Sustainability of investments and assets in the context of a pension and retirement funds

Author: Ringetani Ndlovu, Head: Credit Risk

Investors have an important role to play in creating a better South Africa. Investing with sustainability as fundamental consideration is key in shaping a future in which we want to retire. There is an increasing awareness that how these investments are directed can significantly contribute to a more equitable, productive and prosperous society. Companies are integral parts of the communities in which they operate, and their actions have a direct impact on society. By prioritising sustainability as a key factor in the investment process, we can make meaningful progress in tackling inequality, climate change and economic inclusion. Investors are now looking beyond traditional risk and return metrics and understanding that considering overall sustainability is important for long-term performance.

The long-term investment objectives of pension funds are challenged by recent events. The aftermath of the global pandemic, conflict and social unrest have contributed to deepening inequality and persistent inflation. Climate related catastrophes, such as flood and drought have further exacerbated uncertainty and economic volatility. South Africa has specific challenges – particularly those related to socio-economic conditions that impact our society as a whole. We have plenty of case studies in recent years evidencing how poor governance, a lack of social responsibility and environmental negligence, in both the private and public sectors, affect the bottom line. Labour unrest in the mining sector, unstable governance at state-owned enterprises, and mounting environmental costs in agriculture are just a few examples of how a poor focus on sustainable practices can negatively impacting performance.

Individuals spend the bulk of their productive years investing and are rightfully concerned with long-term returns. Sustainable investing strategies are not just fundamental to risk management but also to long-term value creation. The 2023 Schroders Institutional Investor Study, representing global institutional investors managing nearly $35 trillion in assets, indicates that the prospect of long-term financial returns is a key driver in the shift toward sustainable and impact investing strategies. There is an understanding that pension funds are exposed to the risks associated with unsustainable practices. Sustainable investing offers diverse opportunities to earn risk-adjusted returns. It is not limited to thematic or impact investing but is a philosophy that can benefit traditional investing by not only contributing to returns but also limiting volatility.

At an industry level, there is clear support for investment practices that promote long-term sustainability. Regulation 28 of the Pension Funds Act, 1956 (PFA), and Guidance Notice 1 of 2019 reinforces the importance of responsible investing practices and sustainability. This is further emphasised by the work of National Treasury's Sustainable Finance Initiative, which is supported by ASISA at an industry level. Batseta's Responsible Investment and active Ownership (RIO) Guide was developed to empower the retirement fund industry with a practical tool to support the integration of ESG in the investment process. The 2022 launch of CRISA 2 further guides the move to 'an outcomes-based approach to responsible investment and diligently exercising stewardship and fiduciary duties'.

South Africa has well-regulated and relatively deep financial markets. South Africa's retirement fund system is sizeable, with estimated assets under management exceeding R4 trillion. This significant block

of capital has the responsibility and power to play a leading role on sustainable finance in South Africa. Investment managers can give voice to the concerns of their clients by how they engage with counterparties.

Investment managers can practice their fiduciary responsibility in a variety of ways throughout the investment process. Negative screening, to some extent, is common across the industry, involving the exclusion of specific entities, sectors or activities in alignment with investor preferences and values. An example would be the exclusion of tobacco, arms manufacturing and gambling due to inherent risks. However, in an environment where more and more entities are delisting from the JSE and debt markets are highly competitive, managers need more tools to cultivate an investable universe of assets beyond negative screening.

Investment managers engage indirectly, expressing their views through proxy voting in equities or bidding strategies in debt markets. Direct engagement is even more influential and can encourage corporates to employ more sustainable practices and increase transparency. Open lines of communication facilitate a deeper understanding of sustainability issues beyond glossy integrated reports. This is especially important in a 'buy to hold' market over the long term. Engagement with management also fosters an environment of accountability and responsibility, which is fundamental to overall sustainability.

Long-term returns are built on resilient and sustainable businesses. Directing capital to socially responsible, environmentally conscious and ethically led entities can help scaffold long-term performance. It is incumbent on managers to educate investors on the opportunities available to them within the bounds of mandates and regulatory limits. By ensuring that the investment process is aligned with their current values and future aspirations, holders of capital can be active participants in a better tomorrow.

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