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Comments on the Draft Directive (Pension Funds Act, 1956) on Sustainability Reporting and Disclosure Requirements

May 2018

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Investor power for a fairer South Africa

Mr D P Tshidi
Registrar of Pension Funds

By email: Alta.Marais@fsca.co.za

18 May 2018

Dear Mr Tshidi

Just Share NPC: comments on the Draft Directive (Pension Funds Act, 1956) on Sustainability Reporting and Disclosure Requirements

1. Just Share NPC is a non-profit organisation that promotes the use of investor power for a fairer South Africa. Just Share works with companies, institutional investors, individual savers, and civil society to drive good corporate citizenship, through active ownership and responsible investment. We welcome the opportunity to provide input on the Draft Directive: Sustainability and Disclosure Requirements (Draft Directive).

2. The 2011 amendment to Regulation 28 of the Pension Funds Act, which requires a fund and its board to "at all times … before making an investment in and while invested in an asset consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an environmental, social and governance character", was a groundbreaking recognition of the growing evidence of environmental, social and governance (ESG) factors' impact on long-term performance. Since then, the investment market has matured, and it has now inescapable that the integration of ESG factors into investment processes is essential for long-term sustainability.

3. In South Africa, despite the progressive content of Regulation 28, and other initiatives like the Code for Responsible Investing in South Africa (CRISA), asset owners are not doing enough to ensure that this integration is meaningful and evidence-based, and there is very little verification and oversight of implementation of responsible investment policies. The publication of guidance in the form of the Draft Directive is therefore essential to ensure that the investment industry progresses more quickly in its

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appreciation, understanding, and implementation of ESG factors into investment decisions.

4. Just Share's comments on the content of the Directive are set out below.

Investment policy statement requirements
Paragraph 6

5. We submit that paragraph 6.2 should be amended as follows:
Its policy in applying ESG factors ***to existing assets, and*** *to assets it intends to acquire;*

6. In addition to the items listed in paragraph 6 of the Draft Directive, every pension fund should also reflect in its investment policy statement:
    a. Which of its assets the policy applies to;
    b. When the policy was approved, and by whom;
    c. How often the policy is reviewed; and
    d. Guidelines on engagement, and when and how engagement will be escalated.

7. In addition to the above, we submit that it is now essential for every pension fund to have a **position on climate change**, and that this position should be articulated in the investment policy statement.

8. Climate change is possibly the greatest challenge of our time. It poses unprecedented risks to people, our environment and our economy. Climate change is fundamentally a social justice issue: its impacts will be felt – and are already being felt – by the most vulnerable and least privileged members of our society.

9. It is now also globally accepted that climate change poses significant risks to financial stability. In September 2015, in a now famous speech titled "*Breaking the Tragedy of the Horizon – climate change and financial stability*",[1] Mark Carney, Governor of the Bank of England, identified "three broad channels through which climate change can affect financial stability". These are:

    a. Physical risks: "the impacts today on insurance liabilities and the value of financial assets that arise from climate- and weather-related events, such as floods and storms that damage property or disrupt trade";
    b. Liability risks: "the impacts that could arise tomorrow if parties who have suffered damage from the effects of climate change seek compensation from those they hold responsible"; and

[1] https://www.bankofengland.co.uk/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability

c. Transition risks: "the financial risks which could result from the process of adjustment towards a lower-carbon economy".

10. It is worth noting that the "liability risks" mentioned above could extend to pension funds, if beneficiaries believe that the value of their pensions has suffered as a result of trustees failing to take into account the risks posed to their investments by climate change[2].

11. In June 2017, the Financial Stability Board's Task Force on Climate-Related Financial Disclosures published its final recommendations[3]. It is worth quoting somewhat extensively from its Executive Summary[4]:

"One of the most significant, and perhaps most misunderstood, risks that organizations face today relates to climate change. While it is widely recognized that continued emission of greenhouse gases will cause further warming of the planet and this warming could lead to damaging economic and social consequences, the exact timing and severity of physical effects are difficult to estimate. The large-scale and long-term nature of the problem makes it uniquely challenging, especially in the context of economic decision making.
…
In fact, climate-related risks and the expected transition to a lower-carbon economy affect most economic sectors and industries. While changes associated with a transition to a lower-carbon economy present significant risk, they also create significant opportunities for organizations focused on climate change mitigation and adaptation solutions.

For many investors, climate change poses significant financial challenges and opportunities, both now and in the future. The expected transition to a lower-carbon economy is estimated to require around $1 trillion of investments a year for the foreseeable future, generating new investment opportunities. At the same time, the risk-return profile of organizations exposed to climate-related risks may change significantly as such organizations may be more affected by physical impacts of climate change, climate policy, and new technologies. In fact, a 2015 study estimated the value at risk, as a result of climate change, to the total global stock of manageable assets as ranging from $4.2 trillion to $43 trillion between now and the end of the century."

12. The requirement in regulation 28(2)(c)(ix) of the Pension Funds Act Regulations, that pension funds must, *"before making an investment in and while invested in an asset consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an environmental, social and*

[2] https://ccli.ouce.ox.ac.uk/wp-content/uploads/2018/04/CCLI-South-Africa-Paper-Final.pdf - see in particular page 21
[3] https://www.fsb-tcfd.org/publications/final-recommendations-report/
[4] p i-iii

governance character", was, as mentioned above, a groundbreaking one. It is arguable that climate change is the most significant factor which may materially affect the sustainable long term performance of a fund. However, there appears to be very little recognition of, or action to address, this risk within the South African investment industry.

13. Requiring pension funds to include their climate change position, or climate change "investment beliefs", in their investment policy statements would mean that trustees would be required to acquaint themselves with climate risks, and develop a strategy to minimise the long term impacts on their funds' value. Clearly articulating a climate change position, and a strategy to deal with the risks that climate change poses to the long-term sustainability of investments, has become the hallmark of effective responsible investors around the world[5].

Paragraphs 8 & 9.

14. We submit that investment policy statements should be available publicly, on a pension fund's website, or to any member of the public on request, if the fund does not have a website. There is no reason to limit the availability of the statement to members and employers.

15. Paragraph 9 seems to suggest that pension funds should simply replicate the wording of paragraphs 6 and 7 of the Directive on their website, rather than the content of their investment policy. This should be clarified.

General

16. We submit that the criteria for exemption should be clearly set out in the Directive.

Yours faithfully
JUST SHARE

per:

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[5] See, for example, the UK Environment Agency Pension Fund's *Statement of investment principles* at file:///C:/Users/tdavies/Downloads/Policy%20Statement%20of%20Investment%20Principles%202016.pdf and *Policy to address the impacts of climate change* at http://flippingbook.capitaemployeebenefits.co.uk/ea/2/files/assets/common/downloads/EA1722_ST3995_Climate%20Change%20Impact%20booklet_v8_WEB.pdf