewer: Do you think that there would be any value in including something in revised PF130?

Interviewee: Absolutely, not anything prescriptive. And that was the whole intention, even if it is a half a page. But tell the market or FSB, what it is that you're doing differently. Because ultimately pension funds still have the fiduciary duty in terms of open communication and disclosure to their members. So technically it should be in their newsletter, or up on their website once their financials are out.

To be honest with you it's quite concerning that very little is being disclosed. I've had this discussion many times with the FSB, through Sustainable Returns, and I understand that they are also trying to find their feet, but the space is kind of losing momentum. And you know, now King IV is being commissioned, and I sit on that committee as well. And things are moving. I sit on the CRISA committee as well by the way, but the conversations we're having is that the FSB is not moving ahead in line with how the legislation is unfolding, and the industry needs a lot more guidance from them.

So I think it's more a need for the regulator to become much more involved, and to provide a guiding hand in certain areas. Because you know how our pension industry is. They will not move forward unless the regulator takes up a stick which they don't want to do. The FSB doesn't want to be the bully; they want to make pension funds to become more proactive in their thinking. I call it becoming more present landlords, because I find pension funds to be very much absent landlords in this space.

Interviewer: From that concept of present verses absent landlord, I've got question which leads perfectly on from that. But before I got there I just want to touch back on the CRISA element, because you mentioned you sit on that committee. Do you think one of the contributing reasons to pension funds being absent from the CRISA side of things is because there is not stick? Reports I've seen suggest that there hasn't been much continued impetus and momentum, particularly from asset owner perspective.

Interviewee: I think you ask a valid question. Maybe something just for you to know, there are no asset owners which are represented on CRISA. So it's still very much asset manager and service provider run. With the secretariat being ASISA. And I think perhaps, that is also perhaps a reason why asset owners don't take it so seriously, because a lot of reliance is placed again on whether the manager or consultant is actually going to go back and say are you compliant with CRISA, with the principles. And again, I would say, as much as it is not the responsibility of the consultant, they do have a very important role to play in making sure the fund is CRISA compliant. For me it's like a no brainer. The principles are there, the works been done. It's often a value add. Again it boils down to whether the pension funds are aware, that there are significant benefits, and whether they understand how it will benefit them. And the way that they actually operate their pension fund. So it's about, again, the awareness, the development. I think CRISA, and then also with the PRI, the principles are aligned, almost one and the same. But the asset owners don't see the benefits of going to a PRI conference, because they feel that the costs are too high, which we also agree. The value add is awesome. But it is structure that works well for a first world pension fund in the sense that pension funds which have big surpluses, or big open cheque books, like your DB funds who can say we are sending x, y, and z to the conference because we are members, and this is the value add. But I think that, and it is something we have been discussing through Sustainable Returns and the PRI, that the structure has to be different.

Interviewer: The PRI structure as it stands, has been around for approximately 7 years now and we had a very nice spike in terms of signatories to the UNPRI in 08/09, but other than that it has been slow

Interviewee: And it's still under 50 if I recall. And we sit with about 3300 pension funds currently. I mean we have consolidated quite a bit from where we started off 5 years ago, with about 10 000. The intention is to consolidate even further to get them down to possible 1000 of

the next 5 years, because of the big shift towards umbrella funds. And again, it's about trying to look at your cost structures, to see if the move will be beneficial to your members. Because it's quite expensive to administer large pension funds, and even middle sized pension funds, when you don't necessarily have the right skill set of trustees.

So certainly there is a big shift, and all these things sort of overlap into it with the consolidation process. And that also kind of ties in now with the new RDR, around cost transparency from a service provider point of view. You're also looking at things like the twin peaks model and how that will be translated into what boards need to do. And again it comes back to the complexity of things which boards need to deal with. And are they actually equipped to deal with such things.

Interviewer: You mentioned in your response – DB funds. Do you think there is a difference with respect to DB verses DC funds in the RI space? You've mentioned it alongside surpluses etc.

Interviewee: So basically what we see is that there is a big perception out there, and I think also in terms of reality, is that the DB funds are far more equipped in terms of having an open cheque book. In the sense that if they want to commission an independent person coming in and doing some research on RI, they can do that. If they want to put in a new system they can do. But I think from a DC point of view, they are little more restricted in terms of that open cheque book concept, and what we found is that there is much more fluidity with the DB funds with these areas. However, if you look from a DC funds perspective, the larger funds there are examples of funds who have made a conscious decision in terms of looking at sustainability. Some have now put out their second or third sustainability report, which is really, really wonderful. Risucura as a consultant has been somewhat instrumental, and Risucura is very big on RI and driving that, and they've used the guide somewhat in terms of implementing RI into their policy, they've kind of seen the difference. And I think, that's a nice to have. Because, certain funds are chasing that legal space and not waiting for the regulator to say you should be doing it in this way or the other. But I certainly think that the message out there is that DB funds have the open cheque book to execute this. And I certainly think that it's not going to be another layer of overbearing costs. For me it's about looking at your investment mandate and adding RI in as one of the key deliverables that you want to drive for the next year and planning ahead for it. So really budgeting for it. Because as I've said, it's not overly expensive, it's just trying

to find a strategy which works for the fund and works for the consultant. And if you're working together with the consultant to implement it, it's easier than a fund trying to implement it themselves.

Interviewer: I'm conscious of time, so I just quickly want to go onto the second last question I have, and that comes back to your absent versus present landlords. Do you think there is an acknowledgement and an understanding that these funds are part owners of companies and therefore have significant levers and influence in this regard? Corporate governance plays a big part there, as well as discussion and engagement. And with, for example, all the labour unrest which has been a feature over the last several years, you have these pension funds where the employees who are on strike, actually own part of these companies through their pension funds. And that loop isn't closed or used. But do you think there is an understanding or acknowledgment that we are part owners of company and therefore have an added responsibility, which could, additionally, feedback to benefit our members?

Interviewee: My personal feeling is that it is more of 80/20 principle where 80% don't understand that they belong to the bigger picture and that the 20% do understand. Because if I look at it, my personal feeling, is that the members are ultimately your owners. The pension fund trustees are kind of your custodians. So technically they do own the assets, but they are managing on the assets behalf of the members. And with Sustainable Returns, some of the work that we did, the desktop research, the top 100 pension funds, actually own 60% of the assets on the JSE. And this is something that they are not aware of. They are not aware of the level of governance, and even, for example, when we talk about striking sectors, it eats into their investment time. Which is again about the absent landlord, where they don't know what they don't know kind of thing. It's like the blind leading the blind, and I don't want to use the word naïve, but to the extent that, maybe I should just use the word naïve, because that's what it really is. And the sad reality is that there could be very little transparency around communication. And that for me is that very key as part of the fiduciary duties of any pension fund. Because if you are not communicating, your members don't know, and that is where a lot of noise is created, because of the misunderstanding. And those are things which can be eliminated from the onset. And I'm quite passionate around clear communication. And that is something I see is fundamentally lacking as a whole.

Interviewer: Because the clear communication provides the platform for accountability, which facilitates the change where it needs to take place?

Interviewee: Absolutely, it's kind of a ripple effect and if you have a good starting place you'll see that tide moving. Even if I have to look now in terms of the work I've been doing on the reform side, communication has been terribly unclear, in the sense that National Treasury with likes of Nedlac, Nedlac was then meant to communicate via the top down process to their other constituents. Very little of that took place, which is why we see now, all the wonderful work that the industry has done in terms of the reform has cost the industry in excess of millions of Rands. Industry has spent lots of money in terms of research, system, how it will affect DB versus DC funds. Even right down to tax structures and how it will affect members take home pay, but the sad reality is that it's all come to halt for the time being. And then the poor member's went on a rampage and then just started resigning from the pension funds without any idea the actual purpose was in terms of the reform.

Interviewer: If I can just cap off one of the last points you made. In terms of lack of active engagement in their ownership responsibilities of companies, you would say that's more because they're naïve rather than a lack of resources or logistics problem?

Interviewee: I'd say it's a combination of all of the above, and the big thing I think for me would be the lack of awareness and understanding

Interviewer: I'm cognisant that we've come to the end of our time. Thanks so much for your time, comments and contribution.

Closing arrangements and comments

9.3.6 Interview 6

Interview: Senior Policy Advisor

Introduction

Context

Informed Consent

Interviewer: I'd like to start with exploring your view on the role of Pension Funds in society and the economy.

Interviewee: You know a Pension Fund, it's a means of savings but we also need to remember that we tend to view a Pension Fund as this entity but, behind the pension fund, is a normal man and woman on the street. So, even though it's almost like a pooled vehicle of investment, it is still saving for an individual and their specific needs at retirement. So the pension assets is obviously, long term in nature, which links quite nicely in with the sustainability focus.

Yes, I think a Pension Fund is obviously, to provide for people at their retirement but then also those pension assets are long term in nature, so they have the capability to be 'used' (and I use the word 'used' in inverted commas) or 'deployed' is perhaps a better word, into the greater society. What do I mean by that? It can go into infrastructure investment, which is good for the country. It's good for society and it can give still adequate returns for investees and Pension Fund. It can...

There's multiple layers of why Pension Fund is there and how it can be used for the individual that's actually there to benefit from it, and the broader picture.

Interviewer: In your opinion, do you think Pension Funds view their role in that sort of multi-layered perspective?

Interviewee: No, and that's probably why we see the apathy, in terms of responsible investment, from the Pension Fund side, and again, to be clear, not all Pension Funds. There's some that's obviously taken up the baton. Like the Government Employees' Pension Fund, the Eskom Pension Fund, they've obviously caught onto the concept. But the broader Pension

Funds I don't think have gotten it yet. I think we have some legacy issues that's driving some of that. PF 130, which has still not been revised, after Reg 28 was revised.

Interviewer: Am I correct in saying that the last time it revised was in 2007?

Interviewee: I think so. I'm not sure. It was before I got involved with this type work, so that still basically says, "Make sure you get returns for your investees, and then look at sustainability issues." If that's that message that's still being sent to Trustees, it's easy to understand that they might be confused. Reg 28 to saying one thing and PF 130 is saying another. These things are not talking to each other at this stage. So, no, I don't think Pension Funds necessarily get that they could have a broader impact on society. Like I say, it's a multitude of reasons for that.

Interviewer: Could you speak to what you think some of those reasons are?

Interviewee: Well the number of funds is on. There is something like probably five to six thousand Pension Funds, and they are climbing. So there's a big move from Treasury side, to possibly, move to Umbrella Funds, which might be able to alleviate that problem. Bring these smaller 'Funds' into an 'Umbrella Structure'. That could, potentially be one solution so that you introduce more leverage.

The other problem is the whole structure of the way our trustees are setup for pension funds, where half of the trustees have to be member trustees. For example, if you sit with a coal producer then half of your trustees, of that Pension Fund, must be employees of the company, which means you might sit with blue collar workers that might not even have.

Your level of education of that trustee might not be up there, so you already sit with a situation where you now have to explain to this trustee, potentially, what is equity? Never mind explaining the concept of responsible investment, so in the big scheme of things you sit with a problem. Where we don't have professional trustees, we have employee trustees, so trustee education plays a huge role in trying to address that, but that's pretty much also still lacking. With education will come the understanding. It could potentially be a whole ripple effect.

Interviewer: Maybe that leads quite nicely into my second question, which is around the interpretation of fiduciary duties and responsibilities and obviously, training and education would feed into that.

Interviewee: Yes.

Interviewer: So, as a point of departure then, maybe I could ask you do you think trustees have a sufficient understanding of fiduciary duties and what is their understanding of fiduciary duties?

Interviewee: My impression is they might not and again it might be a structural issue, where they've got other issues to deal with. African Bank has happened, so are you going to worry about the fact whether the guy understands what his fiduciary duty is or are you going to deal with the fact that their pension fund might be invested in African Bank? So there are so many things that need attention.

Interviewer: Rank of priorities.

Interviewee: Yes, there's so many things that are on their lists that they have to take cognisance of. I'm not sure if the fact that there's a fiduciary duty necessarily is brought home that strongly. Then you also have to look at it as a consultant. What's the role that they are playing? Are they making it clear to the trustees, what they are supposed to be doing, and what their involvement should be, etcetera?

It might sound like I'm slanging trustees but I'm not. I'm just saying, I think there's a lack of understanding, there's a lack of knowledge, but you also need to look at the value chain and what is the people that's been appointed to help them; what are they doing about it?

Interviewer: So maybe then let's discuss asset consultants. The interpretation of fiduciary responsibilities, from their perspective, do you think that's solely of a financial nature?

Interviewee: It's going to depend on the asset consultant, and like many things in life all are not created equal. All asset consultants aren't equal. Some have bought into the concept of responsible investment and what that brings. Some have been a little bit more hesitant on it, and is still very much on the old track of, you know, 'what's the performance?' Never mind what the secondary effects of that performance is. It is all, very much dependent on who you're speaking to and their view on it.

Interviewer: Do you feel that the conversations that are happening in the industry, around fiduciary duties speaks to this notion of acting in the best interests of members, in a broad

sense? Or is the conversation still, when people refer to ‘best interest of members’ it’s the best financial interests or return at the time of employment?

Interviewee: Yes, okay firstly, to be quite honest, I don’t hear a lot of conversations happening about fiduciary duty. It is not something that I think is really spoken about enough. It might be happening at the trustee boards but, like I say, I’m not close enough to them to know whether it’s happening or not. It is very difficult, again, for me to give a clear cut ‘yes’ or ‘no’ that this conversation is happening or not. Again, depending on whom you speak to. Some might still be focused on more the financial returns, rather than the sustainable issues that goes with it.

Interviewer: And in your personal opinion, do you think the concept of fiduciary duties lends itself to responsible investment?

Interviewee: Oh yes. You can’t divorce it from that.

Interviewer: What would you say the main, sort of, if you could give two key drivers of that, what would those be?

Interviewee: Well, and this word is going to pop up the whole time, its sustainability because pension funds, we’re looking at long term assets that’s being invested. So it is definitely sustainability and the impact of those investments. Again, not saying ‘returns aren’t important’ but also this concept of you can’t have sustainability, without sacrificing returns and given that concept those two doesn’t necessarily exclude each other. You can have adequate financial returns and have the sustainability issues covered. For me, that’s under fiduciary. You have to link those.

Interviewer: Then with respect to the preamble to Reg 28. I was at the CRISA breakfast that was held, I think, about two months ago. I know you led in with Reg 28.

Interviewee: Yes.

Interviewer: What has the industry, as a whole, pension funds, and investment managers, how are they assimilating this, or what is the interpretation of it? Are people just brushing it aside or are they considering it because I find it very interesting that the preamble to Reg 28 used the word ‘adequate returns’.

Interviewee: Yes.

Interviewer: What is industry's response and interpretation of that?

Interviewee: My organization is thrilled the preamble is there. It couldn't have come quick enough for our purposes. So from the investment management community it's a huge plus, etcetera. That being said, I think the rest of the value chain still needs to get on the track of this. Where I've spoken about CRISA to trustees at POA (when it was still the POA) events, etcetera.

The moment I pointed this out to them, you could see their eyes went wide and they were like 'but how are we supposed to be doing this'? They are not sure what they are supposed to be doing. Then people put up their hands and they asked, "But how do we know whether SAPPI is a good thing to invest in?" I said to them, "I'm not saying you, Mr XYZ, as a trustee, has to do it but you have to tell your asset manager to do it." But you still have to take accountability to check that your asset manager has done it.

There's not a good understanding of what is meant. I think to a lot of them Reg 28 is still a table, with percentages.

Interviewer: Yes, that's another, I suppose, a legacy.

Interviewee: Yes. You know, and then you also look at the FSB. What have they done to promote this? We have board notices on hedge funds on derivatives that have been finalised, etcetera. Are they planning to, perhaps bring out a board notice on what is meant by this preamble? Are they going to, actually enforce it? Are they going to say to a pension fund, "Show us what you've done to satisfy this requirement, in Reg 28?" So it's...

Interviewer: From your perspective, do you think that is something that could happen or is it too far down the list?

Interviewee: I think it's too far down the list. There's bigger fish to fry at this stage. There's so much regulation coming down the line at us, from all areas. That I think if you look at the Pension's Department at the FSB. They are snowed under. However, that being said, Rosemary Hunter who now heads up that unit, she was one of the people that did a lot work for our organisation on fiduciary duty, when she was still in private practice. She actually wrote a paper on fiduciary duty. So she's definitely not oblivious to it. She's very supportive of it.

So it's not impossible that, in future, something might come from their side but, right now, they're still trying to finalise the Derivative Notice. It's been sitting since the end of 2014. That was promulgated in 2011, it's three years down the line, so again, is the preamble of Reg 28 their biggest issue? I don't know.

I think there's a little bit of frustration from the investment management community. You know, we worked hard to get that preamble in...but so what. You know, where's the action coming from that? Trustees are saying, "we don't know." Asset consultants seem to be activating, and going, 'well if you don't know then we don't know' and 'we're interested in returns'. So again, there's a little bit of a 'chicken and egg' situation. Who has to be leading this?

Interviewer: Are you saying that regulation and enforcement is very important here? Will pension funds not respond otherwise?

Interviewee: Yes, and that's again, it's very much a legacy thing, from the old Reg 28. You have to check the boxes because that was the old Reg 28. It was rules. "You have to do this. You have to do this." This new Reg 28 is a new animal. It's got principles in it. How do you police principles? You can't put a check box in place, so it's going to take time. Perhaps something like the Abil thing happening. It might be a good opportunity for the FSB to say, "Well, you know what? You had this in your Pension Fund. Show us (taking Reg 28) how did you get to that?" Will it happen? I don't think so. Again, there's other bigger issues right now -our Pension Funds sitting with Retirement Fund Reform that they have to deal with. They have to deal with the charter. There are so many other things going on that I'm not sure how high up on the priority list that is.

Interviewer: Then perhaps you're the perfect person to speak on this. I know CRISA well part of CRISA promotes the reporting element. From your perspective is this happening at all, from pension funds or investment managers reporting on or abiding by increase of principles?

Interviewee: Yes, some investment managers, yes. I've seen their website. It is definitely up there. I haven't seen a lot from pension funds but again, if you look at the UNPRI list of South African signatories...

Interviewer: Yes, I think there are only two!

Interviewee: Yes, I think there is now three, and possibly a fourth one. If they're not doing the UNPRI, the odds of them doing CRISA. It's so closely related. I haven't seen it really from pension funds, barring those few that have definitely actively embraced it.

Interviewer: Yes, so from your perspective, I would imagine that that maybe slightly discouraging, considering all the work and the thought and the good intention behind CRISA. What are the plans?

Interviewee: Yes, you know, you can see it as discouraging or you can see it as an opportunity because there's at least scope for growth. You can, if you double the number of pension funds, yes, it might just go from four to eight, but you know, if you double it then you've got double the coverage that you used to have. There's definitely scope for work to be done, to get these guys into the fold. Quite recently one of our biggest asset consultants has now adopted the UNPRI.

Interviewer: And that could...

Interviewee: That could potentially drive it a little bit harder (the agenda), so you know, like I say, if you speak to the RI Standing Committee, the guys are frustrated. Because they want to see the mandates coming through and they want to see this being incorporated in to investment policy statements, etcetera, and it's not happening. So there's frustration but yes, you know, sometimes these things do take time.

Interviewer: So you're hopeful.

Interviewee: Yes, you have to be, hey.

Interviewer: Yes, you do. Just touching on the point that, sort of that there're a handful of Pension Funds who are signatories, to the UNPRI, - most of them are DB funds- why do you think that is?

Interviewee: I don't know. Somebody else has asked a question in that vein and it's, in my opinion, it's not necessarily freedom. I think it's a philosophy thing.

Interviewer: In the case of (sorry I'm circling back quickly) trustee education: what are you seeing with respect to trying to get responsible investment into the pipeline of trustee education?

Interviewee: Well, it's already there, so you probably would have found in your research that there was something called the Sustainable Returns Project.

Interviewer: Yes.

Interviewee: That launched a guide in, I think it was last year, 2013. Now that guide has already been taken up into some trustee education. I mean that ASISA, once they've got all their setting up completely final, and they are running, the hope would be that they take up that baton as well. I know they're working with the FSB on doing CBD points, where this will also be brought into that. So there's definitely...it is being taken into account.

Interviewer: Yes.

Interviewee: Yes, again, is it the biggest issue on Trustee education? Perhaps not. Is it very important? Definitely. But again, if you first have to explain to people what's equity and what's a bond, you know, you have to take baby steps.

Interviewer: Thanks, perhaps we can move onto the concept of ownership and stewardship. Do you think that the pension fund industry or pension funds realise that they are part owners of companies?

Interviewee: No.

Interviewer: And that they can potentially influence them?

Interviewee: No, I don't think so. Honestly, I think the fact that they are equity shareholders it hasn't dawned on them necessarily. Some do, again, not all are created equal but if I'm talking about, you know if I exclude say, (let's be generous) 20 pension funds out of the five thousand, then they probably get it. Others, I don't think so.

Again, if you are dealing with somebody who that's struggling to understand what a share is. How are you going to explaining to him that you are actually part owner of Woolworths? 'Then why do I pay for my stuff when I go to Woolworths'? You know, it just might not make sense, so it's ultimately everything comes down to the education part.

Interviewer: So then where is the place of active shareholders?

Interviewee: Well, you know that was happening with Marikana apparently. You know, you have to look at these things that happen in South Africa and you would have to say, “But why, as active shareholders, why are these things happening? If we were active shareholders would these things be happening?” So, no, I don’t think people realise the power that they actually have in their hands and the potential for change that they have in their hands. I don’t think people actually get it.

Interviewer: So you have a firm conviction that active ownership could see very positive impact?

Interviewee: Oh yes, definitely. I mean it without a doubt and, again when I talk to people about responsible investment. I always use the example of ‘if you want to invest in a paper company and you decide, for responsible investment purposes, oh no, they don’t do sustainable foresting then I’m not going to invest’. That’s not necessarily responsible investment. Responsible investment can also be ‘yes, I still invest in them and I try and change the way they do their forestation’.

So, you know, it’s to make people understand that you could actually influence the business processes and how that company does business, to make them more sustainable and to make them, you know. So by doing responsible investment it’s not just picking shares off a list that does things responsibly. It might be meaning picking the one that’s the most irresponsible company and trying to turn them around, from inside. Again, for some people, that seems to be a light bulb moment.

Interviewer: Yes.

Interviewee: They hadn’t thought about it. They see it as picking stock off the SRI Index.

Interviewer: Yes. Do you think then that there is perhaps scope for those organisations and people who are, sort of pushing or driving the responsible investment agenda to shine the spotlight or use case studies, (for education purposes, around this engagement or active ownership? Do you think that if in trustee education, you came with a ‘look at this case study, you own this, this is what you could have done. This is a potential outcome’.

Interviewee: Yes, I think if you make it practical. If you make it something that’s, again, topical. Take something like Marikana. Say to them, “What caused Marikana? What could

you, as shareholders, have done? What happened at the shareholder meetings leading up to Marikana? Was there anything that happened there that could have changed the outcome?” Then you take that to a Union Pension Fund, for example, which...because the whole Marikana thing is very political. You could, potentially open their eyes and make them see what impact they could have had.

Interviewer: Do you think such pieces or work could open up the responsible investment agenda more broadly?

Interviewee: Yes, well I think, case studies like that might open up the active shareholder area. Perhaps not the whole responsible investment arena, but that part of it, yes but again, that might just be one step in getting over that hump and getting up to another level. One level up is better than nothing.

Interviewer: Yes, definitely. Thanks, I think that’s covered most of what I wanted to chat about. Do you have any closing comments or thoughts around where you see this space going? What you’ve seen pension funds doing? I mean, we’ve touched on it as we’ve gone along.

Interviewee: Yes, I think we’re in for an interesting few years ahead, with the pension fund reform and the move to umbrella funds. There’s, if you look in Treasury, there’s a lot of good, really smart people there, and a lot of them get responsible investment and they get the principles behind it. I wouldn’t discount, almost the powers that be, and their ability to make change.

Yes, like I say, people are getting frustrated because changes isn’t happening quick enough but it has to happen at the pace that it’s going to happen. You also can’t force something because then people aren’t doing it for the right reasons.

Closing Comments

9.3.7 Interview 7

Interview: Senior Associate

Intro

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Context

AT: Jumping right, I'd like to explore with you, a bit around your view on the role of pension funds.

H: So the core function and still is from my perspective, is a pot of money for social security purposes. So it's a non-profit. And I think that's significant, as because it's not a for-profit it is not derailed with things like profit hunting. It obviously has the duty to get optimal or rather reasonable risk adjusted returns, for its members. I don't think any corporate entity, especially not in South Africa, is solely there for that core purpose for which it was established. The law backs that up, so for example our constitution applies horizontally to juristic persons. Now we don't know to what extent it applies. It's underexplored in litigation, and there are practical reasons for that. For example you can't get information for a company to gather evidence to sue them. But certainly companies, and juristic persons, which include pension funds are bound by the bill of rights. And that for me changes a company and a fund to more of a social animal that it could be in maybe the US, where it could have a more capitalist imperative. Pension funds operate and marshal huge pots of money and with money comes influence. And I think there are constraints on how that should and could be used to enable good but it can also enable harm. And that is where constraints like fiduciary duties come in, that is evolving. But that also, and this is untested, and this is where the constitution comes in, you have to marshal your resources in a way that is different because of the constitution. Now it's not an argument that is often made in litigation, but it's there. And the fact that it's not enforced as actively as I would like to, does not mean it's not there, it's just enforced. So there could be breaches of the constitution depending on how you look at it. Look, their primary function is to give retirement income to people, but their function is broader and the way in which they give income to people matters. And this is maybe where we go over to the views of funds. There still is a tension among fund trustees as to how they see their role because they are very concerned about the

people they have to give funds to, especially in a DC environment. And they still very easily view anything they do that might slightly detract from that or might be more long term so you can't see the benefits that closely or that soon to detract from their central purpose and therefore potentially be a breach of their fiduciary duties. And this is the type of conversation I've had with a number of trustees informally, at a number of functions and things. I think the boundaries of what is the extra needs to be explored. So that is untested, and I think that is where the new terrain of ESG comes in and the evolution of fiduciary law. And because it's unclear it's difficult with alternatives.

AT: And in your interactions with trustees, do you feel that trustees shy away from this element or are they fully engaged? Are they willing to explore this concept of them being influencers of the economy due to size and capital, and therefore ultimately influencers on the lives of their beneficiaries in some way or another?

H: There's some awareness especially among the union funds of being connected to the community that they serve, that may be a bit broader than just giving funds to their people. They're concerned about their people's wellbeing which are the members, which is also- the roles conflate a bit- but it's also the union members right. So there is some acknowledgement of that. But I don't there is a full engagement with that. What is interesting is- at a conference of pension investment in Africa, not that long ago, and delegates from Nigeria and I think Ghana echoed this. Because ESG is this term which has developed in South Africa, they claim to not have ESG and not know what it is. But when you scratch a bit further you find that it's not that they don't do ESG, and it's not that they're not aware of the impact on the broader economy, it's just that they call it something and it's not mandated by legislation so it was quite interesting to hear - and I don't think it was trustees specific- people in the pension fund industry- that they call it development. And it's kind of haphazard because it's more dependent on what you want to do. For example they align some of their investments with, and this anecdotal stuff, with government development goals, because it makes it easier, it makes their lives easier. I don't know how wide spread this practice is but it was certainly interesting to hear that in many ways, you know South Africa tends to think it's at the forefront of everything in Africa, that some funds to engage with some of this. Many Africa funds are not DC so I don't think they'll be as sensitive to it, but we should be careful about what we call things, because your first instinct would be that they do nothing about it, but when you scratch deeper there is actually more going on than you expect.

AT: You've mentioned two or three times now, this difference in view between DC and DB funds. How do you think that plays a role, with respect, in terms of their role, potentially how they view pursuing ESG or RI. Does it change things?

H: It's difficult to say in a South African environment as you have fewer and fewer DB funds. And one or two DB funds are industry leaders on ESG, but I think they have different things which motivate that. There is more of a structured decision; they follow this as there is complete buy in to the ESG concept and the value of it. If we drill a bit deeper, and go beyond the top 10% of funds, most of them are DC. And my sense is that being DC, every action you take and every investment you make as a trustee can affect someone's pension. Whereas if you're in DB, yes it's important to invest properly, but at the end of the day, and I'm bearing in mind unionist members specifically, they're concerned about how they represent their members. If their members' pension funds are guaranteed, I think it takes away some pressure. And I have not seen any DB funds specifically engage, so that I can say that they're a bit more relaxed about returns, because the employers paying in. But I think DC trustees, especially those who are not that comfortable with investment speak, tend to shy away from ESG because for them that imposes more of a risk, and they don't want to do anything that potentially compromises someone's pension. And there is an education element in that, which I'm sure we'll get to.

AT: Thanks, that's been insightful. You've also woven this into your responses to the first questions, but moving onto the fiduciary duties and responsibilities of trustees and interpretation of that. So obviously the Pension Fund Act speaks to taking all reasonable steps to ensure that the interests of members are looked after, that trustees act with care, diligence, good faith etc, What do you feel is the real life interpretation and application of this from a trustees perspective?

H: I'm often quite impressed when I do training for trustees, because everyone is not equally educated or sophisticated in terms of managing a fund. But they are acutely aware generally that they have fiduciary duties, that this is the core function. The application- I mean these are simple sounding principles, but the application of it is much more tricky and unclear. And the boundary of what is the exercise of your fiduciary duty and what isn't is also often debatable. So they're sure about the principle and that it exists. And they generally try to do the right thing, quite often. How that translates is not necessarily the right thing. I guess this in part encouraging when I speak to funds as at least the intention is there, because they're mostly not remunerated for being there. They see it as their core function to fulfil. But many don't pay attention then to

doing the grunt work that is needed in their fiduciary duty. And I think there is a difference between the understanding of this is serious and what does this actually mean, because in my view it requires a lot more resource, education, and engagement than is happening in practice.

AT: And do you think that if pension funds had greater resources this would be interrogated further?

H: That could be. So my counter to that would be, and it's a bug bear of mine, that pension funds are on charge of their own recourses. They can change, although maybe you'll have politics on a board to get a rule through, but if the board really wants to spend more resources, because they consider it the best thing to do in the exercise of their fiduciary duties, then they should do that. I think it's reckless to not spend enough resources because that probably breaches your duty. You can't sign something you don't understand, you need to understand and these are sophisticated investments. It necessarily requires you to do your job and there might be legal exposure in a situation where you have people who sign off on things... I mean, a partner of mine had a case where trustees took a tracing agreement, and the lawyer said 'fine, sign off' and some of them signed with an X because they actually couldn't read. And obviously there was a huge rip off. So that's an extreme example, but you can change the rules, to say look we're appointing an ESG guy or an investments guy- we need more training to understand yes. Yes, the more resources you spend the more resources you take away from pensioners in a DC environment, but I don't think it's worth the risk, and there should be a base level of both resources and then resources spent on education. If you spend the resources, and you're still not at the minimum level required to do the job efficiently and properly then you shouldn't be a trustee. And there is that issue in industry around that because it's obviously sensitive, especially in union funds. But in any other investment environment in South Africa, in asset management, in banking and finance, it's a sophisticated environment and people are quite jacked up. But somehow in pension funds people get away with outsourcing, with running a fund with billions of assets under management without properly understanding what a derivative is. Things like that. And this tension seems to arise from this transition from passive to active ownership. Because a pension fund for example might meet for example four times a year, so a trustee will tell me that they can't be more involved that they can't expend more resources because they only meet four times a year. But the fund itself decides how often it meets. It just needs to change its rules, it can do stuff through round robin. There are various ways. So that's quite a red herring argument, I think. But it's very popular in industry and

people operate under that. So where I've challenged it a little, people have conceded, but I don't think it translates into any action.

AT: So do you think if any funds decided to put more resource behind certain elements, whether it's ESG or training around fiduciary duties, or more training around the investment element, these things would improve? So, there is space for growth?

H: Yes, absolutely. I think the bar is very low at the moment and so we've been lulled into this sense that where we are is normal and if we add anything on that's expensive. But I think we do need to up it to a normal or adequate level. Just because we've been doing something in a particular way does not mean it's adequate. And I think a lot of it can be fixed through resources.

AT: Coming back to fiduciary duties, and obviously I've probably touted this in one of my e-mails to you before, one of the things that I find quite interesting is this idea of the fact that the fund, or the trustees of the fund are supposed to act in the best interests of their members. And obviously the interpretation of 'best interests' has always been the financial best interests in terms of returns. I'm interested to know if there are discussions or impressions by trustees or people in industry that you've interacted with, that that idea of 'best interests' – the scope is wider than just than optimal amount of cash or income at the end of the day.

H: I would say trustees still interpret that as the best financial interests of the person's retirement money. I think with ESG and a little conversation which has happened around that, there is some indirect acknowledgement that the best interest is a bit broader than that. For example if you invest in your community. Or if say you take on an ESG investment strategy, what do you take into account? You take into account, and this discussion has not been directly around the interpretation of the phrase 'best interests' but it's been around well, what is in the best interest of my members. Say I'm a mining fund, and I'm in a mining community, so my membership is very clearly defined in a geographical sense. Is schooling, water access, or whatever in that community not something I should be investing in? And I've seen little bits of that kind of conversation starting. But it's very early days.

AT: Is there any understanding around part ownership. For example, union pension funds. One thing that's interested me for the last little while, as obviously there has been a lot of activity with respect to labour unrest in the mining sector and asset managers run huge amounts of money for these unions and their pension funds and they actually own part of the company to

a greater or lesser extent and there is potential influencing mechanism there. That is the company makes a decision which affects the employees who are actually members of this pension fund who are actually part owners of the company. Is there any of that sort of thinking? The thinking that if we own a part of this company we could be using our voice.

H: Not at all to my knowledge. There is an under engagement of funds to leverage their investments to effect change in their portfolio companies. It's like they don't appreciate the causal link. I know some of the big guys, like the Eskom, they have engagement; they get the asset manager to do stuff behind the scenes. I won't always know about it, it might not become a legal issue. But I've never heard of a union fund exercising their ownership in their employer to try to leverage change.

AT: You also mentioned some pension funds thinking around water, or schooling etc. What about things not as project specific but more company specific? So for example, unsecured lending might be a huge problem, then they might have identified ABIL as being a huge problem. Have pension funds or have you ever heard discussions to the tune of 'we think that the impact of this company is bad for the members of our funds and therefore we wouldn't like to invest in it for our particular members?'

H: So negative screening that's membership based?

AT: I suppose so, negative screening that is informed by the characteristics of your members and therefore an understanding of what 'best interest' of your members are. So you're not investing in a company whose externalities or actual product has negative impact on your beneficiaries?

H: Of course, I know medical aid funds that have massive investment in BAT. I guess it's good for business. Other than church funds which will probably do negative screening for sin stocks, I don't know that that has actually filtered through to practice. It's something we're advocating and it's something that takes place at a high level, industry leader conversation, but I don't think that that has filtered down.

AT: So you think that rules and regulation provide for that type of discussion and that potential thinking?

H: Yes, so I think that fiduciary duties and the core of all of this is in fiduciary duties. So how do explain ESG and how do you implement ESG? What the law provides is not so much substance as in what is the S what the G is? It is more a procedural tool for trustees to interact with their investments in a responsible way. And so what fiduciary law, one of the things it means is when you exercise discretion, which happens all the time, so when you decide to invest in A and not B or whatever, there are rules in law as to how you can and cannot exercise that discretion. You have to take into account all relevant factors. Ignore all irrelevant factors. That kind of thing. Just responsible decision making. Now if you know that an investment... so just to back up- Reg 28 says “you may consider anything that might affect the long term sustainability of your investments, including ESG factors” –so it does link it to the profitability of the investment. So I don’t think the conversation is beyond the link between those two. It’s not that you must not link those two, it is provided those two are linked. If you know of something going bust in your investment, is it a proper exercise of you fiduciary duty to not engage with it? If you own 5% of ABIL, it would be a breach of your fiduciary duty, and it’s not effective in court, but it would be a breach of your duty in my opinion to not engage. And that does not mean, the law does not prescribe a particular response. It does not say you must divest, that might not be the best solution in the circumstance. All the law says is that you must apply your mind: to what is happening and the impact of things on your investment. And react accordingly. We’ve been saying that funds should have some kind of response protocol. So maybe someone is monitoring investments, maybe someone on the investments committee that looks at stuff, that red flags stuff. Maybe the asset manager does it but you can’t just outsource everything to the asset manager which is one of the other issues around ESG in the pensions industry. You can’t do nothing and that’s at the core of fiduciary duties. If you’re supposed to act or at least consider then you must show that you’ve considered. So basically pension funds will be breaching fiduciary duties, but it’s difficult to put a case together because you need to show damages. But on an interpretation it is a breach of the law.

AT: You mentioned the outsourcing to asset managers. Do you think there is potential slack in the system due to outsourcing? Do you think this is the case especially with respect to RI and the application or the making of the preamble to Reg 28 come alive would be to push with consultants or to push with pension fund trustees?

H: For me all of this originates with the fund trustees. They manage the money ultimately, they are responsible. If an asset manager messes up, in law the fund remains responsible. Now the

fund can maybe sue under the agreement with the asset manager to recoup some money. But ultimately if I sue a member I sue the fund. So the legal principle is that you can delegate but you can't abdicate. So the buck stops with trustees in respect of all their fiduciary duties and it has to come from them. And I know there is some tension to some degree between asset managers, service providers and the funds. But the funds need to be a lot more assertive in terms of what they want and it links with education and resources factor. You need the service providers, and service providers will come in where there is a need for them. But if the fund who marshals the money says look our priorities are ABC, here is our investment belief statement; can you make this happen? They need to engage with the asset manager. What happens rather is, at best, if they do ESG, is that they tell the asset manager to do ESG. And there is no real monitoring or engagement or follow up. Then the fund sits back. And it will take at least one court case linked to personal liabilities to get them to act a bit more and to engage on it. But the pressure needs to be applied to the trustees absolutely.

Interviewer: Obviously this is quite an intricate industry with lots of outsourcing and the lack of resourcing within actual pension funds makes it a bit complicated. What do you think the trends going forward are? Do you think pension fund are going to take ESG or RI or this idea of ownership forward? What do you think the trends going forward will be or do you think it's really going to be flat, unless as you mentioned there some personal liability involved in a court case or something of that nature. Can you see anything changing in the short to medium term in this respect?

Interviewee: The pension fund space is so different. You get these low key, smaller funds, which are not going to change quickly for any reason. They're too engaged with hard breaches of the law. And this is the problem- the industry is very heavily regulated so both the funds' and regulators' focus tend to be on hard breaches. So do I breach my asset class maximum, do I do my surplus allocation and do I report to the registrar accurately? And all of that still takes up the primary time. I think it will change, but it will take some time and it will take more lobbying from industry and industry leaders. Certainly, the legislation is one of the biggest pull factors to change trustees' behaviour. Because no-one mentioned anything about RI until Reg 28. So if there is more Reg 28 focus on it- I think we need a lot of pull factors- and that would be one of them.

AT: So what type of pull factors: regulatory- what about regulation? So we have this preamble and CRISA is not regulation, but it's a code. What else do you think we need?

Interviewee: Something that unpacks what it means, because trustees don't engage with it properly because they don't understand what it means. And to understand it would mean going through a lot of effort. So a circular or some type of guidance note from the registrar to say look this is what I understand by ESG and this is what I recommend. People take those things seriously. I think a requirement for increased transparency. It's not in law, but pension funds operate in this insular space where members don't really know what funds invest in unlike if I'm a shareholder in a company that company is very open to my vote, to my voice, to some degree, to my involvement. But in the pension fund industry, members are not aware of what they are invested in so there can't be any attempt to hold funds accountable from the members' side as shareholders maybe could in a listed company. Regulation around increased transparency will go a long way because you will then publicize what you invest in you already have to make these reports, to report to the registrar. And they go down in to quite a lot of detail, where they list entities and holdings. So it's quite clear on what the fund is and is not investing in. And I think funds would be a lot more alert and have more pressure factors on them. And if members can look at them and go 'hey fund- why are we continuously investing in Lonmin?' then the fund must show them their response protocol- yes we know things went bad, we sat, we took advice. They must have a one-pager rationale for why they are still invested. So procedural. So they've considered the issues, they're continuing to monitor the situation. Don't know if you've look at the Norwegian Sovereign Wealth fund. They have that separate ethics committee and massive engagement around key issues such as child labour for example where Monsanto had kids picking cotton in Asia. And it's not always as simple as it seems, but you must investigate. Because when you look at the child labour for example it's not always kids working in factory not going to school, they are going to school but they're working during the holidays, but they're under 16. So is this community involvement, is this child labour, is this voluntary? It's often more complex, so it's not necessarily that we divest because of x. But the fund must go through that process, especially when there are major issues like that. So transparency of reporting, engagement

AT: And from what I hear it's not necessarily transparency of reporting on ESG in particular, its transparency of reporting across the board? Even if it doesn't include a narrow sense of ESG, more transparency will apply pressure because people will see what's going on.

H: Yes. Although something like an ESG report I think would help, but I'm a bit sceptical about self-reporting. You know like CSI reports of companies also tends to have issues like

self-selection. So I think it could help, but at least it will force a fund to engage with issues. What they might do is outsource it to the asset manager and please report to us: are you doing anything with ESG and then just hand that over and that will not be enough.

AT: But it would not be a bad start to at least get the conversation going?

H: No. That's the kind of thing that could be in a pension fund directive of some kind. And a directive is enforceable in law, but a circular is not. But the registrar can issue either, I think. But I think you need public consultation for a directive. But the FSB can very well require that. The problem is that the FSB is, more concerned with hard breaches and there's a lot of things in industry like fraud that are keeping them very busy and there are a lot of serious things that they are not yet properly engaged with. So I don't think initially even much will realistically come from it. I mean funds have to send very extensive quarterly reports to the FSB detailing their investments. I've never heard of the FSB coming back saying please explain yourself. So yes reporting will help because people will have to apply their minds. There's a danger around outsourcing, just outsourcing the function to a service provider. But they have to sign off on it, and if there is litigation involved they will be held responsible. And that's why transparency might help. So publishing an investor belief statement might help. They need a sophisticated IPS, so regulatory requirements around what your investment policy statement must look like might be the way to go. And legislative guidance. And a lot of these things can come from the registrar; it's just not a priority with a lot of "more serious things going on"

AT: Thank you. Do you have any closing comments, or anything you'd like to say as we wrap up?

H: Just maybe note that there is that issue around the funds level of engagement and the asset manager and what we see in the legal space, the funds are not negotiating those things properly. So it's not good enough to outsource with a one-liner saying, it's the fund responsibility to say please this is our policy. Put in breach mechanisms, put in reporting. Have some kind of engagement that flows from the contract. People see the contract as such a hurdle to get over so that business can be done but it's really supposed to be a framework for engagement and that is not used properly. And that is also where there could be a lot of movement on ESG. But it requires funds to come to the party.

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9.3.8 Interview 8

Interview: ESG Analyst

Introduction

Context

Informed Consent

Interviewer: Okay, brilliant, thank you so much. So my, so the first question to land this interview is around the role of pension funds in the economy and society. What do you feel the roles that pension funds should play or do play in the economy, in the lives of their members and the society at large are?

Interviewee: Pension funds are in a unique position, I think, in terms of having long terms obligations and so that means that they can invest their assets- can, not that they always do, can invest in longer dated assets which lends itself to infrastructure investment, which then have an impact on the economy and also in developmental investments which also have a developmental effect on the economy. So I think it's somewhat different from other pools of capital, the long term nature of pension fund obligations, enables them to invest for the longer term which should be to the benefit of the economy.

Interviewer: So then you would say that's sort of, from your perspective, as a deplorer of capital?

Interviewee: A deployer of capital, yes.

Interviewer: So that sort of capital allocation, and do you think that pension funds acknowledged this unique ability and play to it, or is it something that's more intellectual, discussed more intellectually by the likes of people as yourself?

Interviewee: I think practically pension funds are not deploying that approach in how they invest their assets and it's complicated and I think that they have factors to it. I mean Board of Trustees, I guess, feel they have to demonstrate results from the investments that they make and Board of Trustees can be, you know, can have terms that are limited to the tenure then makes it difficult for them to make decisions that will

only bear fruit in ten years or fifteen years because probably none of them will be on the board then and then they account for the decision that was made. So I think that that makes it complicated and also there are often arguments about liquidity, so developmental investments, infrastructure investments, could be illiquid, like you can't sell a toll road, that kind of thing, or a bridge or dam easily. So then that argument kind of gives it value about how would we get out of this investment if we were to get in?

So I think the many reasons that make it somewhat impractical to make those investments but aside from that I think there's just fear and maybe a mind-set that is so accustomed to traditional investments, so investment equity, money market and a bit of property, and that's been the formula for so long, you know, in the history of pension funds that it really takes some ground work from very innovative thinkers to even consider deviating from that formula.

Interviewer: And do you think there is sort of a point where that type of thinking can come to fruition or do you think we're still a way away from exploring that?

Interviewee: I think we might still be some distance away unfortunately. There are discussions that take place but I don't think they've become mainstream as yet, to the degree that all pension funds in South Africa can start implementing or even most. There's some progress in the right direction, for example, more and more pension funds ... Well, firstly, the Regulation 28 of the Pension Fund Act acknowledges the role pension funds in responsible investing, investing responsibly etcetera, but on the ground that it's going to take a while to actually fully implement.

Interviewer: And why do you think we're still some way off and what are some of the challenges to that implementation, because I mean one of the questions I have here, and I'm glad you've touched on it, is what is your feeling around the digestion on the part of pension funds and their boards of trustees, with respect to that preamble in Regulation 28? So it's there, it's been there for some time now, two and a half, three years.

Interviewee: Okay, so I think in the ordinary business of the pension fund there would be a board of trustees that typically meets four times a year, sometimes more often but four times a year is the norm, and then they would have some sub-committees, including

an investment committee, that also maybe meets four times a year and then there are consultants to the fund and the consultants set the agenda, really, for what goes into those meetings and so the things that are top of the agenda, you know, tend to centre around the existing investments, do the assets match liabilities and are we likely to meet investment return targets and selection of asset management tends to take quite a prominent role in those discussions, and then the other existing policy issue that also can dominate the discussion, you know, not leave them all, also BEE Managers as part of that discussion. How to make sure the transformation and so I think ... and then there are, you know, the approval of investment proposals so can we put R50 million into that investment or that one, etcetera, and so there just seems to be so many other things that dominate the agenda and the consultants, I think, would have to make sure, it would have to be important. The consultant would have to start thinking of responsible investing as critical, and they would have to rank it as important as everything else that they put on the agenda because, as it happened then, it has a four hour meeting, four times a year, and then there are so many other matters to be discussed that the issues of philosophy and responsible investing sometimes become neglected.

Interviewer: It's interesting that you've highlighted the fact that obviously asset consultants bring that agenda to the table and maybe we can look a little bit more closely at the role of the trustees because, to my understanding, almost their fiduciary responsibility would make them, ultimately, accountable for what goes on in that board meeting and obviously final decisions and outcomes and so do you think that if pension fund trustees start to understand more of their responsibility and accountability in this regard, that they would perhaps drive those agenda's a little bit harder or is it completely sort of a spatial structure of how this industry works, that there's a bit of a gap there?

Interviewee: The gap is in terms of expertise and, I think, knowledge and comfort with investment related matters or even pension fund related matters. So, you know, I've worked with pension fund for, I think, twelve years about, and various boards and most board's trustees are not professional, you know. They may be professional in other things. So one might be an engineer and he happens to sit on the board of trustees as an employer appointed trustee. Another person might be, I don't know, a shop steward for a union and becomes a representative on the board of trustees, etcetera, and they do other things in their day to day lives and so they are not specialists in investments and

they not specialists in pension fund legislation or anything like that and so they tend to rely on the consultant perhaps more than they should because it's just not an area in which they feel adequately knowledgeable and so definitely, I think, if we had more professional people on boards of trustees and if there were some kind of minimum qualifications in the way that, I think, non-executive boards of directors for listed companies have. So that would bring a better understanding of the true scope of one's fiduciary duty. So the fiduciary duty is not just about to isolate, you know, correlation over Allan Gray and how is that investment performing then the full range of factors that must be considered when investing, I think, might start to become more prominent in the discussions. That's my view.

Interviewer: Okay, that makes a lot of sense. Then what is your feeling around the training that the trustees undergo? So I suppose my question is three tiered or two tiered, just around training in general, is training adequate and then training in discussion around responsible investment as well.

Interviewee: Yes, from recent experience at my former employer the training was induction training which was basically about the pension fund itself, the different trustees, the history of the pension fund, the nature of the liabilities, the structure of the assets and the policies for various governance structures, you know, in terms of reference for this committee, that committee, the board itself and a general orientation which would take place whenever a new trustee was brought on board and thereafter there were, other than there were that many opportunities for other training, and one of the issues was around who was offering the training and the independence of the company or consultant or whoever that was offering the training because, you know, asset managers are always very willing to come and offer a workshop or some kind of training to the board of trustees but ultimately they wanted something, they wanted assets to manage.

So there were questions around bias I guess, but we did source some independent training from the Institute of Directors, just in terms of corporate governance and so on but I think there's definitely a lot more that can be done to enhance the training and to make sure that responsible investments is included as part of that training. It wasn't, really. You know, it would be mentioned as part of the initial induction I think, of trustees as to this is how we invest, this is our philosophy on these various factors,

including we have a responsible investing policy that speaks about certain identified factors and so definitely there is a lot more that can be done but you know I also found that sometimes trustees were just not available for those kinds of trainings or workshops.

So things would be arranged but the attendance rate would be quite low and I think that's probably because well they have their jobs that they do that they are employed to do at Eskom, etcetera, and so to request them to be away from that desk for their responsibilities for a full day, sometimes is a tall order.

Interviewer: I mean I completely understand that but to me it seems sort of incongruent with their fiduciary duty...

Interviewee: Of course!

Interviewer: ...and so I suppose would elements of making certain training mandatory help or would that not really address the sort of systemic issue around, for example, that they have their day jobs or just simply not available, or that they are not necessarily remunerated so they can't sacrifice, you know, a day or two, depending on what level employee they are, to take some unpaid leave at work? So what I'm driving at, is your thoughts around some of the systemic things we can maybe address to free them up and ensure that trustees receive continual and important training.

Interviewee: Yes, so making it mandatory would definitely go a long way where there's some kind of consequence for non-attendance and I can't think of other ways of which one would ensure a better rate, but I mean we were often at great pains to explain how important it was and would rely a lot on the Chairman of the board of trustees to persuade the members of the board to attend whether a training and industry workshops just for offices to develop one, general knowledge about issues because, you know, ultimately they would have an impact on decisions that would have to be made by the fund itself and the participation maybe was just not always up to expectations. I guess, there are interventions, so making certain training mandatory and have Performance Agreements actually with members of the board of trustees might also go some distance and so, you know, where they had reviews because I'm not aware of boards that actually have those agreements with the board of trustees, where there are annual reviews, you

know, where if you haven't attended two, one out of four meetings or two out of four meetings, or whatever, then you're out of the board. There was nothing like that. There was no real sanction or consequence.

Interviewer: Okay, that's very interesting. Maybe I can take this conversation back when you alluded to it earlier, we talked about earlier, around trustees perhaps not understanding the full scope of their fiduciary duties. What do you think? Do you think the understanding is sort of quite superficial? So when you talk about the fact that the main over-arching attending of your fiduciary duties is to act within the best interest of the member, is that understanding quite superficial and is it still or is it simply well-being that means getting the best returns for my members?

Interviewee: Yes, so I think if I were to consider ... Yes, I think for members of the board of trustees what they are judged on is avoiding the blow ups and the big mistakes in their approval of investment decisions.

Interviewer: Okay.

Interviewee: And so if there's an investment, a hot investment that later turns out to be a scam or some kind of fraudulent structure, they would be judged most harshly if they had invested in it and if they managed to avoid it then that would usually mean that they've discharged their duties very, very well. So I think the focus then tends to be narrower and the focus tends to be at a level of individual investments, you know. Did we manage to not have money with x and that kind of thing and the less time spent on and the less emphasis on the bigger issues at a higher level, I don't know if I'm making sense.

Interviewer: Yes, yes, I understand.

Interviewee: Yes, so that, yes, I think it keeps coming back to expertise and understanding of a true understanding of what fiduciary duties entail and appreciation that yes, it is important to avoid the scams and to avoid poor investment decisions but a stewardship is about so much more than that.

Interviewer: And then maybe from your personal perspective, Linda, when you talk about looking out for the best interest of members with respect to fiduciary duties, you

know, as an industry we've come to accept that that means the best financial interest or optimal, you know, financial returns of reinvestment and from my understanding that's because of the introduction of modern portfolio theory, whenever it was, three, four decades ago, but do you think there is scope for a broader understanding of what best interests are, you know, with respect to members?

So basically, you know, my question is that typically we understand, or the industry understands looking after the best interests of members as looking after their financial returns or getting the best financial returns on their investments. My question is can we, or do you think that we can interpret that as something larger and broader and not just optimal financial returns?

Interviewee: Oh, yes, and so considering things like the impact of an investment the long terms affects, beyond the financial return, a social return as well.

Interviewer: Yes, because to me, you know, best interests could include quite a lot you know, it doesn't necessarily from the outset exclude everything and I think, if I'm correct, the introduction to CRISA speaks about adequate returns and consideration of X, Y and Z. So I'd be interested in your thoughts.

Interviewee: Yes, so I think the mistake that a lot of us who worked in pension fund, in the pension fund industry have made is to separate or to isolate financial returns from everything else. So a typical pension fund would have an investment policy that talks about investments we can make, investments we can't make, expectations from returns of investments that are made, etcetera, so for instance from equities we expect X% about inflation, from bonds we expect this and so on and then separate to that there would be other policies like a BEE policy, a responsible investment policy and various other things, and I think the starting point actually would be to integrate all of these and to have responsible investment policies speaking directly into the investment policies. So when we consider equity investments, for instance, it is integrated in there that there are certain governance standards that are expected of the equity, the listed companies that we invest in. The issue was of bonds but we invested, etcetera, so that these things are not treated separately, and I'm not sure, I think there are some of the international pension funds, the larger ones, that approach this in that manner but in South Africa I think we still having the discussion quite separately and so because of that the policies

are separate, the discussions are separate, it is actually becoming hard to conceive of an investment in its boarder sense as having the financial element as well as having the social element. So, you know, if we are discussing a mining investment, we not just talking about how many ounces they extract from the ground and what will happen in terms of earnings, we also, at the same time, should be having a discussion around their labour issue, how they approach and resolve them. We should also be having a discussion around the environmental impact, rehabilitation of the land, you know, once mining extraction is done, etcetera.

I think in most of time we are not having those discussions as one single interrelated discussion, which is where I think we actually, is how we should be approaching it.

Interviewer: Okay, that makes sense, sort of a consolidated approach would drive an integrated investment, or consolidated policy would drive something that's more integrated.

Interviewee: yes.

Interviewer: Okay, that makes a lot of sense. Then, you spoke to, earlier, the fact that often trustees or boards focus in on specific investments and whether to approve all the risks around certain investments. Perhaps I can take that idea one step further and go on to what you mentioned earlier as well, stewardship of assets, and talk about what I normally refer to as active ownership or engagement, and you are probably familiar with those terms. Do you think that pension fund trustees or the pension fund industry is starting to understand or perhaps adopt some of those ideas around engaging with their assets? Especially given that they are part owners of those assets. So I suppose the first question actually is do you think pension funds realise that they are part owners of an entity?

Interviewee: The larger ones certainly do. I think the government employees' pension fund was a pioneer in bringing to our awareness the concept of active ownership engagement in the PIC, you know, the PIC, going back a few years, under Brian Molefe, was often in the press quoted making comments or being quite active at shareholder meetings etcetera, and they continued to do this and the GEPPF under John Olifant, sadly, he is no longer with the GEPPF, and I don't know actually who is continuing with

those kinds of efforts. So I think in the pension fund industry, my experience is that the larger pension funds would typically take their cue from the GEPF and the PIC, so if they are active in a particular place then other pension funds would feel persuaded to do something too.

So when the PPS, for instance, became a signatory to the UNPRI at the time, and they were quite instrumental to criticize, well then you found the Eskom pension fund, the Transnet pension fund, a couple of others, also started to initiate some policy changes and to also become more active in those kind of structures. And then you get to the corporate pension funds. I don't hear a lot of what they do in terms of active engagement and maybe also one of the differences, and I'm digressing a little bit here, is the larger government-state owned pension funds, a lot of them have in-house staff that are assigned to their shares of the pension fund so at Eskom, for instance, there is, for the Eskom pension fund, there is an investment team dedicated to the business of the pension fund whereas in a lot of the corporate, there's a principal officer and then there are just various consultants, external consultants, and then the board of trustees, etcetera, but there aren't many people, and in some cases there's no one whose daily job it is to look after the business of the pension fund and so I, where was I going with this, I think it is also a matter of resources that are dedicated. If I were a board of trustees member and I have another quite senior full time job, I don't think I'd be following really that closely what's happening with listed companies and how could that have an effect on the pension fund on whose board I sit, whereas when it is my full time job to do so then proper attention, I think, gets paid.

Interviewer: And so do you think there is scope for, you know, most pension funds to actually improve or increase the resources to that pension fund, so perhaps have one or two people whose daily business it is to see to the needs of the pension fund or is that overkill?

Interviewee: Well it's costly. Look, one always has to weigh the benefits against the cost, but I think, for a company that hasn't had a pension fund CIO for instance, to suddenly have one, or that hasn't had certain analysts or whatever, it would be quite difficult to persuade them that they must now come up with a budget and, you know, pay these professionals, because I guess the question would be well, we haven't needed them all of these years, why do we suddenly need them now. Those kinds of

discussions. But I think there is a place for it and there are always discussions around and a reluctance to pay consultants too much and so, you know, the scope of the consultants as well, what I'm saying, short of appointing teams within the companies to look after the pension fund, another alternative is to expand the scope of the consultant, to say you are currently doing the following things for us, we also really want you to focus on our responsible investment integration into, you know the investment arrangement and they would be reluctant to pay a consultant that extra, I don't know R1 million a year but the long term benefits, I think, would justify the costs but, you know, pension funds. Anytime where there is an additional expense to be considered, there is reluctance and there would typically be discussions around well it is member's money that we taking away from so I don't know how receptive most pension funds would be to that approach.

Interviewer: Okay, thanks, and then to go back to this active ownership idea, so is there an acknowledgement or a realisation that there are cases where you, as the pension fund, or investing and therefore part owners of the company whose employees money you are managing or sorry, if that makes sense. I haven't explained that very well. So basically that link that at the end of the day could actually be the employees of the very companies who are part owners of that same company and therefore there are real-, there may be a real need for engagement because the decisions of that company effect those employees.

So you know, if you take mining for example, there is a miner who pays his monthly pension, it goes into a pension fund, that pension fund, the trustees then allocate that money to asset managers who, in turn, invest it back into that same mining company, for example. Is there some realisation around that link and the possible mechanisms for intervention or engagement to look after the best interests of those members, given that they are part owners?

Interviewee: I think a lot of the time it feels like the value chain is too long so the link isn't immediately apparent so you ask the average member of a pension fund; "Do you own any shares" and they might say no and that's his response unless they are investors in their private capacity, and then you might ask them: "Well, do you realise that through your pension fund contributions that you made every day," and these are conversations I've had with some members, we buy shares in MTN etcetera, so you

actually are a shareholder in MTN and then it's kind of oh yes, okay, yes, if you put it that way, yes, I do, but then you get into well what does that actually really mean, I can't attend an MTN AGM and influence decisions but then we would say: "Your asset manager, who holds the MTN shares on your behalf, can and does," and so on, but I think to a lot of members it feels quite far away as a concept, that they are actually owners and then to the trustees ... Trustees are usually quite aware I think but again the larger the pension fund, I think, the more realisation and acknowledgement there is of a duty towards active ownership and engagement because then the shareholding is significant. So if we're talking about the pension fund owning, I don't know, 5% of the listed company, then it's significant, and if you put a couple of large pension funds together then they collaborate and they can really have an impact, but if you're looking at a huge company like NASPERS and the pension fund equation owned 1% or less, then they kind of feel well, we're not that significant in the life of NASPERS there's nothing we can really do to change anything.

Interviewer: Okay, but you'd say in general that currently, in the industry, we are not really utilising those avenues where decisions by the company affect the employees who are, in turn, part owners?

Interviewee: Yes, I don't think we're there yet.

Interviewer: Okay, thanks. So, I mean, I think I've touched broadly sort of all the areas I wanted to and your thoughts and comments have been very helpful. Perhaps I can just sort of pose, sort of, a last question to wrap up. So in your experience, because obviously you've been within this RI space for a while and seen a lot of things happen and not happen. What do you think the trends are going forward from an asset management perspective and from an asset owner perspective?

Interviewee: Okay, from an asset manager's perspective, if we go back a few years, a couple of years, when the GEPF and some of the larger pension funds became signatory to the UNPRI and to CRISA, then they started to also require that the asset managers who manage their funds should also be signatory and, you know, I think, my personal opinion is that some asset managers wouldn't have bothered if it weren't for pressure from the large institutional investors. So they became signatories, which is positive, and they become active in CRISA.

Interviewer: Yes.

Interviewee: Elements has always had that approach to their investments, and a couple of others, and I think Investec, even before them, had had people dedicated to RI and but what you're seeing more and more now is all asset managers are starting to have at least one person in their team whose job it is to look up the ESG or the RI aspects of investing. So I think asset managers are definitely starting to pay more attention. How it works in practice though, there's still a lot of work to be done. I think, you know, from my personal experience, recent experience, I work closely with a team of analysts and the portfolio managers but when considering the valuation of the company and whether it's an attractive investment or not, a lot of the time the numbers, that the emphasis tends to be on the numbers, doesn't make financial sense. So, you know, I could point out all the factors from a governance perspective, where I say, this is an example. You know, the board is dysfunctional at that company, the Chairman of that board is the ex CEO, and he influences everything and there's no independence, etcetera, but if the portfolio manager really feels strongly that this is an investment that's going to earn us 20% in one year, maybe my views might persuade him to not buy R1 million worth of shares, maybe he will buy, I don't know, half a million but he will still buy.

Then I guess what we then have to commit ourselves to doing thereafter is active engagement, where we say: "Okay, now we own these few shares. Let's try and influence. Let's do something about how this company conducts itself and so on.' But I guess what I'm trying to say is even though the asset managers are making the right moves and appointing people and starting to integrate, are a lot more into the investment processes, that the emphasis is still skewed towards the financial analysis and the financial returns.

Interviewer: Yes. Can I quickly interject? I just want to ask one question. You mentioned that, you know, most asset managers these days have one person or someone who takes responsibility or ownership in some capacity for RI and ESG, and do you think that is in spite of the fact that there is a, sort of, not a high demand from pension funds because my feeling has always been that, you know, pension funds should be driver or the demand drivers because they have some reference to this in Regulation 28 and they are, at the end of the day, the owners of the assets, or the owners of the capital,

so in theory they should be the ones making the demand but from what you've indicated it looks like asset managers are doing or making tracks in spite of rather than because of demand on the part of pension fund trustees. Would that be a fair statement or a fair observation?

Interviewee: I think so. The institutions, the asset owner, that matters the most, in South Africa remains the GEPIF or PIC in terms of size. So if their demanding of asset managers to comply with RI and, you know, make certain changes, then that can count for 100 other pension funds because of the sheer size. It's trillions of rands or a trillion.

But the other pension funds haven't really, I think, stepped up and taken their rightful place in terms of making those requirements.

Interviewer: Okay, and then just to go back to the second part of my wrap up question. You know trends you see with respect to RI in the pension fund space, on the part of pension funds.

Interviewee: Yes, so the pension funds that I'm familiar with, have implemented policies around responsible investment and they've been active in terms of proxy voting and to a limited degree, I think, shareholder engagement, and active ownership. So I think the trend now is starting to say: "Okay, the proxy voting is one aspect but it's a minimum," so there's a need to actually engage with boards and more actively influence decisions, but I think that's the next phase that I'm starting to hear a lot more discussion about and to whether it's actually really taking place and practice, I'm not sure but we're moving in the right direction because I think, you know, attendance of an AGM and making a view heard is a kind of starting point but what happens in between the AGM is where the true engagement, I think, takes place, whether meetings that are not necessarily for the public record, but where the asset owner has an opportunity to express a view or to recommend a change and unfortunately, you know, that kind of stuff doesn't get published often. There are the meetings that take place behind closed doors, confidential conversations, so maybe it's taking place and I just, I'm not privy to all of them but certainly in terms of voting and attendance of AGMs we see that a lot more.

There are a couple of independent consultants who represent pension funds, so at the

Eskom pension fund, for instance, even though there is an investment team, etcetera, they can't be represented at every AGM and sometimes they miss things and so, in terms of voting, so they appointed an independent consultant who executes their proxy vote. So they have a policy and guidelines as to, in a situation like this, this is how they'd like to vote, etcetera, etcetera, and then they would go ahead and do that and where there were contentious issues, the consultant discusses them with the board to say there is the following issue at company X where the board wants to get rid of the CEO, etcetera, and the board would talk about it and then reach a decision as to well, this is how they would like the consultant to represent them. So I think a trend would be perhaps more pension funds, more asset owners, appointing those kind of consultants to represent them and to make sure that they are-, well certainly that the issues are brought to the attention of the asset owners, but secondly that the asset owner then is able to have a voice at the company where they have ownership.

Interviewer: Okay, that makes sense. I think that we've touched on everything I wanted to cover. Thank you so much for your time.

Closing Comments