

Socially Responsible Investing

The Minister of Economic Development, Minister Ebrahim Patel, kicked up a hornets' nest when he mooted a plan to use 5% of public and private pension fund savings to pay for development projects. Many are concerned that this is a call for the return of prescribed investments or asset prescription. Up until December 1989, retirement funds were required to invest 53% of their assets in securities as prescribed in Section 19 of the Pension Funds Act. However, our understanding is that it was done as a reminder of the commitment that was made by stakeholders at the Growth and Development Summit in 2003, which was later incorporated in the Financial Sector Charter. Hereunder, we consider the proposal in the context of socially desirable investments.

Socially Responsible Investing (SRI)

Socially Responsible Investment is a general term used to describe investments aimed at maximising financial and social returns (generating returns while making a positive difference). There are a number of types of investments that are often associated with SRIs.

Screened Investments

The screening of investments allows the screening out of one's portfolio investments that are considered undesirable, for example, based on religious grounds. Alternatively, one could favour investments that support environmental, social and good corporate governance (ESG) issues. These are the investments envisaged in King III and the United Nations Principles for Responsible Investments (UNPRI). In South Africa, SRIs are relatively underutilised. Our first SRI index was established in May 2004 (and there is still some debate about the suitability of the criteria used).

Targeted Investments

These typically focus on areas where gaps or backlogs in economic development and job creation have not been adequately addressed by normal commercial activity. Examples such as those identified in the Financial Sector Charter include agricultural development, black small- to medium-sized enterprises, low-income housing and transformational infrastructure. These often take the form of private equity, preference shares and debt arrangements. The concern is that these focus on infrastructure development, which is relatively concentrated. Many asset managers will however assert that the track records of their portfolios will dispel this concern. We expect that these are

the type of investments that Minister Patel has in mind.

Shareholder Activism

It is not only important to invest in the "correct" shares, but also necessary for funds as shareholders to be proactive and vote with a view to ensure appropriate corporate outcomes. The UNPRI, for example, suggests a policy of engagement with companies rather than screening or avoiding stocks based on ESG criteria. The reason for this is that large investors are typically highly diversified and have large stakes in companies, which makes divestment or avoidance impractical.

Financial Sector Charter

The charter (the adoption of which has not yet been finalised) seeks to bring about transformation. As such, it has a political agenda which goes beyond the normal SRI concepts. The Financial Sector Charter requires retirement funds to comply with its empowerment financing, targeted investments and shareholder activism requirements.

Retirement Fund Trustees

Retirement funds that wish to invest in targeted-type SRIs have certain practical constraints. Many underwritten funds can only invest in policies of insurance. As a result, their strategy will depend on the availability of appropriate SRIs offered in the form of insurance policies. While privately administered funds can make direct investments in such SRIs, they also have to consider their liquidity and risk implications. "Packaged" SRI products are likely to provide these funds with a better liquidity and risk spread.

Targeted-type investments often fall under the "other" category or under unlisted equities in the annexure to Regulation 28. Many funds may not have sufficient capacity left under these limited allocations. The revised draft has not addressed this concern.

In addition, most DC funds offer member investment choice. To facilitate an investment in targeted type SRIs by all members, the fund may have to create an additional SRI portfolio in which all members will be required to invest a percentage of their assets. This will of course create ongoing portfolio balancing requirements to ensure compliance with the requirements of Regulation 28.

In the next article, we consider the implications of King III on retirement investments.

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Socially Responsible Investments

A common misconception is that socially responsible investments constitute a separate asset class. This is not correct, as these principles apply to the entire investment portfolio.

Targeted Investments

Targeted-type SRIs require that funds invest a percentage of their assets in infrastructure development.

Contact: Dirk Oosthuizen
Tel: +27 11 263 4333
E-mail: dirk.oosthuizen@simekaconsult.co.za

