

**PUBLIC PENSION FUNDS AND SOCIALLY
RESPONSIBLE INVESTMENT IN SOUTH AFRICA**
A CASE STUDY OF THE PUBLIC INVESTMENT CORPORATION

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ABSTRACT

Socially responsible investment (SRI) and now commonly known as sustainable responsible investment is starting to gain a momentum in South Africa among asset owners and managers. Of a particular interest is that the leading public pension fund manager, the Public Investment Corporation (PIC) which invests on behalf of the Government Employee Pension Fund (GEPF) has a significant interest in driving this phenomenon in South Africa.

In actual fact, GEPF was the first public asset owner in South Africa to subscribe to the United Nations Principles of Responsible Investment in 2006. This is not surprising because a pension fund such as the Government Employees Pension Fund (GEPF) is one of the largest investors through the PIC in the South African economy and the fund is equivalent to 1/3 of the country's GDP with almost R1 trillion assets and has investments in all sectors of the economy.

Given the significant power that this fund has in the South African economy, it was of particular interest for this research to link whether SRI agenda in the PIC is also embedded in a broader strategy/policy around South Africa economic development and by whom is this agenda is being driven in the PIC? Furthermore, this research helps to understand the key drivers, challenges, enablers for the PIC to advance SRI agenda in South Africa. The research adopts a case study approach to understand how entrenched is the SRI agenda in big public pension asset managers in South Africa.

The research found that over the past few years, the PIC SRI strategy focused on equity and developmental investing with low focus towards fixed income and property asset classes. In general, the research has found that the PIC SRI Strategy responds to issues that meet government objectives of ensuring growth and economic development of South Africa. In all four asset classes, the PIC SRI Strategy broadly addresses issues such as black economic empowerment, skills development, economic growth, economic and social infrastructure (roads, energy, housing, and education), enterprise development and job creation. However, the government has not taken any concrete steps for greater collaboration with the PIC on ESG issues in South Africa. PIC is advancing its SRI strategy mainly through active share ownership and developmental impact investing.

Key Words: Socially Responsible Investment, Institutional Investors, Corporate Governance, Development Investing, South Africa, Economic Growth

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GLOSSARY OF TERMS

Black Economic Empowerment	A programme designed by the South African government to redress inequalities caused by the Apartheid to historical disadvantaged groups of Africans, Indians and Coloureds. This is implemented through employment preference, skills development, ownership, management, socio-economic development and preferential procurement
Corporate Governance	Refers broadly to the rules and practices by which Board of Directors ensures accountability, fairness, and transparency in company's relationship with all its stakeholders
Development Investing	Investment aimed at maximising developmental impacts such as job creation and SME financing and infrastructure development
Fiduciary duty	A relationship in which one person has a responsibility of care for the assets or rights of another person.
Institutional Investors	Organisations with large sum of money that invest on behalf of the members such as pension funds and asset management firms
Isibaya Fund	A Fund created in 1995 by the PIC to specifically invest in socially desirable projects in economic and social infrastructure in South Africa
Shareholder Advocacy	An SRI strategy that promotes greater engagement with investee companies in order influence greater responsibility on ESG issues
Pension Fund	In the Pension Fund Act, pension funds are defined as “any association of persons established with an objective of providing annuities or lump sum payments for members or former members of such association upon their retirement dates or for the dependents of such members or former members upon the death of such members or former members”
Public Pension Fund	A pension funds whose members are employed by the government or state-owned enterprises
Socially Responsible Investment	An investment that takes into consideration environmental, social and governance matters in investment decision-making process.
Sustainable Development	Development that meets the present needs without compromising the ability of future generation to meet their own needs
Regulation 28	Issued in terms of the Pension Funds Act and sets out investment limits of funds e.g. 75 percent can be invested in equities. The revised Regulation 28 also called for pension funds to consider ESG matters in investment decision-making.

ACRONYMS

ACSA	Airports Company of South Africa
AGM	Annual General Meeting
BBBEE	Broad-Based Black Economic Empowerment
BEE	Black Economic Empowerment
CDP	Carbon Disclosure Project
COSATU	Congress of South African Trade Unions
CPF	Community Property Fund
CRISA	Code for Responsible Investment in South Africa
DFIs	Development Finance Institutions
DBSA	Development Bank of Southern Africa
ESG	Environmental, Social, and Governance
FSB	Financial Services Board
GBCSA	Green Building Council of South Africa
IDC	Industrial Development Corporation
GEPF	Government Employee Pension Fund
JSE	Johannesburg Stock Exchange
PFMA	Public Finance Management Act
PIC	Public Investment Corporation
RSA	Republic of South Africa
SANRAL	South African National Road Agency Limited
SMMEs	Small, Medium and Micro Enterprises
SRI	Socially Responsible Investment
SOEs	State-Owned Enterprises
RI	Responsible Investment
UNPRI	United Nations Principles of Responsible Investment

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1 INTRODUCTION

1.1 Research Area

Retirement funds have huge capacity to make a significant change in an economy through their investment decisions. This is partly due to the fact that they have become increasingly large shareholders with wide variety of asset classes (listed and private equities, fixed income, infrastructure funds etc.) in the economy. Retirement fund industry provides a source of investment capital in an economy and substantial stakes in listed companies. Therefore, this intermediary role by pensions funds in the capital markets play an important role in growing economies.

However, in recent past, beyond a positive role of providing capital to grow economies, there is a growing understanding that financial tools, such as investments, have the power to effect social, economic and environmental outcomes (Giamporcaro, Pretorius and Visser 2010). This is important because institutional investors are starting to recognise that these non-financial matters have correlation to financial performance of investments in the long-term (UNEPFI, 2007). Therefore, institutional investors are now treating environmental, social and governance issues (ESGs) as part of risk-adjusted returns and long-term responsible investment (UNEPFI, 2007). Their long-standing investment horizon has increasingly made them to consider long-term immaterial risks from ESG factors in their investment decisions (Hamilton and Eriksson, 2011).

The rise of this practice in the investment landscape is commonly known as Socially Responsible Investment and recently Sustainable Responsible Investment (SRI). The SRI agenda was accelerated by the adoption of United Nations Principles for Responsible Investment (UNPRI) in 2006 by 20 largest public pension funds in the world. Thus far, signatories have risen to 1000 in 2011, comprising both public and private institutional investors. The value of assets under management of signatories to the UNPRI in 2011 stood at \$30 trillion (UNPRI 2011).

However, SRI is not a new phenomenon and has a long history. Modern era of SRI gained momentum in the late 1960s in the United States (US). SRI began to gather a wider appeal

captivated by more causes in the wake of opposition to the Vietnam War and South African apartheid regime (Richardson, 2008). In the US, civil rights activists appealed to institutional shareholders to use their voting power to improve corporate policy (Richardson, 2008). Furthermore, in South Africa, initially, trade unions attempted to transform companies in which their pension funds were invested by raising issues of concern to workers and working conditions (Giamporcaro, Pretorias, Visser 2010).

The emergence of an SRI agenda is also changing the fiduciary role institutional investors such as pension funds. In the past, the conventional wisdom argues that the fiduciary responsibility of the pension funds' trustees must solely focused on their beneficiaries and therefore, their investment criteria must be based strictly on narrowly defined financial measures (Sethi, 2005). However, to depart from this narrow-based thinking, many European countries have reformed their regulation of pension funds to redefine the fiduciary roles. They now require pension funds trustees to formally disclose the extent to which SRI and voting rights form part of their investment decisions (Herringer, Firer, and Viviers, 2009).

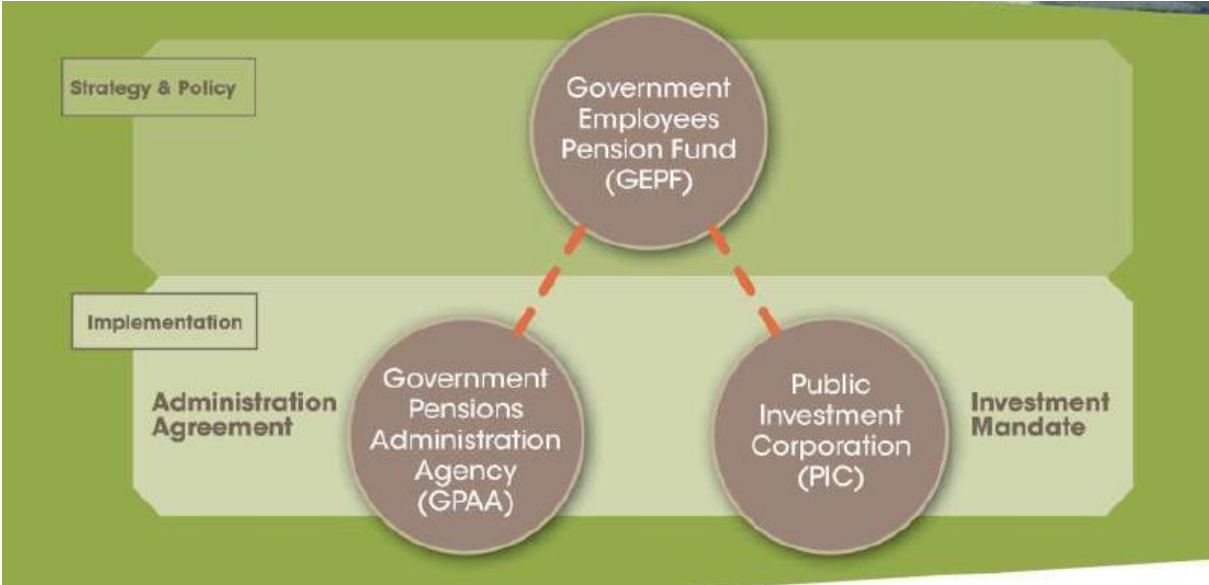
Given this trend, what are the implications for emerging markets and South Africa in general? Previous studies on SRI in South Africa have argued that the advancement of SRI agenda by retirement industry is particularly relevant to the emerging market such as South Africa, because it provides an alternative investment model that also addresses socio-economic challenges (Viviers, Bosch, Smith and Juijis 2009). They argue that pension funds are largely stores of wealth that government can use as a catalyst for change in the country.

Collectively the pension fund industry size is quite significant and provides huge spin-offs to the entire economy. In South Africa, total asset under management of retirement industry is estimated at R 2 trillion in 2011(IFC 2011) and the public pensions funds contribute more than half of this estimated figure.

The public pension fund industry is dominated by the Government Employee Pension Fund (GEPF) and which has mandated the Public Investment Corporation (PIC) to invest and manage its assets. A pension fund such as the Government Employees Pension Fund (GEPF) is one of the largest investors in the South African economy and the fund is equivalent to one third 1/3 of the country's GDP with almost R1 trillion assets and has investments in all sectors of the economy. The Government Employee Pension Fund is the largest fund in

Africa for public servants in South Africa with assets of R 911 billion, about 1.2 Million members and 345 000 beneficiaries in 2011 (GEPF, 2011).

Figure 1: Visual Chart: Relationship between GEPF and PIC



Source: Presentation _GEPF Stakeholder Update 2012
<http://www.gepf.gov.za/index.php/news/article/gepf-strategy-update1>

The investment mandate governs the relationship between GEPF and the PIC. GEPF is the largest client of the PIC contributing 90 percent of the assets under management by the PIC. PIC is mandated to invest funds on behalf of GEPF. The GEPF is a defined benefit pension fund, meaning that its members are entitled to their benefits regardless of the performance of PIC in managing their funds.

PIC is registered with the Financial Services Board (FSB) as a financial services provider and is required to follow FSB-approved client investment mandates when investing funds. PIC run its operations through management fees charged from the clients, mainly from GEPF.

PIC is fully owned by the state and focuses entirely on managing pension funds of the public sector. It has a long history in South Africa and in 2011 the institution celebrated 100 years of existence. Currently, the PIC remains the largest South Africa’s investor, with above R 1 trillion assets under management (Cohen, 2011). In March 2011, asset under management of the PIC reached R 1, 036 trillion (PIC, 2011). In 2011, PIC had 296 full time employees. It has invested in wide variety of assets including: equity, bonds, property, money market, etc.

1.2 Problem Statement

A huge public pension fund and asset manager in South Africa is relatively expected to embed its SRI agenda towards addressing socio-economic challenges. This due to the fact that South Africa is a country faced with huge economic and social transformation challenge. With large of South Africa's wealth tied to its savings through the pension funds, an opportunity exist to use the capital more efficiently and sustainably to address the developmental challenges (New Growth Path, 2010).

The New Growth Path stated that South Africa should strive to redirect savings and investment towards productive and infrastructure projects in support of employment and sustained growth and developmental aims (National Department of Economic Development, 2009). Therefore, SRI could provide an alternative investment model to support this developmental agenda in South Africa.

As a long-term investor in the South African economy, the PIC is expected to use shareholder advocacy and targeted investing approaches to address environmental, socio-economic, and corporate governance challenges of South Africa. Therefore, the emerging SRI agenda give the PIC an opportunity to use its investment power in the South African economy to address some of these challenges.

1.3 Purpose and Significance of the Research

The aim of this research study is to investigate how large public pension funds are integrating SRI agenda into the broader investment landscape in South Africa. Therefore, the research aims to contribute to broader understanding on how such a phenomenon is important to socio-economic transformation of South Africa. This research is significant to help in understanding how entrenched is the SRI policy in big public asset managers in South Africa. It will further help to understand the key drivers, challenges, enablers for the PIC to advance SRI agenda in South Africa.

The existing literature and previous research has focused in general at the trends, size and patterns of SRI in South Africa. No specific research has been done on a case study particularly public pension funds and SRI in South Africa.

Furthermore, the case study is also important to help other asset managers in understanding how other largest asset managers such the PIC are integrating SRI policy in South Africa.

The Public Investment Corporation (PIC) is chosen as a case study due to the following reasons: PIC has a wide variety of asset classes and investment muscle in the South African economy; PIC is one of the first asset manager signatories to the UNPRI; PIC is one of the largest investment manager of public pension funds in South Africa with over R1 trillion invested assets, and the extent of government influence in its investment policies towards developmental agenda.

1.4 Research Questions and Scope

The study intends to understand how the PIC is integrating SRI policy into its investment process. The study was structured through the combination of a semi-structured interviews survey with ESG managers of GEPF and PIC and portfolio investment managers of the PIC. During the semi-structured interviews, the following four questions were intended to be answered, (1) is the SRI agenda in the PIC embedded in a broader strategy/policy around South Africa economic development? (2) How and by whom SRI strategy and ESG integration is driven at the PIC? (3) are there impediments (organizational, legal and institutional) to the implementation of the SRI agenda/policies at the PIC? (4) are there enablers (organizational, legal and institutional) to the implementation of the SRI agenda/policies at the PIC?

1.5 Research Assumptions

This research makes some underlying assumptions: (1) the qualitative methodology used to conduct this research was quite relevant to provide answers to the main research questions. (2) It is assumed that the interviewees have provided honest and reliable information that would enable the researcher to describe and draw research conclusions to the main research questions. (3) The case study is big enough to be researched in order to understand of the SRI phenomenon in South Africa.

2 LITERATURE REVIEW

There is a growing body of literature focusing on the institutional investors such as pension funds and SRI. This literature review will highlight various issues that contribute to the understanding of pension funds and SRI agenda broadly and the development of this phenomenon in South Africa. The review focuses on (1) SRI definitions, (2) the role of pension funds in the rise of an SRI agenda, (3) SRI strategies, (4), SRI impediments, (5) SRI in South Africa, (6) Regulatory framework of SRI in South Africa and (7) and the history of the Public Investment Corporation in South Africa.

2.1. SRI Definitions

There is no single definition of socially responsible investment. Even where there is some agreement as to the wording in a definition, there is no consensus as to what those words mean or ought to mean (Sethi 2005). Even the term itself has evolved from “ethical investment”, “socially responsible investment”, and more recently “sustainable and responsible investment”.

Socially responsible investment is an investment strategy that balances financial and social objectives (De Cleene & Sonneberg 2004). Others defined responsible investment is an investment that incorporate an active consideration of environmental, social and governance (ESG) issues into investment decision-making and ownership (UNEPFI, Noah 2007). The IFC defines sustainable investing as explicitly incorporating ESG related risk factors and fundamentals into traditional financial analysis (IFC 2009)

Sometimes SRI is often confused with philanthropy or activities that lead to a greater sustainability or environmental protection as use of corporate assets for the benefit of third parties or society-at-large (Sethi 2005). Responsible investment is not about philanthropy, it is not about sacrificing financial returns, in pursuit of some broader social good (UNEPFI, Noah, 2007). However, ESG or sustainable investing is a way of casting a wide net to gather a lot more information and to analyze its impact on company’s long-term fundamentals (IFC 2010).

For the purpose of this research both concept of socially responsible investment and sustainable and responsible investment (SRI) will be used interchangeable. However, it will be referring an investment that actively takes into consideration of environmental, social and governance into investment decision-making and choices.

2.2. The Role of Pension Funds in the Rise of SRI agenda

Institutional investors as such pension funds has played a huge role to the global advancement of the SRI agenda. In 2005 GEPF with other 19 largest public pension funds was invited to join the multi-stakeholder group of experts coordinated by the United Nations to form an advisory council that led to the development of United Nations Principles of Responsible Investment (UNPRI). The principles were eventually launched in 2006 and GEPF become one the first largest asset owner in Africa to be a signatory.

Other prominent public pension funds that constituted the Investor Group as part of various stakeholders in the design of UNPRI include: California Public Employees Retirement System (CalPERS), Government Pension Fund Global of Norway, ABP of Netherlands, PREVI of Brazil (UNEPFI, 2007).

The UNPRI have grown to be the major influence to the institutional investors to advance the SRI agenda. The principles are the benchmark for global best practices of responsible investment attracting wider interests from the global investment community. Thus far, signatories to the UNPRI have risen to 1000 in 2011, comprising both public and private institutional investors from various countries. The value of assets under management of signatories to the UNPRI in 2011 stood at \$30 trillion (UNPRI 2011).

One way to explain a huge interest to the SRI agenda by pension funds is through a “universal ownership theory.” According to the “universal ownership” hypothesis, pension funds have become so big that they are not as much only invested in single companies as they are in broad markets, marking their investment performance dependent on how aggregate market develops (Alliaz Global Investors, 2010). Pension funds have become increasingly large shareholders; their widespread investment in passive index funds has resulted in difficulties to withdraw from companies’ with poor ESG standards without experiencing short-term losses (Hamilton and Eriksson 2011).

Large public pension funds are classical universal owners, and in relation to aligning investee corporate behaviour with their long term interests (Wildsmith, 2008). In the context of South Africa, GEPF through the PIC investments fall under such a category of universal owner. Its portfolio is widely spread in different sectors of the South African economy. Therefore, the Fund has long-term interest in the economic-wellbeing of South Africa and hence the SRI agenda is at the core to achieve such a long-term sustainability.

However, some scholars such as Richardson challenge the notion of “universal ownership theory”. He challenges the belief that universal owners such as pension funds invest responsibly may not be always true because they are not a proxy for the interests of all stakeholders in society (Richardson, 2008). Some costs affect the poor, marginalised and dispossessed, without a stake in the economy. He further argued that fund managers to whom asset management is commonly delegated may enjoy substantial discretion and power, provided they meet investment objective and performance targets (Richardson 2008).

2.3. Fiduciary Duties of Pensions Funds and SRI

Trustees have a fiduciary duty or legal responsibility, to act in the best interest of beneficiaries. However, such fiduciary duty could be an obstacle for SRI if it only focuses on financial returns (Sethi, 2005). The conventional wisdom argues that the fiduciary responsibility of the pension funds’ trustees must solely focused on their beneficiaries and therefore, their investment criteria must be based strictly on narrowly defined financial measures (Sethi, 2005). In the past, it appeared that the fiduciary obligations have been interpreted too narrowly by investment agents (Freshfields 2005). The narrow definition became an obstacle to the advancement of SRI by pension funds.

In the recent past, narrow definition of fiduciary duties was also an obstacle to the advancement of SRI in South Africa. A research done by (Herringer, Firer, Viviers, 2009) found that fiduciary duty was seen as the most critical barrier to SRI among local pension funds, asset managers and advisory pension advisers.

However, this is beginning to change after the effect of the Regulation 28 of the Pension Funds Act. In 2011, the government through the National Treasury has made some amendments to the Regulation 28 of Pensions Fund Act, 1956 under section 36 to encourage

retirement funds to consider ESG issues. It highlights the fiduciary responsibility of a retirement fund's board to invest members' savings in a way that promotes the long-term sustainability of the asset values when taking into account environmental, social and governance issues (National Treasury, 2011).

The reform to the Regulation 28 was done after a wide consultation which involves the private pension industry and GEPF. Although this reforms was much welcome by the GEPF, the GEPF is not regulated by the Pension Funds Act. However, the GEPF is seen a key player in advancing the ESG agenda in South Africa and provided an advisory role to the reforms to the Regulation 28.

A broader definition of fiduciary duties that covers incorporation of ESG factors is becoming a global best practice. South Africa is not the only country to have reformed the pensions fund legislation that considers ESG factors as part of the fiduciary duties. Many European countries have reformed regulation of pension funds to redefine the fiduciary roles. They now require pension funds trustees to formally disclose the extent to which SRI and voting rights form part of their investment decisions (Herringer, Firer, Viviers, 2009).

Furthermore, (Hoepner, Rezec, and Siegl, 2011) research found zero indications that the integration of aggregated or disaggregated corporate environmental responsibility ratings into pension fund investment processes has any detrimental financial effect. Hence they concluded that pension funds' fiduciary duties do not appear to prohibit the integration of environmental responsibility into their investment.

2.4. SRI Strategies

Institutional investors such as pension funds and investment managers use various SRI strategies to promote responsible investment into their asset classes. In the context of this research, the aim is to understand and analyse those that the PIC employs in advancing its SRI policy in South Africa. SRI strategies differ as a result of institutional investor's size, preferences, and investment style.

Worldwide there are two main strategies available to responsible investors: screening and active ownership strategies (Giamporcaro, Pretorius, Visser, 2010). Moreover, community

investing or targeted investing is also one of the SRI strategies. Community investing directs capital to people and institutions underserved by providers of financial services (Statman 2007). In the context of South Africa, this is usually referred as targeted investing or developmental-focused investing.

Screening strategy can be categorised into two parts: negative and positive screening. Negative screening is an SRI approach that excludes certain sectors or companies from the fund if involved in certain activities such as tobacco, alcohol, arms etc. (Statman 2007). The major criticism of this strategy is that ostracising bad companies does not necessary reform them (Viviers, Bosch, Smith, and Juijjs, 2009). Positive Screening is a strategy where investors strive to include securities of companies in their portfolio which are perceived to be reputable as good corporate citizens (Viviers, Bosch, Smith, and Juijjs, 2009). Investors who apply positive screens argue that companies with good corporate citizenship tend to be more profitable.

The last approach is active ownership or shareholder advocacy. Shareholder advocacy approach is an attempt by shareholders to influence the direction of companies in a direction that they consider to be commensurate with their best interests (Gostner, 2004). This approach implies that shareholders actively engage with the management boards on a range of ESG considerations (Vivers, 2007). They do so by engaging in dialogue, filling resolutions, using their voting rights at annual general meetings and divesting from companies that fail to transform (De Cleene and Sonnenberg, 2004). However, the major drawback to this strategy is that an investor needs to have a significant stake to make progress in advancing ESG issues.

When it comes to the analysis of the case study during the course of research, strategies that are commonly used by the PIC have been examined. This is specifically the shareholder advocacy and development investing strategies.

2.5. SRI Impediments

Constraints to the implementation of SRI policy differs from one institutional investor to another. Since the PIC is taking leading role to integrate ESG factors in its assets classes, it is critical for this research to highlight some of the impediments to the implementation of such a

policy in the context of the PIC. It is also important to find out how those impediments' differs from what other authors have identified as broadly SRI impediments.

Scholars such as Guyatt have identified the behavioural impediments to the adoption of and effective implementation of responsible investment practices from an institutional investor's perspective (Guyatt, 2006). Guyatt found out that external convention of short-termism, over-emphasis on relative asset-based index returns and valuation models heavily weighted towards tangible financial criteria are reinforced by internal conventions within institutions including the performance review process, team interactions and criteria used for manager selection (Guyatt, 2006).

Furthermore, fund managers generally adopt myopic behaviour, amounting to an overemphasis of the short-term movements on financial markets, notably fuelled by the use of valuation designed to exploit short term mispricing in the market (Giamporcaro, 2011). This discounting behaviour is also driven by the fact that performance of active investors is primarily reviewed and measured on the basis of their ability to outperform an index over a one-year period (Giamporcaro, 2011). This incentive system provides fund managers with little incentive to challenge the dominant conventions that prevail in the market (Giamporcaro, 2011).

At a local level, factors that are impeding the growth of SRI in South Africa include the lack of a standard definition, the performance of SRI funds, the use of short-term benchmarks and a lack of skills among investment analysts and asset managers (Herringer, Firer, and Viviers 2009). Furthermore, the lack of interest and skepticism of institutional clients and local investment consulting industry in responsible investment is a major market impediment in South Africa (Giamporcaro, 2011). There is also a belief that investors will lose their beneficiaries' money if they make social and environmental concerns focus of the investment decisions (Giamporcaro, 2011).

This research also looks at whether these impediments identified by these authors are related to the case study.

2.5. SRI in South Africa

The literature on SRI in South Africa is limited. However, South Africa's literature on the origins of SRI in South Africa gives a good background to this research. For example, the origins of SRI in South Africa can be traced back to the investment practices of trade unions in the 1990s. They refused to invest their members' contributions into companies that were supportive of apartheid regime or practice poor industrial relations, (Herringer, Firer, and Viviers, 2009).

In 2006, research conducted on the South African SRI market determined that there were 35 SRI-labelled funds available to investors (Viviers, Bosch, Smith, and Juijis, 2009). A research conducted in revealed that there 38 SRI-labelled products in South Africa, with an approximate market value of ZAR 23.28 billion (Giamporcaro and Pretorious, 2012). The recent research reveals that the market grew slightly since 2009 with a total of 52 SRI-labelled funds in existence at the end 2011 (Giamporcaro and Viviers, 2012).

The South African SRI market is focused on social transformation and developmental goals such as investment in infrastructure (Giamporcaro, 2011). However, of recent past, the SRI Growth in South Africa has influenced by initiatives such as Financial Sector Charter and JSE SRI Index ((Viviers, Bosch, Smith, and Juijis, 2009).The studies by Viviers, Bosch, Smith, and Juijis also revealed that local SRI strategies adopted by the local funds have a combination targeted investment and positive screening which centres around the promotion of BBBEE and social infrastructure development, such as housing, roads, electrification etc.

The research done by Giamporcaro also found the environmental concerns still receive little focus among institutional investors in South Africa. Belief by both civil society and the market that South Africa needs to deal with more urgent social priorities, such as social transformation and infrastructure improvement, will block environmental concerns from reaching the top of the agenda (Giamporcaro, 2010).

Furthermore, according to UNEPFI, Noah, UNISA CC Report (2007) most notable changes in South Africa since 2002 that have led to the rise of SRI agenda include: (1) The introduction in 2004 of the Johannesburg Stock Exchange (JSE) SRI index, (2) The evolution of the more matured understanding of Black Economic Empowerment (BEE), and dimension

of BEE that goes beyond ownership in areas including equity, procurement, training and CSI. This conceptual development is now supported by scorecards, charters and independent verification bodies, (3) an increasing focus of ESG performance by South African companies. SA companies have responded well to stakeholders' demand for accountability (e.g. in the 2006 Accountability Rating, SA companies outperformed the global average), and (4) the commitment of the South African largest pension fund GEPF to the UN facilitated PRI

The demand for SRI in South Africa is posed to grow as in response to enabling legislation such as amended Regulation 28 which enables the pension funds to consider ESG factors (IFC 2011). Furthermore, the recent adoption of the Code for Responsible Investment in South Africa (CRISA) which is an institutional investors' initiative demands that institutional investors such as the PIC to comply with the codes to ensure responsible investment its asset classes.

2.6. Regulatory Framework for SRI in South Africa

The strong regulatory framework for South African institutional investors is beginning to emerge. The adoption of SRI in South Africa has been influenced by international initiatives and recently domestic initiatives that will be discussed shortly. The asset owners and managers such as GEPF and PIC are guided by these internal and local initiatives.

Since 2005, the emergence of UN backed Principles of Responsible Investment (PRI) has guided the adoption of responsible investing in South Africa. The GEPF, the public pension fund was the first signatory to UNPRI initiative in 2007. Today, South Africa has about 40 institutional investors (including asset owners and asset managers) that are signatories to the principles. The signatories have begun to issue Responsible Investment Policy Statements to show their commitment to the adoption of ESG issues.

At the local level the institutional investors have been guided by the King Report II and III on Corporate Governance to excise ownership rights to influence companies to adhere to good corporate governance standards. Since 2010, the country's King Code of Corporate Governance has required JSE listed companies to integrate sustainability into their operations and report on their ESG issues (IFC, 2011).

In 2011, the government through the National Treasury has made some amendments to the Regulation 28 of Pensions Fund Act, 1956 under section 36 to encourage retirement funds to consider ESG issues. It highlights the fiduciary responsibility of a retirement fund's board to invest members' savings in a way that promotes the long-term sustainability of the asset values when taking into account environmental, social and governance issues (National Treasury, 2011).

The Preamble of the Regulation 28 stated that *“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 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”*

South Africa has also seen the emergence of industry-led initiative when the Code for Responsible Investing in South Africa in 2011. CRISA is a voluntary code which aims to encourage retirement funds and insurance companies as the asset owners, as well as their asset managers and service providers, to consider sustainability issues in their investment decisions. Although, the code is voluntary, institutional investors are expected to publicly disclose to stakeholders the extent which they have applied the code. CRISA also calls for greater collaboration between asset owners and managers to advance responsible investment in South Africa.

However, there are some reporting challenges that need to be addressed by local institutional investors. According to Crotty (2013), the vast majority of institutional investors and asset managers in South Africa are still not disclosing how they voted at shareholder meetings despite being signatories of CRISA and UNPRI, which both call for such disclosure. Only five local asset managers are disclosing their proxy votes.

2.8 History of the PIC in South Africa

PIC is an investment corporation in South Africa. It is fully owned by the state and focuses entirely on managing pension funds of the public sector. It has a long history in South Africa and in 2011 the institution celebrated 100 years of existence. The PIC was initially established in terms of the Public Debt Commissioners Act in 1911 (PIC, 2011). Its original mandate which was valid until 1984, was to be a custodian of, and to manage all monies available for investment of the government and trust funds placed in care of government. This included funds that were earmarked for redemption of government debt (PIC, 2011).

Its mandate has evolved over a century as a result of political changes. The fact that the PIC is owned by government makes it susceptible to developments in the political economy in South Africa. The changes in the political situation resulted in three main legislative periods of the PIC, namely: between 1911 to 1983, 1984 to 2004, and 2005 to date (PIC, 2011). These legislative changes led to a change in the mandate of the PIC.

In 1991, the PIC mandate was broadened to allow it to make investments in other asset classes as opposed to fixed interest government bonds only. In the post 1994, PIC diversified to socially responsible investment. The PIC created the Isibaya Fund in 1995 and the fund takes part in projects that have an impact on employment creation, poverty alleviation and redistribution of wealth (PIC, 2011). The stated purpose of this fund is to “pursue the transformation of the economic landscape of the country by contributing to infrastructural development and economic transformation initiatives” (Hendricks, 2008).

In 2005, the government passed the Act No.23 of 2004 dealing with the establishment of a corporation, a juristic person outside the public service to be known as Public Investment Corporation Limited. The idea was that the management of government money will reside outside government. However, while the corporation is akin to a privately managed company, it is wholly owned by the state, and the Minister of Finance is the sole shareholder (Hendricks, 2008). Furthermore, accountability appears to be an issue of concern, because 90% of PIC funds come from GEPF, yet the PIC has to act in the interest of beneficiaries but it is accountable to the government (Hendricks, 2008).

The trade unions have opposed the corporatisation of the PIC in South Africa. COSATU defines corporation as being “inextricably linked to the broader processes of privatization and commercialization of state assets” (Hendricks, 2008). In its view the PIC should be a vehicle for social investment to deal with the huge development problems in South Africa, instead of equity investment and specifically BEE deals.

Currently, the PIC remains the largest South Africa’s investor, with above R 1 trillion assets under management (Cohen, 2011). Exceeding trillion Rand assets was one of the major milestones celebrated in 2011, when the PIC turned 100 years old. In March 2011, asset under management of the PIC reached R 1, 036 trillion (PIC, 2011).

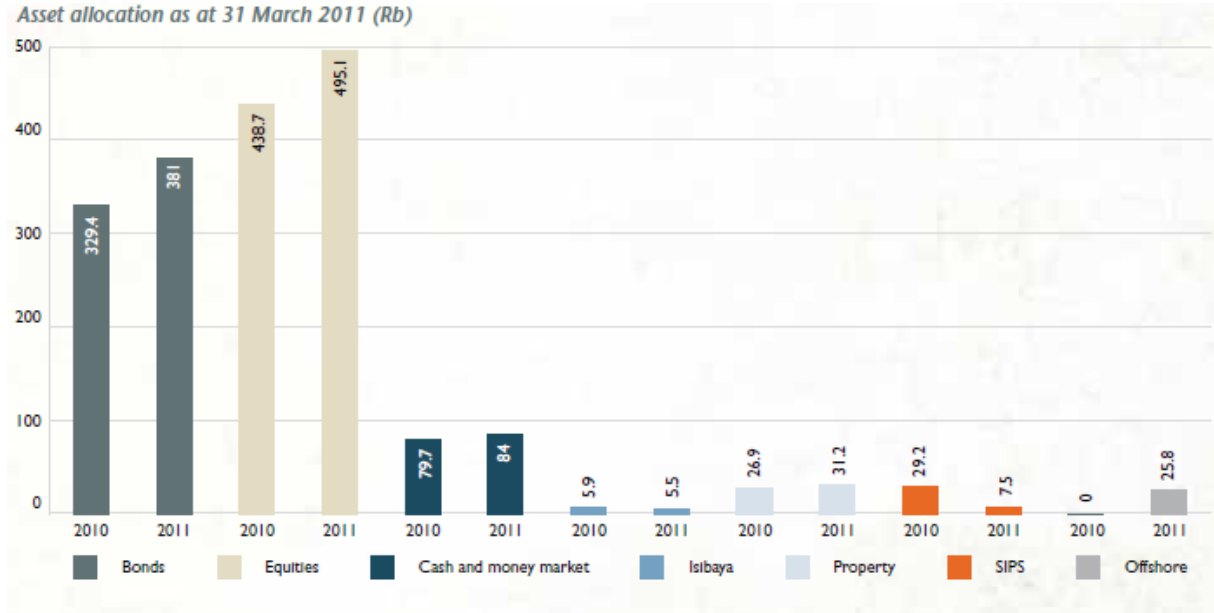
Figure 2: Total Asset Under Management



Source: PIC Annual Report 2011

Over the years, PIC has diversified its investment portfolio from a total focus to government bonds. It now covers all asset classes including: equities, bonds, money market, property, Isibaya, and offshore. Figure 2, below indicates total value of allocation under each asset class in 2011.

Figure 3. PIC Asset Allocation



Source: PIC Annual Report 2011

Equities are by far the largest investment with half of the PIC assets invested in the Johannesburg Stock Exchange. PIC holds 11 percent of the JSE all share market capitalisation. 80 percent of the investment in equity of the PIC portfolio is passively managed internally and 20 percent of the portfolio is actively managed by appointed externally private asset managers.

2.8 Conclusion

The literature above has highlighted various issues that contribute to the understanding of pension funds and SRI agenda broadly and the development of this phenomenon in South Africa. There is enough evidence that pension funds have shown a huge interest in the development of the SRI phenomenon. This can be easily explained through a “universal owner theory.” The universal theory is based on the understanding that there is a clear link between the performance of the portfolio and the health of the overall economy.

In the context of South Africa, GEPI through the PIC investments fall under such a category of universal owner. Its portfolio is widely spread in different sectors of the South African economy. Therefore, the Fund has long-term interest in the economic-wellbeing of South Africa and hence the SRI agenda is at the core to achieve such a long-term sustainability.

3 RESEARCH METHODOLOGY

3.1 Research Approach and Strategy

The approach adopted in this research is a qualitative research design. The qualitative approach performs a careful “content analysis” of the primary and secondary sources, which adduce as interviews, evidence-speeches, press statements, government reports, personal memoirs, scholarly studies etc (Dougherty and Pfaltzgraff, 1981).

In this research, the research tools used a case study. Qualitative approach to analyse a case study was deemed the most appropriate method for this research. This is due to the fact that a case study is a type of qualitative research in which in depth data is gathered relative to a single individual, program, or event, for the purpose of learning more about an unknown or poorly understood situation (Leedy and Ormrod, 2010).

The case study tool was selected because it leads to capturing real-life contemporary phenomenon and brings understanding to complex issues (Yin, 2004). Case studies further offer a systematic way of documenting a large number of events and analysing actions taken by individuals or organisations, and the possibility to observe responses by and effects on other participants, which contributes to drawing an analytical conclusion (Merriam, 1988; Hancock and Algozinnie, 2006).

Leedy and Ormond (2010) go further to indicate that researchers may choose to focus on a single case study because its unique or exceptional qualities can promote understanding or inform practice to similar situations. PIC was chosen based on its unique position as the largest public asset manager in South Africa. This case study will help in understanding how a large public pension asset manager is driving the concept of SRI in South Africa.

Furthermore, case studies are useful to answer “how” and “why” research questions and in this role can be used for exploratory, descriptive and explanatory research (Rowley, 2002). This research is mainly exploratory, descriptive and explanatory in nature.

3.2 Data Collection, Frequency and Choice of Data

This research was done through a semi-structured interviews survey with asset managers of PIC and Executives at the GEPF. The interviews were necessary because the existing literature could not provide sufficient answers to all research questions of this research. The aim was to find out how PIC asset managers are practically implementing SRI in South Africa. The interview guideline was developed to specifically target research questions that existing literature could not provide with sufficient answers. The interview guideline consisted of a majority of semi-structured questions which also allowed for some follow up questions.

The interview guideline was divided into two sections. Section one focused on institutional arrangement and key drivers of SRI policy at the PIC. This sections targeted ESG managers at the PIC and GEPF. Section two of the guideline focused on specific questions in the four asset classes of the PIC: equities, fixed income, property, and developmental investing. The second section targeted portfolio managers of the four different asset classes at the PIC.

However, not all interviews were conducted at all other portfolio managers. Other portfolio managers preferred to respond to the research survey via email. This presented a difficulty in having extensive discussions through follow-up questions with the respondent and diluted the richness of the interview process.

The information collected from the interviews and survey was supplemented by other secondary documents obtained from international organisations such as the UN and policy documents from South African government and institutions. This included: UNPRI, National Treasury Regulation 28 of the Pension Funds Act, PIC Act No.23 of 2004, Code of Responsible Investment in South Africa, King III Report on Corporate Governance, and GEPF Responsible Investment Policy statements, PIC Corporate Governance Rating Matrix, PIC Annual Reports. These policy documents were necessary to analyse the case study because they provided a regulatory framework under which the case in point has to operate.

Furthermore, data was collected from secondary documents such as books and journal and newspaper articles on responsible investment throughout the research study.

3.3 Sampling

The population identified in this research consisted of investment managers and decision makers in the GEPF and the PIC. A total number of ten people took part in the interviews survey. Interviews were conducted with the two ESG managers of GEPF and PIC and 8 portfolio investment managers at the PIC. The process to identify rightful interviewees was done with the assistance of the Head of SRI at the PIC who is also part of the executive management. The head of SRI at the PIC facilitated the correspondence between the researcher and investment managers. The Head of SRI at the PIC identified 8 portfolio investment managers consisting two per each of the four asset classes: equity, fixed income, property and developmental investment.

The initial plan was to interview 20 investment managers but the head of SRI at PIC decided to reduce the number to 8 because of the anticipation that interviewees will provide same information since they all work in the same institution. Five people were interviewed and 5 people responded to the research survey by email.

The interviews were conducted at the premises of the PIC and GEPF during October to December 2012 in Pretoria. The interviews on average lasted for about 40 to 60 minutes. Due to limited time the busy schedule of the portfolio investment managers, the interview process was rushed and others prefer to provide a written reply to the research guideline at their convenient time.

3.4 Data Analysis Methods

The method used in this research was the general inductive approach to data analysis. The inductive approaches are intended to aid an understanding of a meaning in complex data through development of summary themes or categories from the raw data (Thomas, 2003). In this method, data analysis is determined by both research objectives and multiple readings and interpretation of the raw data. The primary mode of the analysis is the development of categories from the raw data into a model or framework that captures key themes and processes judged to be important by the researcher.

A rigorous and systematic reading and coding of transcripts allows major themes to emerge (Tomas, 2003). Therefore, interviews were transcribed and the written surveys were compared to identify the relevant themes emerging from the raw data.

The analytical strategy used was to develop a descriptive framework of organising the case study. The framework of sections reflecting the themes of the case study was developed and evidence was gathered within the different themes and analysed from multiple sources (Rowley, 2002).

In order for the findings to be usable, the researcher made decisions about what is more important and less important in the data. In writing the findings, the main heading were developed and followed by the use of sub-heading to answer the research questions.

3.5 Research Reliability and Validity

Socially or sustainable responsible investment is a new phenomenon and still evolving in South Africa. Many asset owners and managers are starting to respond to this phenomenon. Therefore, trustworthiness of the findings from the interviews is not always easy to validate. However, efforts were made to validate data with other published reports or information with regards to the case study. Furthermore, one a major weakness of the case study is that the findings cannot be generalised to other fund managers in South Africa.

3.6 Limitations

The limitations of are as follows: (1) the field of study is quite relatively new in South Africa and information is still difficult to gather. (2) The research focused on one case study and the findings are mainly relevant to the particularly case study. (3) The interviews were limited in terms of time and scope and meaning that not all areas were discussed in detail.

3.7 Research Ethics

There is a minimal ethical implications from the research conducted. The interviewees expressed a caution for being directly quoted. They preferred their names not to be mentioned in direct quotes to avoid any controversy that may arise. This was prevented by the researcher by not mentioning names. Finally, the requisite of Ethical Clearance form was also submitted

to the University of Cape Town's Ethics in Research Committee and all associated rules and guidelines were duly followed.

4. RESEARCH FINDINGS, ANALYSIS AND DISCUSSION OF THE CASE STUDY

The research findings and discussion on this section are based on the interviews and respondents to the questionnaire submitted to the ESG managers and portfolio managers under each asset class. The responses they gave were classified into headings to help with the analysis and providing answers to the main research questions on what the PIC is doing in implementing the SRI policy in South Africa.

4.1. The Evolution and SRI Approach in the PIC

In order to understand the historical approach of the PIC to SRI, heads of SRI policy at the GEPF and PIC were targeted during the research questionnaire. The first part of the research questionnaire addresses issues related to the governance framework and the key drivers of the GEPF/PIC SRI policy.

4.1.1. Introduction

In 2005 GEPF with other 19 largest public pension funds was invited to join the multi-stakeholder group of experts coordinated by the United Nations to form an advisory council that led to the development of United Nations Principles of Responsible Investment. The principles were eventually launched in 2006 and GEPF become the first asset owner in Africa to be a signatory.

Due to the fact that the GEPF does not manage its assets, the responsibility to implement SRI strategy into investments rest with the PIC. However, the PIC has to take an ultimate consideration of its clients' demand when implementing SRI in the assets classes. The GEPF as the largest client with 90 % of the assets and gives the direction on SRI policy. Therefore, the GEPF sets the Responsible Investment Policy Framework for the PIC to implement in its investment undertakings. Client's demand of ESG integration is one of the critical enablers of SRI consideration by asset managers that invests on behalf of the clients or asset owners. Today ESG issues form part of the fiduciary duties of the GEPF.

In the past five years, two responsible investment policy documents have been developed by the GEPF to provide policy guidance to the PIC. The first one is the GEPF Responsible Investment Policy that was produced in 2009 and the second one is the GEPF Development

Investment Policy produced in 2011. The first document was developed as a response to UNPRI's requirement that signatories have to develop Responsible Policy Statement as symbol of commitment to ESG factors and the second policy was developed by the GEPF and PIC after wider consultation with key domestic stakeholders to advance the development agenda of South Africa.

The two documents set out intentions to integrate environmental, social and governance in all investment decisions. These policies have indicated that two strategies will be employed to advance SRI by the PIC. The strategies will be through (1) Active Ownership/Shareholder Advocacy and (2) Developmental Investing.

4.1.2. Active Ownership/ Shareholder Advocacy

The GEPF Responsible Investment Policy has clearly indicated that the SRI agenda will be advanced through active ownership or shareholder advocacy. The GEPF understands the active ownership as the practice of using a range of formal and ownership rights to signal encourage and request change in the behaviour of entities on ESG issues (GEPF, 2009). Formal ownership rights include such rights as participating in annual general meetings, voting shares, and lodging shareholder resolutions. Informal ownership rights refer to the right of owners to engage less formal such as through telephone, email and meetings with management of investee companies (GEPF, 2009).

Through active ownership of the GEPF, PIC seeks to enhance the performance in ESG areas by entities in which it has invested to protect and enhance investment over the long term. Through shareholder advocacy, PIC intends to support and encourage boards in their leadership and governance of business, rather than prescribing what companies need to do or attempting to interfere in the management of companies (GEPF, 2009).

Active ownership is persuaded through engagement. Engagement involves investor interactions with company managers and directors to signal concerns, understanding how concerns are being managed, and communicating steps deemed necessary for improvement (GEPF, 2009). If engagement appears to be unsuccessful, GEPF and PIC will consider strategic voting. However, the drawback with strategic voting is that the issues that are usually brought to investors are corporate governance issues. Environmental and other social issues require a stronger engagement with the boards and management of companies.

4.1.3 Developmental Investing

Apart from the active ownership, developmental investing is part of the broader SRI strategy for the PIC. The objective of the Developmental Investment Policy is to earn good returns for the members of the Fund while also supporting positive, long-term economic, social and environmental outcomes for South Africa (GEPF, 2011). Despite, the fact that the policy was recently developed in 2011; this is not a completely new strategy. PIC had already created an Isibaya Fund in 1995 to look at investments that will address some socio-economic challenges facing post-apartheid South Africa. The new policy from GEPF states that 5% of the total assets has to be invested in projects that have huge developmental impact. According to the current asset under management by the PIC, 5% is roughly about R 50 billion. However, despite this allocation, the amount committed to projects in 2011 was about R5, 5 billion.

4.1.4 The Institutional Arrangement for SRI Policy: GEPF and the PIC

An investment mandate governs the relationship between the GEPF and PIC. This mandate has been extended towards the implementation of the SRI policy. GEPF is an asset owner and the PIC is an investment manager of the GEPF assets. As indicated earlier, GEPF sets the Responsible Investment Policy Framework for the PIC to implement in its investment undertakings. However, to encourage collaboration between the two institutions an ESG Working Group has been established in 2011 to enhance both parties effectiveness in dealing with ESG matters. This is in line with the spirit of CRISA and UNPRI where asset owners and asset managers are encouraged to work together on ESG matters.

The ESG Working Committee regularly discusses ESG issues pertaining to listed companies. It is a general practice for the Working Committee to meet once a week and discuss the upcoming proxy voting resolutions from listed companies. The committee constitute four members, two from the GEPF and two from the PIC.

However, according to the finding from the ESG managers of the GEPF and PIC the ESG Working Group is currently not working according its full mandate. The problem is more about full concentration on weekly proxy votes. Apart from the proxy votes, the ESG Committee has a mandate to look at other thematic issues on ESG such as that have a long term impact on investment portfolio. The scope has to be expanded to look at other themes

and sectoral ESG issues such as in mining, energy and climate change, property and agriculture, etc. However, a successful move towards discussion on the thematic issues will require strong internal research capacity to provide research or commissioned studies by the two institutions.

4.1.5 Key Drivers of ESG Integration into the Assets of the PIC

The Heads of the ESG at the GEPPF and PIC were further asked to highlight key drivers of SRI policy. They were presented with 7 issues. Issues included: (1) Impact on the shareholder value over the long term, (2) Demand from the beneficiaries, (3) Development Agenda of South Africa, (4) International trends on SRI, (5) Reputational risk, (6) Government policy, (7) Influence from other local institutional investors.

The Heads of ESG were asked to indicate whether an issue is more important and less important. Out of the list, four issues were stressed as the most important factors guiding the PIC SRI policy. The issues listed below constitute key drivers at the centre of the SRI strategy at the PIC.

Table 1. Drivers of ESG Integration

Driver	Explanation
1. Protection of Shareholders’ Value	PIC invests on behalf of public pension fund (GEPPF) that has to meet its long-term liabilities to the beneficiaries who are major shareholders of the fund. Therefore, GEPPF’s commitment to integrating ESG issues in investment decisions is primarily based on a concern that these issues have an impact on GEPPF’s portfolio value over the long-term. This enables the GEPPF to seek better risk-adjusted returns.
2. Development Agenda of South Africa	90 percent of the PIC assets are invested in South Africa and committed to grow the economy of South Africa. This is further consolidated by the Development Investment Policy that commits 5 percent to an investment projects focused on social and economic infrastructure for the economic development of South Africa.

3. International Trends	GEPF was the first signatory of UNPRI in 2006 together with other 19 largest public asset owners. As the largest pension fund in Africa, it is important to follow trends of other global asset owners on the SRI.
4. Reputational Risk	PIC believes that to be a responsible investor as the largest stakeholder in the South African economy is very important. Furthermore, by virtue of being the largest pension fund in Africa, GEPF wants to be a thought leader on ESG issues in South Africa. GEPF/PIC played a strong leadership role in initiating local initiatives advancing ESG issues such as CRISA and PRI SA network with other local investment managers.

Source: constructed by the author based of information gathered from the interviews

The impact of the ESG on shareholder value came out strongly across all interviews and survey responses. In fact across all the four asset classes, there was an understanding that ESG issues can affect the financial return in the investment and should not be approached as a goodwill exercise. Almost all portfolio managers believe that ESG factors are important and not just for social goals but critical to protect the PIC investments over a longer a long-term. However, the portfolio managers from fixed income and property assets believe that there is still a more concentration of ESG issues in the equity assets. SRI strategy for the fixed income and property investments is still at an initial stage of conceptualisation.

Portfolio managers in all four asset classes believed that the development agenda forms a core objective of the SRI strategy. Throughout the interviews and survey responses, all people surveyed believed in SRI and highlighted its important as an investment model to contribute to growth and development of South Africa. Some mentioned the commitment by the PIC for allocating 5% of the total assets going to developmental projects a strong belief by the PIC on responsible investment.

International trends on SRI play an important role for benchmarking the PIC with other world large asset owners and managers. This is not surprising since the GEPF was among the first of

16 large global public pension funds that led to the development of UN principles of responsible investment.

The reputational risks as a driver towards adoption of SRI policy by the PIC can be explained in terms of institutional branding. It is an opportunity to use the SRI agenda to promote a positive image of the PIC as responsible investor in South Africa. Furthermore, a stronger leadership role taken by the PIC and GEPF to advance ESG issues in South Africa as enabled these institutions to be thought leaders on ESG issues.

4.2. Execution of SRI in the Asset Classes

The PIC SRI strategy is concentrated towards four asset classes: equities, bonds, property and developmental investing. In order to understand how the PIC actually incorporate ESG factors into investment making process, a survey was done to portfolio managers under four asset classes: equities, bonds, property and developmental investing. Two people were surveyed under each asset class. The findings and analysis under each asset are presented below.

4.2.1. PIC SRI strategy in Equities

Listed equities constitute largest concentration of the PIC investment portfolio with an amount of approximately R500 billion in 2011. In accordance with the UNPRI principle that calls for greater active ownership on ESG factors, the major focus of the PIC SRI strategy is centred on this asset class through a shareholder advocacy strategy. According to ESG managers of GEPF/PIC the aim is to ensure that entities in which PIC invests on behalf of its clients are well managed, accountable and transformed to provide a better shareholder value for a sustainable period.

From the interview with portfolio managers under this asset class, there was a general awareness that a failure to exercise shareholder advocacy on the investee companies in the Johannesburg Stock Exchange (JSE) might have a long-term negative consequences to the PIC's investment performance. The PIC accounts for about 11% of the JSE total market capitalisation.

Through active ownership strategy, PIC engages with companies on ESG issues behind closed doors and at the Annual General Meetings (AGMs) through proxy votes. However, if little success is made through engagement, the second alternative to the PIC is usually

through increasing a stake to get an opportunity to nominate directors in the board to try and influence from within. This is motivated by the fact that using the shareholder advocacy successfully sometimes requires an institutional investor to have a significant stake in a company. However, from the interviews, it was not clear how often the PIC increases a stake to exercise more influence or whether this is a general practice.

To source ESG information on the listed equities, PIC relies on internal research and external ESG providers. Internally, PIC research team uses public available information on companies such as websites, annual and non-financial reports. Externally, PIC uses rating tools such as JSE SRI Index, Stellenbosch Business School's Corporate Governance Index to assess companies' commitment to ESG issues.

However, at the present moment, there is still more reliance to external ESG service providers rather than internal research. PIC prefers to use the Stellenbosch' Corporate Governance Index and JSE SRI Index. The Centre was co-founded by the PIC in 2008 to develop a Corporate Governance Rating Matrix to be applied to listed South African corporations. The centre started with top 40 companies at the JSE but now covers top 100 companies. JSE SRI Index was initiated in 2004 and the research is now carried out on behalf of the JSE by global investment research provider EIRIS (with a local partner the Corporate Governance In Africa at the University of Stellenbosch).

Information gathered from these tools is not used to avoid investment in certain companies. They are used to help the PIC to exercise its shareholder advocacy to engage companies on certain issues that are lagging in terms of the matrix rankings. This is consistent with the shareholder advocacy strategy of advancing ESG issues. It was stressed that PIC will not divest from companies that are at the bottom of the ranking because the institution is a long-term investor.

Therefore, it was also quite clear from the interviews that the use of shareholder advocacy is also seen as important vehicle to stabilise the domestic market. PIC does not want to cause any market reaction by divesting from other sectors or certain companies. As a largest investor in the top 40 companies, PIC understands that it is critical to exercise responsible leadership for the purpose of stabilising the market.

Currently, on the equity portfolio the PIC ESG Rating Matrix is weighted equally. All the categories (environmental, social and governance) are weighted 33.3% each.

(a) Environmental Priorities

There is an acknowledgement from the interviews that in the couple of years ago, PIC attached less value on environmental sustainability issues and more value to governance and social issues as part of its sustainability approach towards investment. Environmental issues were partly ignored because they appeared less significant to rather more pressing social ills affecting South Africa. However, in the last four years PIC has moved to attach value on environmental issues. Within the institution, there is a growing understanding that environmental risks too could have a long-term impact on shareholder value if investee companies totally ignore them. Moreover, it is now being acknowledged by the PIC that climate change poses a threat to long-term sustainable development, economic growth and quality of life in South Africa. Water and food insecurity came as the top concerns that climate change poses a danger to livelihood of poor people in South Africa.

The table 2 below highlighted 20 environment issues that the PIC analyses to engage with investee companies.

Table 2: PIC’s Top Environmental Considerations

Environmental Issues
1. Initiatives to promote greater environmental sustainability
2. Precautionary approach to environmental challenges
3. Existence of board subcommittee responsible for environment/sustainable development
4. Executive performance linked to sustainability performance
5. Participation in voluntary standards and networks
6. Total paper usage
7. Direct energy consumption by primary energy source
8. Indirect energy consumption by primary source

9. Energy saved due to conservation and efficiency improvement
10. Total direct and indirect greenhouse gas emissions by weight
11. Initiatives to reduce greenhouse gas emissions by weight
12. Total water withdrawal by source
13. Percentage and total volume of water recycled and re-used
14. Total water discharge by quality and destination
15. Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation
16. Environmental performance of suppliers and contractors
17. Percentage of materials used that are recycled input materials
18. Total weight of waste by type and disposal method
19. Total number and volume of significant spills
20. Encourage the development and diffusion of environmentally friendly technologies

Source: Information supplied during the Survey with Equity Portfolio Managers

The environmental information is sourced internally through public available information such as integrated reports and websites. Information obtained is then used to highlight concerns and engage with companies. However, it was highlighted that there is lack of disclosure especially on environmental violations by companies which make it difficult for the PIC to quickly figure out this information. These violations are usually disclosed by the media, but never disclosed by the companies in their integrated sustainability reports.

Regarding the greenhouse emissions data which is now central on climate change debates on the industry, the PIC now heavily rely on Carbon Disclosure Project (CDP) South Africa Report. CDP collects data on climate change, carbon emissions, and water usage. CDP allows top 100 companies in the JSE to voluntary send data. In 2011, 83 South African companies voluntary sent data which were publicly published in its CDP South Africa Report (CDP 2011). An effort is made by the PIC to directly engage with those companies that do not send data to the CDP. Although the disclosure of carbon emissions is the first step, it is necessary

to pave second way towards discussion on concrete actions for climate adaptation and mitigation by the industry.

Despite the long list of all key environmental issues to assess the investee companies, it is not clear whether some issues are more prioritized than others. However, the development of key environmental issues signals an important step by the PIC to incorporate environmental sustainability into equity asset.

(b) Corporate Governance Issues

Corporate governance issues are a central focus by the PIC in the equity asset class. In actual fact the GEPF/PIC ESG working group discusses proxy votes on corporate governance issues on weekly basis. PIC believes that companies that maintain good level of corporate governance tend to be more sustainable and will therefore deliver a better value over a long-term period. Some of the key metrics used to determine the level of corporate governance are: the independence of directors and auditors, transformation, attendance at the board meetings, remuneration and legal contraventions (PIC 2011). Table 3, shows a full list of aspects that constitute corporate governance priorities.

Table 3: PIC’s Top Governance Issues

Governance
1. Independent non-executive directors in majority
2. Diversity (percentage of female and black directors)
3. Evidence of board performance evaluation
4. Composition of Audit Committee
5. Composition of Remuneration Committee
6. Composition of Nomination Committee
7. Diversity (percentage of black executives)
8. Diversity (percentage of female executives)
9. Disclosure of CEO’s terms of contracts and notice terms

10. Succession planning for directors and executive management
11. Disclosure of prosecutions, legal contraventions, judgement and fines
12. Anti-competitive practices and behaviour

Source: Information supplied during the Survey with Equity Portfolio Managers

When the PIC started investing in equities in the 90s, the management of listed companies were completely dominated by white boards and executive management. Therefore, the PIC deemed it necessary to focus on transforming the top 40 companies in South Africa by making their executive directors more representatives of the democratic realities of the country (Hendricks, 2008). Transformation was seen as necessary to meet some social objectives such as empowering historical disadvantaged individuals and changing ownership structure in the JSE. Since then, PIC is primarily focusing on promoting the black executives at the board level using corporate channel of the AGM to accelerate change in the upper echelon of the corporate world (Hendricks, 2008).

Recently, at the core of the PIC corporate governance strategy is the need to curb exercise remunerations of companies' executives. Excessively large remuneration package for top executives which is not linked to performance is an issue of concerns for the PIC. More importantly, in the context of a country like South Africa with huge social inequality, this issue usually finds its way in public policy discussions specifically through labour unions. PIC is compelled to look at this issue. To ensure that the PIC plays an influential role in this issue, the PIC has always strived to have a Board representative in the Remuneration Committee.

With regards to transparency, it is now a common practice to disclose the proxy votes on corporate governance issues that PIC undertakes on weekly basis. All proxy votes are now disclosed of the PIC website at the end of each month. This reflects a growing commitment by the PIC to increase transparency on corporate governance issues to the general public. This is a growing best practice internationally which other big public pension funds have adopted such as CALPERS in the United States.

According portfolio mangers, it was highlighted that there is a need to increase coverage of the South African companies through international proxy advisers. PIC believes a better

coverage could be provided by international proxy advisers since there is a little capacity in South Africa. However, there has to be a demand of such a service by South African asset managers. The need of proxy advisers was also confirmed by a research done by Winfield (2011) that reveals that local asset managers are often unfamiliar with documents and institutions that aim to help them develop and implement strong voting and stewardship policies. Furthermore, policy documents are typically weak and do not communicate effectively to clients, internal investment professionals or investee companies.

(c) Social Issues

South Africa is a country with significant social challenges such as unemployment, inequality and HIV pandemic. It is within this context that the PIC intends to address these challenges through its investment in the JSE. Under social issues PIC has made a lot of emphasis on companies to focus on empowerment of historical disadvantage individuals through employment equity and skills development, BEE ownership etc. The full list is highlighted below on Table 4.

Table 4: PIC’s Top Social Issues

Social Issues
1. BEE ownership
2. Employment equity
3. Disclosure of procurement practices-BEE procurement
4. BBBEE level contribution
5. Accidents, deaths and injuries
6. HIV/Aids policies and practices

Source: Information supplied during the Survey with Equity Portfolio Managers

The PIC is also directly involved in empowering other small black asset management firms. The 20 percent of the PIC assets that is externally managed is used for this purpose. The externally managed funds in equities are allocated to BEE fund managers or asset managers with empowerment partners. By so doing PIC is supporting transformation of the industry by building skills of BEE asset managers through incubation manager selection process (PIC, 2011). Allocation of funds to incubation managers affords them an opportunity to build track records with which to attract funds from other institutions (PIC, 2011).

Initially, the 20 percent allocated to private asset managers used to be managed by big players in the industry such as Old Mutual Asset Managers, Stanlib Asset Management, Futures Growth Asset Management and Rand Merchant Bank Asset Management. The withdrawal of such funds was done as result of lack of transformation in the sector with little effort by these asset managers to have empowerment partners.

4.2.2. SRI in Fixed Income Assets

In the current practice, SRI does not really form part of the PIC daily fixed income strategy. According to the portfolio managers the weight allocation towards this asset class is relatively small. Furthermore, there is even insufficient ESG information available under this asset class. ESG integration into the PIC's bond investment strategies is still in infancy stages and is anticipated to take a longer period, even years, before responsible investment in bonds reaches the level it has in equities. According to the portfolio managers under this asset class, the ESG information that PIC gets is usually deal specific and that would come from third-party experts such as banks.

However, according the portfolio managers from the interview, PIC believes that through its strong investment in government bonds and state-owned enterprises (SOEs) indirectly help to address some social goals such as employment and growth of South Africa. Investing in these bonds, or providing them with needed capital, the PIC seeks to achieve fair returns while preserving capital as well as enhancing the potential for economic performance and growth in South Africa (PIC 2011). Portfolio managers highlighted that economic growth in South Africa is also good for the PIC assets. There is a high positive relationship between PIC assets and the South African GDP. The correlation between the two is 97% for the period 1984 to 2009 (PIC 2011). This indicates that PIC growth tend to be positively associated with the growth of the economy of South Africa.

South African bond market is dominated by the government bonds. Government bonds are approximately 90% of all total bond issues while parastatal (quasi-govt) bonds make up about 8% and the balance of 2% is corporate listed companies on the JSE. PIC strongly invests in bonds offered by other state-owned enterprises, such as Eskom, Transnet, SANRAL, ACSA, and DFIs. For example, PIC holds 61 % of all parastatal bonds issued in the domestic market.

In general, according to the portfolio managers under this asset class, it is still difficult for the PIC to implement an ESG issues in the fixed income assets. Most ESG integration into mainstream investments has been in equities and bondholders lack the voting power as shareholders have in equities. However, in principles, on the Fixed Income front, ESG can only be applied when a proposed bond issuer can be reprimanded on certain unethical practices which might affect the successful placement of the proposed issue.

Under this asset class there are huge trade-offs facing the PIC that needs to be understood. It is not always easy to influence SRI policy as PIC has to balance the need to invest into government and parastatals' bonds. On the other hand bonds provide stable income and also preserve capital of the GEPF. Furthermore, one portfolio manager emphasized that the extent of participation is dictated by client mandates and a bigger portion of the assets would be in government bonds by virtue of their default-risk free status and that government issuance is 90% of total bond issuance in which pension funds can invest in capital market.

Furthermore, PIC has to make trade-offs between economic growth and environmental considerations. For example, PIC holds 50% of Eskom bonds and Eskom is issuing bonds to build coal-powered power stations in South Africa which has negative impact on the natural environment. However, at the same time energy scarcity would hamper future economic growth of South Africa. PIC has justified investing in Eskom's bonds as critical to ensure economic growth in South Africa.

4.2.3. SRI in Property

Property portfolio is managed internally through a newly created property division in 2010 called PIC Real Estate Managers. The division manages commercial office, retail and industrial properties in South Africa with a tenant base including national retailers, major corporate and industrial groups on long-term leases.

SRI policy for property investment is relatively new and was recently developed in 2011. The strategy focuses on investing in green buildings and investment opportunities that are socially transformative through Community Property Fund. The focus on green buildings is linked to climate change adaptation in the built environment. Green buildings have to be energy efficient, resource efficient and environmentally responsible. There is a strong understanding

that PIC's investment in green buildings should be future direction to address environment sustainability issues.

PIC strategy is to ensure that all new buildings comply with the provisions of the Green Building Council of South Africa (GBCSA). The PIC also sits at the Board of the Council. GBCSA provide rating tools to new residential, commercial office buildings to award a green building status. However, since the green buildings market is still very small in South Africa, it is still at the very an initial stage to measure the development of the green building market.

There was a strong emphasis or believe from the portfolio managers that SRI in property is critical to achieve some social goals such as job creation through expansion of retail property development in townships and rural areas. The Community Property Fund (CPF) established in 1996 as a social investment vehicle focusing on retail development in rural and semi-urban areas is seen as an effect tool achieving social transformation in South Africa. The Fund has developed and managers 30 retail shopping centres in rural and semi-urban townships. According to the PIC these retail developments has contributed immensely to job creation in rural and township areas. However, it was difficult to get the exact figure of the estimated jobs created by these retail shopping centres.

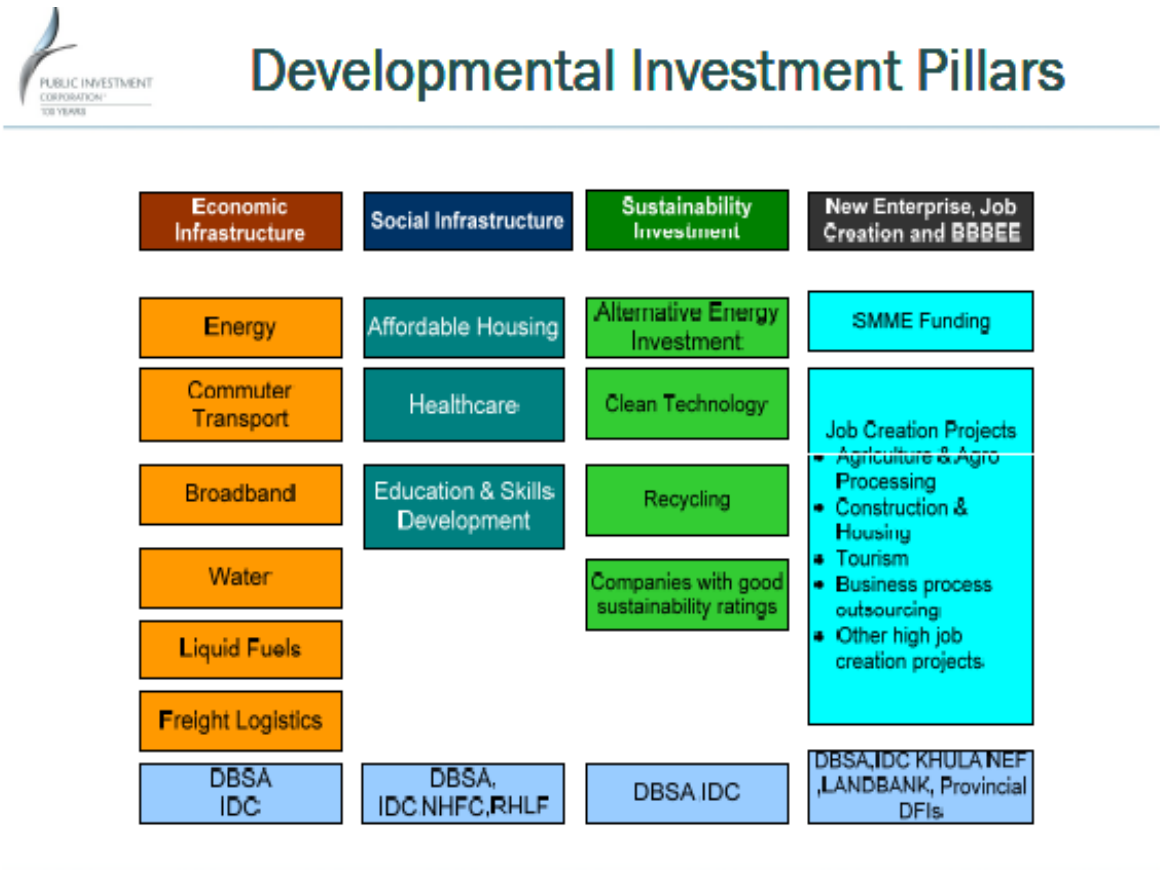
Developmental Investing

In developmental investing strategy the PIC directly invests in projects with high-developmental impacts for the purpose of addressing socio-economic challenges in South Africa. According to portfolio managers under this asset class, by virtue of being the largest asset manager located in a country with high unemployment and poverty that has influenced the PIC to adopt developmental impact investment strategy.

This SRI strategy was adopted long before emergence of the UNPRI and CRISA initiatives. PIC established the Isibaya Fund in 1995 after the advent of democracy in South Africa. Isibaya Fund specifically and explicitly finances projects which are able to generate good financial returns while supporting positive, long-term, economic, social and environmental outcomes for South Africa (PIC 2011). The Fund mainly invests in the private equity space. The Fund's investment is capped at 5% of the total assets. In 2011, 5% of the R1 trillion assets equals was roughly R 50 billion.

Up until four years ago, the Fund mainly focused on financing BEE deals. However, in the last four years the strategic focus has changed. The current policy says such investments must be in economic infrastructure; social infrastructure; economic growth — including investments in small and medium enterprises and black empowered enterprises; and environmental sustainability, such as renewable energy (GEPF Development Policy, 2011). Figure 3 shows in full the investment focus areas under each pillar.

Figure 4. Developmental Investment Pillars



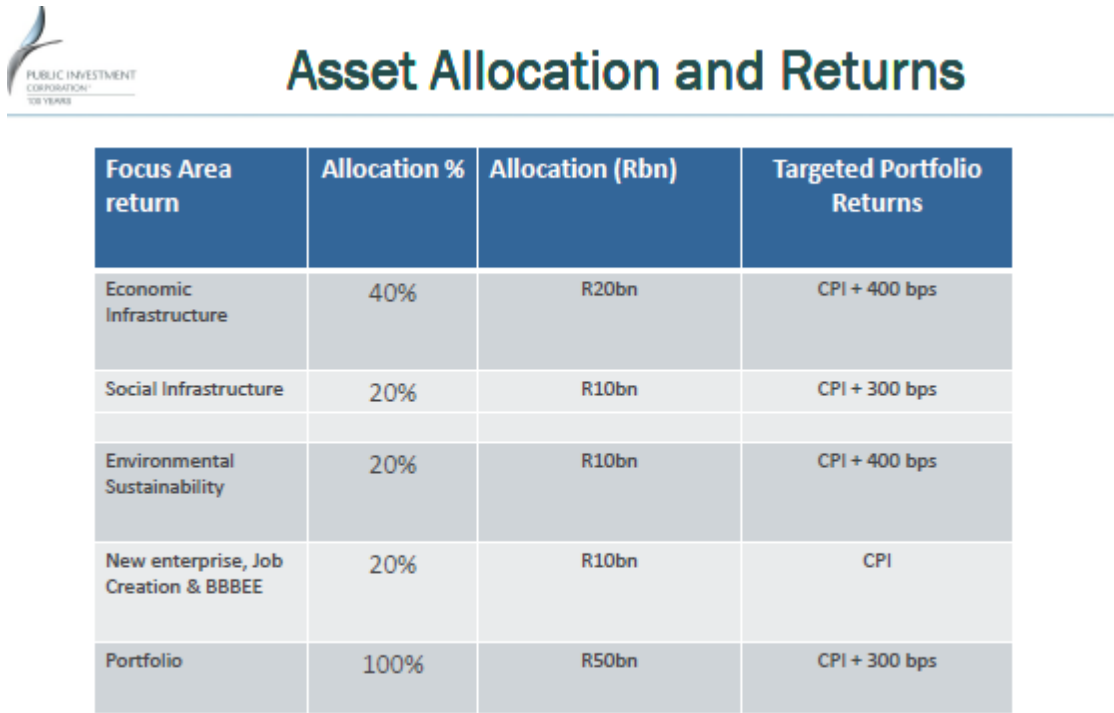
Source: Development Investment Policy, PIC 2011

The Isibaya Fund’s priorities were designed to respond to the government priorities highlighted in the 2009-14 Action Plan, New Growth Path Document, and Industrial Policy Action Plan. The focus of these policies is to promote economic growth and job creation in South Africa.

Currently, the highest current concentration of the Fund is on economic infrastructure. According to figure 5 below, in 2011 40 percent of asset allocation was under the economic infrastructure. According to portfolio managers under this asset class infrastructure is a sustainable long-term investment that offers low risk in comparison to equity markets.

Furthermore, the PIC believes that investment in economic infrastructure is critical to unlock constraints of South Africa’s economic growth.

Figure 5. Isibaya Fund: Asset Allocation and Returns



Source: Downloaded from the PIC website, www.pic.gov.za A Presentation at a Centenary Celebration of PIC in 2011

The environmental sustainability is a new focus area for the fund and gets equal allocation with social infrastructure and SMME financing. This actually shows a greater awareness that that environmental sustainability issues are linked to social-economic development. Under this priority the fund is focusing on investment in renewable energy. According to the portfolio managers, the PIC is investing in recently launched green bonds of the local DFIs to support with funding to the new renewable energy projects. The bonds are issued by the IDC and DBSA. PIC is also set to participate directly in renewable energy projects by investing in energy companies generating renewable energy in South Africa.

The portfolio managers of Isibaya Fund believe that the PIC experience in development investing has otherwise challenged the conventional understanding that such investment may produce lower returns. Despite for the period during economic recession in 2009 and 2010 the

Fund produced negative 28 % and 39% respectively (PIC Annual Report 2009 and 2010). In the last two years, the Fund has had positive returns of 16% in 2011 and 10.47% in 2012 (PIC 2012). Before the financial crisis, the fund produced positive returns of 19.9% in 2008 (PIC 2008) and 36% in 2007. The PIC has attributed its success in development investment to limiting high exposure and co-investing with other key players in this area such as other development finance institutions (DFIs).

Furthermore the PIC involvement in developmental investing has been critical to crowd-in other private investors in social infrastructure. For example, investment in low-cost housing has attracted other private funds to invest in this sector. Old Mutual Investment Group of South Africa (OMIGSA) has recently launched a R10 billion Housing Impact Fund which focuses on investment in low-cost housing (PIC 2011). This will achieve housing provision to the members of the public earning less than R 15 000 a month.

In overall, the move towards developmental investing strategy implies that as public entity, PIC is also responsive to government's developmental objectives. The focus on developmental projects after the end of apartheid symbolized the responsiveness of the PIC to meet new developmental agenda of the newly democratic elected government.

Finally, a broad focus developed under the new Developmental Investing Policy addresses some of the serious criticism of the Isibaya Fund for heavily involvement in BEE deals that do not add value to broader developmental impacts. The PIC has been heavily criticized by labour unions such as COSATU on investing in narrow BEE deals (Hendricks, 2008). For example, the PIC's funding of the purchase of a 15% stake in Telkom by a consortium aligned to the African National Congress (ANC) had been particularly controversial, given the evidence of political favouritism that emerged and the role that ANC politicians had played in securing the deal for the successful consortium (Paton, 2012).

4.3. Enablers of ESG Integration in the PIC

From the research interview and survey, several issues emerged as critical success factors that enable the PIC to implement the SRI policy in South Africa. The table 5 give the highlight of some of the factors. A full explanation and discussion was provided on these factors below the table.

Table 5: ESG Enablers for the PIC

1. A Clear Demand from the client (GEPF)
2. Stronger leadership by the PIC and GEPF to advance SRI in South Africa
3. Availability of ESG information
4. Collaboration with other asset managers

Source: Researcher own construct based on Interviews analysis

The demand of SRI by its largest client, the GEPF has enabled the PIC to actively consider ESG matters into its investment approach in different asset classes. PIC's investment policy is determined by the mandates received from the client. So there is a clear mandate provided by GEPF to the PIC for consideration of ESG factors into investments. GEPF strongly believe that there is a strong linkage between the Fund's fiduciary duties and adoption of ESG policy. According the GEPF, acting in good faith encompasses consideration of ESG issues because they are central to long-term sustainability of the Fund.

PIC together with its largest client the GEPF has shown a greater leadership role in promoting SRI concept in South Africa. This has been demonstrated through introducing local PRI network which eventually led creation of CRISA. The network aims to raise awareness about the business case for responsible investment in order to persuade more South African pension funds and other asset owners to consider ESG factors in their investment decisions (GEPF

and PRI joint release, 2009). By virtue of being the largest asset manager in South Africa, that has enabled the PIC to take a leadership role in advancing ESG matters in South Africa. The aspiration to be a thought leader is making GEPF/PIC to actively adopt shareholder advocacy in its equity assets. This is also driven by the virtue of being the long-term investor in the JSE.

Availability of ESG information through various external platforms does enable the PIC to exercise its shareholder advocacy strategy. ESG information is now widely available in South Africa through USB Centre for Corporate Governance Rating Matrix, JSI 40 SRI Index, and the Carbon Disclosure Project South Africa’s Report.

Finally, collaboration with other asset managers’ emerged as one of the critical success factor enabling the PIC to advance ESG agenda in the JSE. Other small asset managers who want to raise ESG issues with companies usually approach PIC to join them in discussion with investee companies. Furthermore, more foreign asset managers are requesting PIC to accompany them to company engagements with local South African companies. This is in line with the principles of PRI and CRISA which call for greater collaboration among asset managers to advance the ESG factors.

4.4. Impediments to the implementation of the PIC SRI strategy

From the research interview and survey, several issues emerged as impediments to the PIC for implementation of the SRI policy in South Africa. The table 6 below give the highlight of some of the factors. A full explanation and discussion was provided on these factors below the table.

Table 6: Impediments to SRI Implementation

1. Mismatch of long-tem focus with short term performance
2. Minimal in house research capacity of ESG issues
3. Poor understanding by the Trustees and Beneficiaries
4. Short-supply of ESG education to investment

managers

Source: Interviews during research

It emerged during the interviews that there is a mismatch of long-term focus ESG issues and short-term focus on investment performance. PIC reports quarterly on investment performance to its clients and yet the focus is on long term sustainability, because 90 percent of the assets under management are pension funds. Pension funds usually have an outlook beyond 10 to 15 years. It is only after a long term where a better correlation between good governance and investment performance can be fairly judged. Engagement strategy should be viewed as a long term objective with no quick results.

Minimal of in-house research capacity in the PIC was also mentioned by the two ESG managers of both GEPF and PIC. GEPF has created an ESG research team comprising three people and but PIC is yet to establish internal research team. The internal capacity has to be increased to demonstrate a stronger leadership on advancing ESG agenda. Presently, PIC relies on external research providers such as the Stellenbosch's Centre for Corporate Governance. The internal research would be critical to cover thematic topics on ESG issues beyond the matrix ratings of the ESG issues particularly on the listed equities. It was highlighted from the ESG managers of the GEPF and PIC that the internal research would be critical in researching thematic ESG issues that are sector specific such as in mining, energy, climate change etc.

While the PIC manages public pension funds, the members of the GEPF who are the final beneficiaries are silent on ESG issues. Reasons given by ESG manager of GEPF was that of lack of understanding of ESG issues among the members and poor institutional arrangement which give union leaders (Trustees) to represent the beneficiaries. From the interview with the GEPF, it emerged that there is a lack of consultation channel. Trustees, unlike an agent who is subject to control of his or her principal, are not legally obliged to consult with beneficiaries (Richardson, 2011). Furthermore, lack of unanimity among final beneficiaries- in terms of the view of SRI may be an obstacle for the transfer to act on beneficiaries' demand (Richardson, 2011).

There was also an emphasis on the short supply of ESG education to portfolio managers at the PIC. Although PIC executives regularly speak on ESG on public platforms, provision of ESG

education to its investment managers is still lacking. To address this concern, it was highlighted that the GEPF is in the process of developing an ESG Toolkit to educate investment managers.

4.5. Reporting of ESG Information

Internally, ESG issues are reported to the PIC Investment Committee (Board subcommittee) before they are presented to the Board of Directors. However, the Sub-committee could pass only pressing ESG issues to the board for discussion and decision-making. The ESG reporting is also covered partially through the Integrated Annual Report which has been made available in the PIC's website. Furthermore, a significant step has been undertaken by the PIC to increase transparency by making proxy voting resolutions publicly available. PIC now discloses how it has voted at companies meetings on its website.

However, ESG reporting to the international initiatives such as UNPRI and UN Global Compact is still not made public. The reporting to these initiatives is done through online mechanisms. The UNPRI does not presently disclose these reports. However, these agencies encourage asset owners and managers to voluntarily disclose their ESG implementation.

Most of the ESG information is still not publicly available as provided by the PIC. Going forward, the new CRISA is help to increase transparency on reporting of the ESG matters. It requires asset owners and managers to publicly report on how they are incorporating ESGs into investments analyses and decision-making. PIC is currently in the process of re-aligning its reporting process to accommodate the CRISA requirement.

4.6 Government's Role in the PIC SRI Strategy

The South African government has shown an interest on ESG issues through legal reforms to the Pension Fund Act. In 2011, the government through the National Treasury has made some amendments to the Regulation 28 of Pensions Fund Act, 1956 under section 36 to encourage retirement funds to consider ESG issues.

However, the findings from the interviews is that at an institutional level, government cooperation with the PIC in advancing ESG issues is still very minimal. Although, PIC is

owned by the state, government (National Treasury and other economic cluster departments) has not strategically devise a collaboration strategy on advancing ESG issues. However, the Deputy Finance minister chairs the Board of PIC on behalf of the Finance Minister. The Minister of Finance is there single shareholder of the PIC.

There biggest interest of the Minister of Finance is that the government through the Ministry of Finance provide guarantee to the GEPF in case of the financial loss of the PIC's investments. This is due to the fact that the GEPF is defined benefit fund and has to meet its liabilities irrespective of investment performance.

In terms of reporting, PIC reports annually to the Portfolio Committee of Finance in the National Parliament as required by the Public Finance Management Act. According to the PIC, Parliament has frequently expressed more interested on developmental investment portfolio and often raises issues such as job creation, infrastructure and SMMEs financing.

PIC view its developmental investment portfolio as naturally aligned to government objectives of poverty eradication through job creation, educational and housing funding, SME support, and infrastructure financing. However, collaboration between the PIC and the government for greater alignment to achieve developmental objective should be prioritised. There exist a scope for a more defined collaboration between government and the PIC but there is a lack of stronger action from the government's side.

If government has a strong will to see public pension funds directed into infrastructure spend, there has to be a stronger dialogue between the PIC and other government departments (specifically the Economic Cluster departments). Furthermore, currently, the South African government has special mega projects such as the R 3 trillion master infrastructure plans. Pension funds are usually interested in financing long-term projects and the government should explore opportunities for co-financing in these long-term infrastructure projects.

Furthermore, although the Responsible Policy from GEPF has highlighted collaboration with government departments and regulators to advance ESG agenda, such mechanism is yet to be explored. For such mechanism to be realised a strong collaboration from both sides is needed. Although the government recognises the valuable contribution that the SRI can play in

channelling funds to national priorities (Viviers, 2007), it has not taken an initiative to engage with the public pension funds to explore this possibility.

5. RESEARCH CONCLUSIONS

Socially responsible investment (SRI) agenda is starting gain a momentum in South Africa among asset owners and managers. Interestingly, the leading public pension fund manager, the Public Investment Corporation (PIC) which invests on behalf of the Government Employee Pension Fund (GEPF) has taken significant interest in implementing SRI strategies in South Africa.

As PIC operates under client's investment mandate, the GEPF plays a key role in setting the responsible investment policy or strategy for the PIC to implement in South Africa. GEPF strongly believes that there is a strong linkage between the Fund's fiduciary duties and adoption of ESG policy. The GEPF believes that acting in good faith encompasses consideration of ESG issues because they are central to long-term sustainability of the Fund.

Therefore, PIC SRI Strategy is directed towards key four asset classes: equity, fixed income, property and developmental investments. Over 90% of the GEPF portfolio is investment in these four asset classes. Although the SRI strategy covers all four major asset classes, the highest concentration is in equity and development investing. This is where the PIC exercises stronger ownership to integrate ESG factors. The portfolio managers in property and fixed income highlighted that ESG approach in their asset class is still in infancy.

According to research findings from the interview, the underlying drivers for SRI adoption by the PIC are the following: the impact of ESG factors on shareholder's value of the GEPF, the development agenda of South Africa, international trends in SRI agenda, and reputational risk.

In general, the research has found that the PIC SRI Strategy responds to issues that that meet government objectives of ensuring growth and economic development of South Africa. This research has found out that in all four asset classes the PIC SRI Strategy broadly addresses issues such as black economic empowerment, skills development, economic growth, economic and social infrastructure (roads, energy, housing, and education), enterprise development and job creation.

Throughout the interviews and survey responses, all people surveyed believed in SRI and highlighted its importance as an investment model to contribute to growth and development of South Africa. Most mentioned the commitment of the PIC of the 5% of the assets going to developmental projects as a strong belief by the PIC on responsible investment. In development investing, PIC SRI Strategy seeks to address some socio-economic challenges of South Africa through Isibaya Fund which invests in job creation projects, social and economic infrastructure and SMMEs financing. The ultimate aim of this strategy is to drive economic growth and development of South Africa.

Despite the fact that there is a wide range of externally provided ESG information enabling the PIC in exercising its shareholder advocacy, it was also highlighted by the ESG managers that there is a need to increase coverage of the South African companies through international proxy advisers. Since there is little capacity in South Africa, international proxy advisers could fill the gap. However, there has to be a demand for such a service by South African asset managers.

Although the SRI strategy responds to many government objectives of ensuring growth and economic development of South Africa, however, there exists no direct collaboration between government and PIC in driving the SRI strategy in South Africa. Since the PIC is fully owned by the Government of South Africa, it would appear logical that the government should take a direct role in influencing the SRI strategy.

This research also found that there is still some trade-offs between economic growth and ESG issues in certain asset classes particularly fixed income. For example, PIC holds 50% of Eskom bonds and Eskom is issuing corporate bonds to build coal-powered power stations in South Africa which has a negative impact on the natural environment. However, at the same time energy scarcity would hamper future economic growth of South Africa. PIC has justified investing in Eskom's bonds as critical to ensure economic growth in South Africa.

The research also found out that there is a significant collaboration between the PIC and other asset managers to implement ESG issues particularly in equity assets. Many international and small asset managers usually approach the PIC seeking collaboration in proxy voting issues and with the engagement of companies' management on other ESG issues. This is in

line with CRISA and UNPRI initiatives that call for greater collaboration among asset owners and managers.

The enablers of SRI integration in the PIC include the following: The demand of SRI by its largest client, the GEPF has enabled the PIC to actively consider ESG matters into its investment approach in different asset classes, the effective leadership role of the GEPF/PIC to advance responsible investment through drafting of CRISA and introduction of PRI-SA local network, collaboration with other assets manager in advancing ESG issues in the JSE, and wider availability of ESG information.

The impediments to ESG integration in the PIC include the following: the mismatch of long-term ESG issues and short-term focus performance reporting, lack of internal research capacity to cover thematic ESG topics, and a short supply of ESG education to investment managers and trustees.

Public disclosure of ESG issues is still very limited. However, this is set to change due to the new CRISA requirement calling for public disclosure of ESG reports. CRISA will require the PIC to produce a public report on its implementation of the ESG issues. On the new ESG Report, PIC should outline what they are doing, and track improvement over time and highlight future direction on sustainable investing. One way the paradigm shift toward ESG principles by the pension funds can be demonstrated is by the public disclosure of these investment practices to their clients and the general public (Bianchi, Drew and Walk, 2011).

Finally, although PIC executives regularly speak on ESG issues on public platforms, provision of ESG education to its investment managers is still lacking. ESG education is still not yet provided widely within the institution. To address this concern, it was highlighted that the GEPF is in the process of developing an ESG Toolkit to educate investment managers.

6. RECOMMENDATIONS FOR FUTURE RESEARCH

There are number of research areas that emerged as critical for future research. Future research could look at (1) SRI and long-term financial performance of the PIC investments (2) the long-term sustainability of developmental projects funded by Isibaya Fund and SRI Strategy in private equity space. Since this study focused on one public pension fund manager, it is recommended that a future research need to look at how other South African public pension funds are integrating ESG factors in their investment portfolio.

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APPENDICES

Appendix A- UN Principles of Responsible Investment

The Principles for Responsible Investment

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.

Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis
- Encourage academic and other research on this theme
- Advocate ESG training for investment professionals

2. We will be active owners and incorporate ESG issues into our ownership policies and practices.

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Develop an engagement capability (either directly or through outsourcing)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement

3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
- Support shareholder initiatives and resolutions promoting ESG disclosure

4. We will promote acceptance and implementation of the Principles within the investment industry.

Possible actions:

- Include Principles-related requirements in requests for proposals (RFPs)
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)
- Communicate ESG expectations to investment service providers
- Revisit relationships with service providers that fail to meet ESG expectations
- Support the development of tools for benchmarking ESG integration
- Support regulatory or policy developments that enable implementation of the Principles

5 We will work together to enhance our effectiveness in implementing the Principles.

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

6 We will each report on our activities and progress towards implementing the Principles.

Possible actions:

- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles
- Report on progress and/or achievements relating to the Principles using a 'Comply or Explain' approach
- Seek to determine the impact of the Principles
- Make use of reporting to raise awareness among a broader group of stakeholders

Source: UNPRI (<http://www.unpri.org/principles/>)

Appendix B – Code for Responsible Investment in South Africa

CRISA applies to institutional investors such as pension funds and insurance companies as the owners of assets, and their service providers including asset managers and consultants. It encourages institutional investors and service providers to adopt its principles and practice recommendations on an '*apply or explain*' basis. The effective date for reporting on the application of CRISA is 1 February 2012.

Responsible investing and corporate governance guidelines in South Africa are largely voluntary. The Code aims to put in place the checks and balances needed to make this voluntary framework successful. Together with the King Report, which is also not legislation but rather principles and practices that are adhered to on an '*apply or explain*' basis, the new Code will seek to encourage best practice conduct by shareholders and companies. In summary, CRISA consists of five principles:

Principle 1 – An institutional investor should incorporate sustainability considerations, 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 – An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.

Principle 3 – Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.

Principle 4 – An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should pro-actively manage these when they occur.

Principle 5 – Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

The Code requires institutional investors to fully and publicly disclose to stakeholders at least once a year to what extent the Code has been applied. If an institutional investor has not fully applied one of the Principles of the Code, the reasons should be disclosed. Disclosure as well as policies should be made public.

CRISA has been endorsed by the Institute of Directors in Southern Africa (IoDSA), the Principal Officers Association (POA), and the Association for Savings and Investment South Africa (ASISA). The principles of CRISA are supported by the Financial Services Board (FSB) and the Johannesburg

Stock Exchange (JSE).

Source: <http://www.asisa.org.za/>

Appendix C: Other Private SRI Funds in South Africa

South Africa SRI labelled funds

Fund Type	Fund Name	Assets Managed Million
Equity	Element Earth Equity Fund	R476
	Element Islamic Equity Fund	R103l
	Futuregrowth Albaraka Equity Fund	R801.5
	Futuregrowth Infrastructure & Development Equity Fund	R490,2
	Futuregrowth SRI Equity Fund	R42
	Investec Jadwa Africa Equity Freestyle Fund	USD 11
	Investec RI Equity Fund	R390
	Oasis Crescent Equity Fund	R3127
	Oasis Crescent International Fund of Funds	R374
	Old Mutual Community Growth Equity Fund	R2.4 billion
	Prescient SRI Equity Active Quant	Unavailable
	Sanlam SRI Equity Fund	R50
	Sasfin TwentyTen Fund	R97.04
STANLIB Shari'ah Equity Fund	R123.4	
Balanced	Advantage Shari'ah Fund	R4.6
	Advantage/Momentum Super Nation Fund	R72
	Cadiz Money Market Fund	R112
	Futuregrowth SRI Balanced Fund	R6
	Investec TDI Balanced Fund	R96
	Metropolitan African Wealth Creator	R1.1 billion
	Old Mutual Community Growth Equity Fund of Funds	Unavailable
	Sanlam Infrastructure Fund	R250 mill
	STANLIB Corporate Wealth Development Fund	R250 mill
27 Four Shari'ah Fund	R30 mill	
Fixed Interest	Cadiz Infrastructure Bond Fund	R53.9 mill
	Cadiz SRI Bond Fund	R105.7 mill
	Coronation Siyakha Bond Fund	R27 mill
	Futuregrowth Infrastructure and Development Bond Fund	R 4.6 bn
	Old Mutual Community Growth Gilt Fund	R 900 mill
	Old Mutual Community Growth Money Market Fund	R 17.7 mill
	Sanlam SRI Bond Fund	R 150 mill
Alternative/ Private Equity	EMF Kaqiso Infrastructure Empowerment Fund	R 649 mill
	Investment Solutions Sakhiswe Fund	R80 mill
	Investment Solutions Shari'ah Fund	R1 bn
	Macquarie and Old Mutual AIIF African Infrastructure Investment Fund	R 721 mill
	Macquarie and Old Mutual SAIF South African Infrastructure Fund	R1.32 bn
	OMIGSA Ideas Fund	R2.25 bn
Property	Futuregrowth Community Property Fund	R2.6 bn

Source: Giamporcaro, 2009

Appendix D: Research Interview Guideline: PIC SRI Case Study

Introduction

The Guideline is divided into two sections. **Section 1** addresses institutional arrangement of SRI policy at PIC. This section is specifically targeted to senior executives. **Section 2** goes into specific questions in four Asset Classes: **Equities, Fixed Income, Properties, and Community Investing**. This section is specifically targeted at the investment managers of the four different asset classes.

Section 1: Governance Structure of SRI

1. Introduction

Please state your **name, Job title, and main responsibilities**

How many years of **experience** in the investment environment and the length of employment with the current organizations.

2. Regulatory framework

What are the current local and international initiatives on SRI guiding the PIC to advance the ESG issues in South Africa?

3. Key drivers of ESG Integration

Which of the following issues serve as key drivers to adopt ESG strategy in the PIC:

- Impact on the shareholder value over the long term
- Demand from the beneficiaries
- Development agenda of South Africa
- International trend
- Reputational risk
- Government policy
- Influence from other local institutional Investors

Or other, please explain?

4. GEPF/PIC Organisational Structure

Could you explain the organizational structure between the GEPF and PIC driving the ESG policy integration into the PIC asset classes?

5. Source of Information

Where do you source your ESG information: Internal research or external ESG policy advisors?

Are you satisfied with the current method of sourcing your ESG information?

How is that information filtered into decision-making?

6. The Role of Government

As PIC is owned by the Government, does the government have any influence in the PIC SRI policy agenda? If yes, what mechanism does the government use to influence the adoption of SRI policy?

7. Reporting Mechanism

How is the ESGs implementation reported to the Board of the PIC and other stakeholders of the PIC? And what mechanisms are used to channel the feedback?

How do you report your ESGs implementations to the international and local initiatives such as PRI and CRISA?

8. Fiduciary Duties

Is there is a strong linkage between fiduciary duties and ESG policy that gives the clear mandate for PIC to pursue responsible investment in South Africa?

9. Performance

How do you monitor performance or success of your fund and investment managers in incorporating ESGs in their asset classes? Or do you believe this is still difficult to measure?

Leadership role

Do you believe that by virtue of being the largest Pension fund manager in South Africa and Africa put the PIC in a position to lead on responsible investment in South Africa?

Could you provide any specific examples where this leadership role was exercised?

SECTION 2: IMPLEMENTATION OF SRI STRATEGIES AT THE PIC

ESG factors for Equity Asset Class

1. Introduction

Please state your **name, Job title, and main responsibilities**

How many years of **experience** in the investment environment and the length of employment with the current organization.

2. Value of Assets

Could you please indicate your current total value invested in equities and the concentrated sectors?

3. SRI Strategies

Which of the following SRI Strategies do you use when choosing to invest in Equities: Screening or shareholder advocacy/active ownership?

If it is the screening approach, what are the screening methods do you apply in your investment decision making process?

If it is a shareholder advocacy, which ownership strategies do you use to enhance ESG factors in investee companies?

4. Integration of Environmental Concerns in Equity

In some previous research done on SRI in South Africa indicated that environmental issues are not very important to assets managers. Do you think the same applies to PIC?

In the context of South Africa what are the environmental issues that influences your investment decisions in Investee companies?

Where do you source information on environmental issues of the listed equity?

What approaches to you use to engage companies on environmental concerns? And do you experience any obstacles to engage companies under this issue?

5. Corporate Governance

Given a huge list of aspects on corporate governance, what aspects of corporate governance does the PIC prioritize? And why?

Where do you source information on corporate governance? Do you think there is enough information on corporate governance issues in South Africa?

Would you like to see more supply of information on corporate governance on listed equity?

What approaches do you use to engage companies on corporate governance issues? Do you experience any specific challenges in engaging in these issues?

6. Social Issues

What are the key social aspects you consider, that influences your investment decisions in equities?

If Yes. Which criterion exists to score social issues in investee companies?

7. Risks

As an investment manager, what do you consider as the major risks or challenges of incorporating of ESG in deciding to invest into equities?

8. Collaboration

Do you collaborate with other investment managers outside the PIC when engaging with the investee companies on ESG issues under this asset class?

If Yes. Do you believe that such collaboration could help foster a collective change in Investee companies?

9. ESG Education

As an investment manager, do you think your institution provides enough ESG training to its managers for this asset class?

10. Personal Beliefs on SRI

As an individual, do you believe in SRI or just implementing it because PIC is pointing to that direction?

Do you believe SRI offers an alternative investment model to address some socio-economic challenges in South Africa?

SRI Strategy for Fixed Income

1. Introduction

Please state your **name, Job title, and main responsibilities**

How many years of **experience** in the investment environment and the **length** of employment with the current organization.

2. SRI Strategies

What SRI strategies do you apply before deciding to invest under this asset class?

3. ESG Information

Where do you source ESG information under this asset class? Do you think there is sufficient information on fixed income?

4. Challenges

Integrating ESG into fixed income portfolios has been quite a challenge as fixed income does not entail voting rights. Do you believe it is difficult to apply ESG analysis on the fixed income asset class?

What are specific challenges do you face in implementation ESG criteria under this asset class? How do you think they could be overcome?

5. Government and SOEs Bonds

Do you believe PIC is obliged to buy government bonds by virtue of being a state-owned company? Or simple with the desire to support government in pursuing the developmental agenda of South Africa?

6. Credit Rating and ESGs

Do you want to see the incorporation of ESGs on credit risk analysis provided by the rating agencies?

7. ESG Education

As an investment manager do you think your institution provides enough ESG training to its managers for this asset class?

8. Personal Beliefs on SRI

As an individual, do you believe in SRI or just implementing it because PIC is pointing to that direction?

Do you believe SRI offers an alternative investment model to address some socio-economic challenges in South Africa

SRI Strategy for Properties

1. Introduction

Please state your **name**, **Job title**, and **main responsibilities**

How many years of **experience** in the investment environment and the length of employment with the current organization.

2. SRI Strategies

Which SRI strategy do you use on investment decisions under this asset class?

3. Source Information

Where do you source information on sustainability scorecard for property analysis?

4. Environmental Concerns in property investment

Which environmental concerns do you consider guiding your investment decisions in properties?

5. Social concerns

Which social concerns do you consider guiding your investment decisions in properties?

6. Obstacles

It is usually said that expansion of retail shopping centers in township hamper the survivalist enterprises in township? What SRI justification would you consider to invest in township properties?

7. Collaboration

Do you collaborate with other investment partners, community groups, environmental NGOs and government bodies in property investments?

8. ESG Education

As an investment manager, do you think your institution provides enough ESG training to its managers for this asset class?

9. Personal Beliefs

As an individual, do you believe in SRI or just implementing it because PIC is pointing to that direction?

Do you believe SRI offers an alternative investment model to address some socio-economic challenges in South Africa

SRI Strategy on Developmental Investing: Isibaya Fund

1. Introduction

Please state your **name**, **Job title**, and **main responsibilities**

How many years of **experience** in the investment environment and the **length** of employment with the current organization.

2. Fund Priorities

South Africa is a country which endless socio-economic challenges, does your priorities choice for the Isibaya Fund influenced by the government developmental priorities.

On your current strategy of the Fund, the PIC has identified four priority areas: economic infrastructure, social infrastructure, Sustainability Investment and BBBEE. Where lies the major concentration in terms of funding and why?

3. Source of Information

Do you use any Government policy documents to influence your developmental priorities?

4. Challenges

What are some key challenges you face in investment in development projects?

5. Financial Return

With the main focus at maximizing development impact, do you think the Fund has made considerable financial return in the last ten years?

6. ESG Education

As an investment manager, do you think your institution provides enough ESG training to its managers for this asset class?

7. Personal Beliefs

As an individual, do you believe in SRI or just implementing it because PIC is pointing to that direction?

Do you believe SRI offers an alternative investment model to address some socio-economic challenges in South Africa