

RESPONSIBLE INVESTMENT

Through the maze

After the Net1 blow-up, investment processes for ESG integration bear scrutiny.

For the benefit of their retirement-fund clients, what steps can reasonably be expected of asset managers and consultants to ensure they comply with the UN Principles for Responsible Investment (where they're signatories) and the Code for Responsible Investing in SA (now underpinned by King IV)? Then too with Regulation 28 under the Pension Funds Act with its requirement to consider environmental, social and governance (ESG) criteria in making and remaining in investments (also see elsewhere in this *TT* edition)?

These issues are brought into sharp relief as a consequence of the Constitutional Court judgment on the SA Social Security Agency and the publicly-listed Net1 which administers the social grants. Asset manager Allan Gray, a signatory to the UN PRI, is the biggest single shareholder in Net1 after the International Finance Corporation which is supposed to be the world's standard bearer for responsible investment (RI).

Here is a dramatic instance of RI implementation having failed. But what are investors and potential investors *reasonably* supposed to do where a company already bears the IFC imprimatur and where the contentious abuse of a database by a subsidiary is carefully concealed? Where should reasonable investigation end and forensic investigation begin?

Any number of investors could have been caught short in the manner of Allan Gray, singled out for the "materiality" of its Net1 stake. But from the specific to the general, other investors can be as easily trapped even where smallish interests in investee companies are subsequently exposed for RI censure.

What sort of resources, in terms of time and

personnel, should be devoted to RI research? In the research, would there be a difference in the resources applied for larger investments? Having considered that the outlook for a share is bullish, would a decision be made to disinvest or not to invest for reason of a company's non-compliance with King IV?

To get a handle on the practicalities, and to assist in guidance for robust treatment of CRISA, *TT* canvassed a random cross-section of industry views. There was broad consensus on the latter two questions – little difference in resources for larger investments on the second; engagement with companies or proxy votes on the third – so space limitations allow snapshot responses mainly to the first.



Kirshi Totaram of Coronation: If ESG is done properly, it is not a tick-box exercise. ESG factors must be taken seriously from the start, and integrated into an investment case when researching a security begins.

We focus on calculating long-term fair value and then adjust for any risks, ESG included. Where ESG risks can't be quantified, we do a qualitative assessment. A company which scores low on ESG factors would require a much bigger margin of safety before we invest. If we have material governance concerns about a company, we exclude it from our investment universe. ESG considerations are best understood by analysts and fund managers who know a company intimately, not by third parties.



Bernard Fick of Prudential: We are signatory to the UNPRI and subscribe to the CRISA principles. Our proxy-voting records are distributed quarterly to our clients

as they are the actual owners of the shares we vote. Also, as active shareholders, we engage with company managements and use other legal remedies to challenge actions that we believe are not in our clients' best interests. All our analysts are required to consider ESG factors as part of our fundamental analysis since we recognise that these issues can carry risks that could diminish potential returns for our client portfolios.



David Couldridge of Investec Asset Management: We've elected the most comprehensive, but challenging, approach to integrate ESG across all our investment capabilities. Integration ensures that the investment analysts and portfolio managers, with in-

depth knowledge of the businesses, are making the decisions. Structuring resources in this way avoids the difficulties that firms experience when they have separate governance or ESG teams trying to persuade the analysts.

Robert Lewenson of Old Mutual Investment Group: ESG analysis is a specialist skill. We have a team that works across our various capabilities to undertake ESG research. With

fundamental listed equity, our ESG specialists prepare specific investment-relevant research on material ESG issues. It's then used for debate and discussion with the relevant analyst or portfolio manager so that these views are incorporated into a quality "conviction assessment" of the underlying company. Where an investment has been made, these views inform our responsible-ownership practices.



Delphine Govender of Perpetua Investment Managers: We weigh ESG factors, including the workings of the board, explicitly and formally

at the pre-investment stage. The weightings to focus on E, S or G matters depend on the industry and what we perceive to be its inherent risks. We'd have assessed these in a generic template at an industry level, given our understanding of the core drivers in an industry group, and then apply the industry focus areas to the unique specifics of each investment being considered. For example, the banking sector inherently has a higher G risk and above-average S risk (given the client base) but a lower-than-average E risk. Events at African Bank illustrate the point.

Dirk Oosthuizen of Simeka Consultants & Actuaries (associated with Sanlam): In the

funds with which I'm involved, we contract out most of the services to specialists. Application of PRI/CRISA principles has certainly required more resources and are designed to involve engagement. It seems that the larger asset managers have dedicated more resources to improve these processes, but smaller managers lack similar resources. My concern is with bonds where pension funds invest. The only way to deal with ESG issues in the bond market is not to invest or to sell. There is no mechanism of influence similar to a proxy vote at a shareholders' meeting.



Henry Munzara of Stanlib: Key is truly to integrate ESG into the investment process. In our coverage of the JSE Top 100 universe, ESG is part and parcel of the research effort. Using our influential position, our starting point is encouraging companies to be exemplary corporate citizens.



Malcolm Fair of RisCura: Institutional investors must have appropriate governance in place to guide their actions, in particular a policy which defines how the institution intends to exercise its fiduciary duties and regulatory requirements including

but not limited to ESG factors that may impact on the long-term outcome for fund members. Policies should be communicated to service providers with a view to

catching issues before they come to a head. Net1 should have raised S and G red flags for investment managers before the story broke.



Andrew Lapping of Allan Gray:

Our analysts are responsible for researching ESG aspects of companies they cover, before we invest and on a continuing basis once invested. We also have a dedicated analyst who looks at G issues and recently appointed

a dedicated E&S analyst to assist our analysts with systemic research as an additional level of scrutiny. We're doing more on-the-ground research and from time to time hire third-party firms to assist. All companies in which we invest go through the same process which includes ESG research. We discuss potential concerns around ethics or governance with companies' boards, aiming to influence them. If the board is not receptive to our input, we may decide to take an active role in changing the board. We've recently given our chief investment officer the discretion to veto or disinvest from any investment based on ethical concerns.

Inge West of Investment Solutions:

Our engagements with asset managers indicate that that many are more comfortable incorporating governance considerations than environmental and social factors into their investment processes.



But E&S can also have a material impact, as shown with BP and Lonmin. Even where there may be dedicated RI specialists, their influence and expertise do not necessarily filter through into final investment decisions. In an ideal world there should be no need for RI specialists, as analysts should be able fully to integrate ESG into their process, but we believe that the current level of ESG integration requires RI specialists to strengthen the process.

Jana van Rooijen of Momentum Investments: The PRI and CRISA principles resonate with our values and inform our processes. We have dedicated RI specialists



to assist the investment team. Its decisions affect stakeholders. It is absolutely reasonable for them to expect our compliance with the principles.

Shainal Sukha, an independent consultant:

It is important for asset managers to be consistent and clearly to articulate their ESG approach to asset consultants and asset owners. Inconsistency will open them to criticism that they treat ESG integration as a marketing benefit rather than a genuine risk-management tool. It doesn't help that G is the overriding factor and then having to explain why they're invested in a FirstStrut, African Bank or Net1. Asset managers should seek appropriate ESG disclosure from company managements and keep a record of their engagements. If disclosures are inadequate, the next steps should be articulated i.e. engage further or disinvest. Doing nothing is not an option.



Asief Mohamed of Aeon

Investment Management: The analyst and portfolio manager should take primary responsibility for the companies in which they invest. The Net1 grants issue is one where Allan Gray and the IFC could have done more fundamental research. When we raised the issue of Net1 "unauthorised debits" on the PRI Xchange over two years ago, no SA investment manager responded. And when we raised the issue at a Remgro agm, the chairman was unaware that a non-executive Remgro director and an associate investment in Grindrod Bank was involved in the Net1 "unauthorised debits", which included debits from unemployed grant beneficiaries for unemployment insurance. If only the large investment-management firms applied their minds to what a normal and equal society would look like, SA would have looked like a more normal and equal society by now.



May these perspectives help to encourage CRISA awareness, not only to stimulate its credibility but also strengthen adherence to its widely lauded principles. ■