

The Experience of Governance Innovations in South Africa



The Inquiry

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme to advance policy options to improve the financial system's effectiveness in mobilizing capital towards a green and inclusive economy—in other words, sustainable development. Established in January 2014, it published its final report, *The Financial System We Need*, in October 2015 and is currently focused on actions to take forward its findings.

More information on the Inquiry is at: www.unep.org/inquiry and www.unepinquiry.org or from: Ms. Mahenau Agha, Director of Outreach mahenau.gha@unep.org

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The Global Green Growth Institute (GGGI) is an international organization dedicated to supporting and promoting strong, inclusive and sustainable economic growth in developing countries and emerging economies. Established in 2012, at the Rio+20 United Nations Conference on Sustainable Development, GGGI is accelerating the transition toward a new model of economic growth – green growth – founded on principles of social inclusivity and environmental sustainability.

About this report

This report has been written by Sharmala Naidoo (GGGI) and Alison Goldstuck. It draws on a series of semi-structured interviews, with 21 individuals undertaken between October 2014 and January 2015. Organizations included experts from and stakeholders South African universities, asset management companies, asset consultants, industry associations, consultants, international non-governmental organizations based in South Africa and parastatal organizations. Furthermore, the Inquiry recognizes the support of critical reviewers who gave insightful comments. Errors and omissions in this paper are the responsibility of the authors.

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EXECUTIVE SUMMARY

This paper explores the impact of four financial governance policy innovations in South Africa that have aimed to encourage the integration of environmental, social and governance (ESG) factors into investment decisions:

- ⦿ **Regulation 28** requires that trustees of pension funds take ESG factors into consideration in their investment decision-making process.
- ⦿ **The Code for Responsible Investment in South Africa (CRISA)** provides a voluntary set of principles and guidance for institutional investors and their service providers on how to execute investment analysis and be active investors to promote sound governance.
- ⦿ **Integrated reporting** has been adopted by the Johannesburg Stock Exchange (JSE), making it a mandatory requirement for listed companies to provide both backward- and forward-looking analysis and data describing how the company creates and distributes value, and how it mitigates negative impacts.
- ⦿ **The Financial Sector Charter (FSC)**, focusing on black economic empowerment (BEE), was developed through sector leadership, but has a more formal monitoring approach, with outcome-based targets, backed up by incentives built into public procurement criteria.

The ESG governance innovations Regulation 28, CRISA and integrated reporting are based on a common **disclosure-transparency-accountability** model that encourages shareholders and stakeholders to ask questions, companies to disclose information and investors and analysts to consider ESG risks and related opportunities. The Financial Sector Charter, while sharing some elements of this model such as reporting on performance, also has a direct public incentive element as it is linked to public procurement criteria.

To date, while the governance innovations have successfully increased awareness of the interrelationship between ESG factors and financial performance, the issues are not systematically integrated into the investment process and outcomes. This finding implies they have had only made a limited contribution towards achieving their objectives.

Three specific weaknesses are highlighted:

- ⦿ **Weak trustee capacity:** trustees have low financial literacy and little time, leading to reliance on outdated benchmarks and mandates
- ⦿ **Lack of common information standards:** poor comparability of information makes it harder for stakeholders to compare information and hold actors accountable.
- ⦿ **Lack of clear implementation standards and monitoring:** actors have considerable leeway to interpret the principles, and often their interpretation supports business-as-usual practices.

Interventions proposed by interviewees to strengthen the innovations focused on introducing stronger incentives (especially a stronger monitoring and evaluation system), while continuing to function within the free market system. They do not advocate for shifting to a system prescribing investment in particular assets, but one that strengthens the market mechanism.

ACRONYMS

ABSIP	Association of Black Securities and Investment Professionals
ASISA	Association of Savings and Investment South Africa
ATMs	Automatic Transaction Machines
BASA	Banking Association of South Africa
BEE	Black Economic Empowerment
B-EEE	Broad-Based Black Economic Empowerment
CRISA	Code of Responsible Investment in South Africa
E&S	Environmental and Social
ESG	Environmental, Social and Governance
EY	Ernst and Young
FS Code	Financial Sector Code
FSB	Financial Services Board
FSC	Financial Sector Charter
FTSE	Financial Times Securities Exchange
GEPF	Government Employees Pension Fund
IBA	International Banks Association
ICGN	International Corporate Governance Network
IIRC	International Integrated Reporting Council
IMASA	Institute of Management Associations of South Africa
IoDSA	Institute of Directors in Southern Africa
JSE	Johannesburg Stock Exchange
Nedlac	National Economic Development and Labour Council
NGO	Non-Governmental Organizations
PIC	Public Investment Corporation
POA	Principal Officers Association
PRI	Principles for Responsible Investment
SAIA	South African Insurance Association
SARB	South African Reserve Bank
SMEs	Small Medium Enterprises
WWF	World Wildlife Foundation





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