

INSTITUTE OF DIRECTORS IN SOUTHERN AFRICA

KING IV: RETIREMENT SECTOR SUPPLEMENT

ABOUT THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has 1500 signatories globally with \$60 trillion in assets under management.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors, and the long-term health and stability of the market as a whole. It recognises that generating long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems.

OVERARCHING RESPONSE

REVISION OF THE KING CODE

PRI responded to the IoDSA's [April 2016 consultation on revision of the King Code](#). This response should be read in the context of the overarching response, which is briefly summarised below. PRI:

- Agreed that the revision of the code has met its redrafting objectives and hence provides a clear, coherent and integrated model for corporate governance.
- Proposed some enhancements to the sections relating to director nominations, anticorruption, executive remuneration and tax responsibility for corporations.
- Proposed that Principle 5.2 (*The governing body should ensure that the fund responsibly exercises its rights, obligations, legitimate and reasonable needs, interests and expectations, as a holder of beneficial interest in the securities of a company*) be broadened to exercise of ownership rights and incorporation of ESG factors into investment decision making.

In our view, the final recommendation establishes King IV as a governance framework which supports implementation of the CRISA code and the Principles for Responsible Investment.

RETIREMENT SECTOR SUPPLEMENT

With King and CRISA, investors and companies in South Africa have established reinforcing industry-led principles for responsible business and investment. This is supported by Regulation 28 of the Pensions Fund Act, which provides clarity on the relevance of ESG issues to investment decision making.

Regarding the retirement sector supplement, we have three key recommendations:

1. **The CRISA Practice Note on reporting, referenced by the Retirement Sector Supplement, should be updated to reflect established industry standards, including reference to the PRI Reporting Framework.**
2. **That the Retirement Sector Supplement should reference model mandate clauses on ESG integration in investment decision making.**
3. **The Retirement Sector Supplement should require asset owners to include how ESG factors are included in investment decision making in their Statement of Investment Policy.**

We group the remainder of our comments around the five chapters of the code: Leadership, ethics and corporate citizenship, performance and reporting, governing structures and delegation, governance functional areas and stakeholder relationships.

DETAILED RESPONSE

1. LEADERSHIP, ETHICS AND CORPORATE CITIZENSHIP

Noting that the Pensions Fund Act sets expectations for Retirement Fund Boards of Trustees, Principles 1.1 (*the board should set the tone and lead ethically and effectively*), 1.2 (*the board should ensure that the retirement fund's ethics is managed effectively*) and 1.3 (*the board should ensure that the retirement fund is a responsible corporate citizen*) are either aligned with the Act or represent complementary good practices.

We support the Code's acknowledgement that the Board should put in place processes and frameworks to ensure that service providers act in line with the fund's investment policy statement and responsible corporate citizenship objectives.

On Principle 1.3, the retirement sector supplement notes the following:

"A retirement fund gives substance to its duty to be a responsible corporate citizen by ensuring that its investment analyses and practices, whether executed by the fund itself or a fund administrator, fund manager or other service provider, take account of sustainability including environmental, social and governance (ESG) considerations as provided for in Principle 1 of CRISA. This should be extended to demonstrating its acceptance of ownership responsibilities in its investment arrangements and investment activities provided for in Principle 2 of CRISA".

We agree that the majority of a fund's impact is through its investment and active ownership activities. However, rather than being a question of corporate citizenship, **considering ESG factors in investment decision making is a requirement of all funds under their fiduciary duties**, as codified in Regulation 28 of the Pensions Fund Act.

2. PERFORMANCE AND REPORTING

The PRI welcomes the King Code's clear articulation of the links between good governance, good management of environmental and social issues, sustainable value creation and good quality reporting.

We agree that meaningful disclosure is important. Such disclosure allows beneficiaries to hold their funds accountable for their investment approach¹.

The retirement sector supplement guidance for the King Code references the disclosure requirements of the CRISA Code. These are supplemented by *CRISA Practice Note: Guidance on disclosure of the application of CRISA*.

The CRISA practice note on reporting was created in 2009, before a number of key changes in the responsible investment reporting industry. **In particular, the PRI Reporting Framework was launched in 2013 as a mandatory, structured framework for disclosure of ESG incorporation.** As of 2016, over 1,000 investors globally, including 34 in South Africa, use the PRI Framework as a standard disclosure format.

We therefore recommend that the CRISA Practice Note on reporting be updated, and consequently, disclosure under the King Code retirement sector supplement is aligned with established industry standards.

In particular:

- Investors should report on contextual information, their strategies and governance of responsible investment, and implementation by asset class.
- Such disclosures should align with PRI Reporting Framework indicators to increase the comparability of reports and efficiency of reporting processes.

Details about the PRI's reporting framework, reporting requirements, definitions and access to South Africa signatory reporting is available on the PRI's website (www.unpri.org).

3. GOVERNING STRUCTURES AND DELEGATION

The election and appointment processes for South African pension funds are mandated by law, but we agree that within these constraints, skills and diversity should be paramount. We note that the skills and diversity in the Board of Trustees is recognised as best practice by other codes, such as the Code of the Dutch Pension Funds².

Delegation to management is an important issue. PRI's 2016 report "*Beliefs to mandates: How asset owners can drive responsible investment*" examined the role of ESG commitments in

¹ Principle 6 of the PRI commits all Signatories to report on their progress towards the Principles.

² Chapter 3.5: Diversity Standards 65-71. The code provides the following clarification: *The board of trustees must make every effort to ensure the composition of the pension fund's various bodies is diverse. When representatives of various groups are involved in processes, a multi-dimensional perspective can be achieved, which is of benefit to the decision-making process.*

Investment Policy Principles³, and effective structures for ensuring these are implemented into investment decision making through mandates and effective monitoring. The Code's recommendation that a clear mandate is established is supported by this analysis, which identifies several model clauses.

PRI Recommends that the retirement sector supplement reference model clauses on ESG integration. These are listed below:

- **Investment Policy Statement:** In carrying out its duties under this agreement, the Investment Manager will manage the client's portfolio in line with the client's investment policy statement and responsible investment policies, copies of which are attached as Appendix 1 to this agreement. The manager will also ensure the portfolio is managed in line with the Principles for Responsible Investment, to which the client is a signatory.
- **ESG integration:** Consistent with its fiduciary duties and with the client's investment policy statement and responsible investment policy (copies of which are attached as Appendix 1 to this agreement), the Investment Manager will establish a structured process for integrating environmental, social and governance issues into its investment processes and decision-making. The Investment Manager will ensure that its staff apply due care and diligence to following this process. The Investment Manager will report annually on the implementation of this process and on how the analysis of environmental, social and governance issues has influenced investment decisions and portfolio performance.
- **Aligning time horizons:** The Investment Manager will have a process for monitoring current or potential investments in relation to relevant long-term factors such as ESG concerns. The Investment Manager will ensure that its staff apply due care and diligence to applying this monitoring process, including considering the extent to which such long-term factors generate investment risks or opportunities. The Investment Manager will report annually on the implementation of this process. The Investment Manager will report annually on portfolio turnover, including the costs incurred from portfolio turnover. The Investment Manager will, as part of this reporting, provide an explanation of any divergence from expected risk-adjusted returns.
- **Stewardship:** The Investment Manager will be an active owner, implementing a programme of engagement and, where relevant, voting, aligned with the Client's responsible investment policy statement and policies (copies of which are attached as Appendix 1 to this agreement). The Investment Manager will agree engagement priorities with the client on an annual basis. Where appropriate, the Manager will provide the Client with the opportunity to join company meetings. The Investment Manager will participate in, and promote, stewardship codes in countries relevant to the investment portfolio. The

³ In our report (Beliefs to Mandates), we refer to investment beliefs, which we take to mean codified principles and policies that the board of trustees use to make decisions about the fund's assets. This terminology was chosen to be internationally relevant, as some countries do not have a legal requirement to produce investment policy statements. We note that in RSA, some funds choose to establish investment beliefs in addition to their investment policy principles, in which case the recommendation should refer to the suite of documents.

Investment Manager will report annually on the financial outcomes and the environmental, social and governance outcomes that have resulted from these activities, The Investment Manager will also report on how stewardship activities have influenced its investment decisions.

- **Public policy engagement:** The Investment Manager will allocate resources to public policy engagement on responsible investment-related issues, in line with the Client's investment policy statement and responsible investment policies, copies of which are attached as Appendix 1 to this agreement. The Investment Manager will agree engagement priorities with the Client on an annual basis, and will report annually on progress against these priorities.
- **Reporting:** In addition to the specific reporting requirements above, the Investment Manager will report annually on:
 - The staff and other resources it has for the implementation of its responsible investment commitments and for the analysis of ESG issues;
 - How its compensation structures align with the objectives of the mandate;
 - The internal and external ESG research it uses in its investment research and decision-making, including information on its chosen research providers and on research expenditures;
 - How its responsible investment and ESG-related activities (investment research and decision-making, active ownership, policy engagement) have affected the underlying value and strategy of the portfolio. The Manager will allow access by the Client to its staff and systems to monitor ESG integration in investment decision-making.

Establishing clauses in the mandate is not sufficient on its own - effective monitoring is also required. The code should emphasise the reciprocal responsibility of the fund to monitor service providers and, where appropriate, document these activities.

4. GOVERNANCE FUNCTIONAL AREAS

As noted above, in our report "*Beliefs to mandates: How asset owners can drive responsible investment*" **we propose that asset owners incorporate ESG into Investment Policy Statements.**

This practice should be referenced in relation to Principle 4.1 (*The board should govern risk and opportunity in a way that supports the fund to set strategic objectives*). It is also relevant in relation to Principle 5.1 (*As part of its decision-making in the best interests of the fund, the Board should ensure that a stakeholder-inclusive approach is adopted, which takes into account and balances their legitimate and reasonable needs, expectations and interests*).

5. STAKEHOLDER RELATIONSHIPS

The King Code articulates a stakeholder-inclusive model, as clarified in Principle 5.1 (*As part of its decision-making in the best interests of the fund, the Board should ensure that a stakeholder-inclusive approach is adopted, which takes into account and balances their legitimate and reasonable needs, expectations and interests*).

Our view is that considering stakeholders in investment processes and decision-making is necessary to achieve sustainable value creation and a stable and resilient financial system. Therefore, a stakeholder-inclusive model is in the best interests of beneficiaries. Stakeholders include customers, employees and the local communities impacted by investee companies' business operations.

To consider stakeholders, pension funds need:

- The resources and tools to engage with their beneficiaries and stakeholders to best understand their investment preferences.
- Access via their investment consultants to a full range of investment products that respond to these preferences.
- The resources and knowledge to understand these products.

The PRI's fiduciary duty programme, and in particular, the Global Statement on Investor Obligations and Duties confirms that investors and other organisations in the investment system must:

- Take account of environmental, social and governance (ESG) issues, in their investment processes and decision-making, encourage high standards of ESG performance in the companies or other entities in which they are invested, and support the stability and resilience of the financial system.

We recommend that, as part of the stakeholder-inclusive model, the IoDSA provide clarification to this effect.

ONLINE QUESTIONS

Questions	Strongly agree to strongly disagree with an "I don't know" option	Provide comments and suggestions for enhancement
The Sector Supplements provide adequate guidance and explanation of how the recommended practices in the Code could be customised to meet the situational specifics of the various sectors	Agree	Please see our overarching response
The supplements illustrate the general approach to the application and interpretation of the Code in such a way that it enables users to formulate their own sound solutions to corporate governance challenges	Agree	Please see our overarching response

The King IV Sector Supplements connect and reconcile the King IV Code and legislation applicable in the particular sectors	Agree	
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