

King III and Socially Responsible Investing by Retirement Funds

The King III Code of Governance became effective on 1 March 2010 and serves as general governance criteria against which listed companies and all other entities (such as retirement funds) should assess their level of governance. The principles laid down include the requirements that (our emphasis):

“1.1 The board should provide effective leadership based on an ethical foundation. Ethical leaders should consider the short- and long-term impacts of the fund’s (investment) strategy on the economy, society and the environment;”

“1.2. The board should ensure that the fund is and is seen to be a responsible corporate citizen and should protect, enhance and invest in the wellbeing of the economy, society and the environment (the so-called triple bottom line reporting approach).”

The recommended practices were developed with listed companies in mind. Retirement funds are very different in their structures and operational dynamics in comparison to companies. As a result, the code will be enforced on an “apply or explain” basis i.e. a board of trustees could resolve that it is not in the best interests of their fund to follow a particular recommendation contained in the code. In such a situation, the board can apply the recommendation differently or employ another practice as long as it still achieves the objective of the over-arching corporate governance principles of fairness, accountability, responsibility and transparency. By explaining the reasons for not applying the recommendation, a board may in this manner still achieve compliance.

PF 130

PF 130 is a good governance guide specifically prepared by the FSB for retirement funds. It asserts that:

“The primary obligation of a fund is to provide optimum returns for its beneficiaries. However, once these returns have been met, funds should consider socially responsible investments.”

Even though it requires boards of funds to consider formulating a suitable policy regarding such investments, as well as incorporating shareholder activism into the investment mandates, the second sentence quoted above effectively neutralised any pressure to invest in Socially Responsible Investments (SRIs). We understand that the FSB will review these requirements during the year to

ensure alignment with King III. SRI practices have not yet been well developed in the retirement industry.

The United Nations Principles for Responsible Investment (UNPRI)

An international example that funds can consider in the context of complying with King III, is the Principles for Responsible Investment as launched by the United Nations in April 2006. These principles were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance (ESG) issues for investment practices.

The principles are based on the fact that institutional investors have a duty to act in the best long-term interests of their beneficiaries. In this fiduciary role, it is believed that ESG issues can affect the performance of investment portfolios to varying degrees across companies, sectors, regions, asset classes and through time. It is recognised that applying these principles may better align investors with broader objectives of society. Those who subscribe to the UNPRI undertake the following:

“Where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.”

The Fiduciary Duties of Trustees

An important aspect that the UNPRI’s designers took into account is that investments in ESGs can only be made if they are consistent with the fiduciary duties of the trustees. Trustees of South African retirement funds are typically required to maximise returns given the members’ needs and risk profile. Trustees should make sure that they have authority in terms of the fund rules to invest in any investment that in theory may not generate a return commensurate with the risk taken.

“Where consistent with our fiduciary responsibilities, we commit to incorporate environmental, social and corporate governance (ESG) issues into investment analysis and decision-making processes.”

UN Principles for Responsible Investment

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