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AN ACTIVE OWNER

INVESTMENT GROUP

THE STATE OF STEWARDSHIP IN 2019

If 2018 was a watershed year for stewardship, then this year certainly picked up where last year left off. It wasn't long before some key ESG themes came squarely into the spotlight again as a number of companies became victims of their failure to manage material ESG risks appropriately. Fortunately, given the robustness of our ESG integration process and pro-active stewardship, we avoided some of the bigger controversies by selling down on our holdings prior to the destruction of value and material falls in those companies' share prices. Here Tongaat comes to mind: prior to the admission by the company that their 2018 financials would need to be restated, we had already highlighted some key governance risks faced by the company – namely board succession and remuneration. After our engagements with the company our portfolio managers took a view that the heavy indebtedness of the company, along with the governance risks mentioned, meant we had to significantly reduce this holding. We have subsequently stated our views publically, including our expectation for a change in the combined assurance function (internal audit, audit committee and external auditors) to prevent opportunities for financial mismanagement within SA companies.

We have also seen a renewed effort by investors demanding that companies in the extractive industries disclose both the impact their operations make on climate change as well as how these companies intend to position their business strategy to transition towards the green economy and avoid the resources on their balance sheets becoming unusable or, as we describe them, "stranded assets". Shareholder activists voiced their concerns on climate risk at both the Sasol and Glencore annual general meetings (AGMs), which resulted in both companies undertaking to disclose appropriately in terms of the Task Force on Climate Related Financial Disclosures (TCFD) guidelines. Glencore also committed to placing a coal cap on its production. The sincerity of these companies to truly dimension their climate risk exposure still remains to be seen.

Interestingly, it isn't only extractive companies that find themselves subject to shareholder proposed resolutions on climate risk exposure. This year Standard Bank Group had two resolutions up for voting at their AGM. The first resolution called on the bank to report on its exposure to climate risk in its lending, financing and investment activities. The second resolution called for the bank to adopt and publically disclose a coal power and mining lending policy. The latter resolution was passed (with 55% of shareholder support) even though management opposed both resolutions. Old Mutual Investment Group voted in favour of both resolutions.

WHAT TO EXPECT NEXT

In SA a number of important regulatory changes and guidelines that provide tailwinds for ESG integration have been introduced and will further shape how SA Inc. approaches responsible investment.

STEWARDSHIP TRENDS TO LOOK OUT FOR

- More shareholder resolutions and activism about key ESG issues
- Greater disclosure across industries on key risks, such as climate change
- A binding vote on executive remuneration
- FSCA's Sustainability Guidance Notice is coming into effect
- Asset owners taking a bolder stance on key ESG issue

The most important development for responsible investment has been the much awaited Sustainability Guidance Notice from the Financial Services Conduct Authority (FSCA) in June 2019. This notice provides guidance to boards of pension funds on how to comply with parts of Regulation 28 under the Pension Funds Act, 1956 that deal with the sustainability of their investments and assets, as well as setting out the FSCA's expectations on disclosures and reporting on this issue. It paves the way for all pension funds to set an explicit ESG integration strategy and active ownership policy in their investment position statements. While currently not a compliance standard, it is clear that the FSCA wanted to give pension funds some time to get their house in order from a responsible investment perspective before forcing them to comply with a binding standard. As pension funds adjust to the new Sustainability Guidance Notice, we expect to see far more pressure from our clients to evidence how we've practiced responsible investment and disclose the outcomes of our stewardship of their assets – as we have done in this Listed Equity Stewardship Report.

Other notably developments would include the proposed changes to the Companies Act aimed at enhancing corporate governance. These include amendments to broaden pay disclosure to include "prescribed officers, typically being executives of a public company, in addition to the directors. We have been engaging with the drafters regarding the inclusion of a binding vote on executive remuneration among other important governance changes. In addition, the Johannesburg Stock Exchange (JSE) has set out some amendments to the JSE Listing Requirements to strengthen governance disclosures. The proposed changes include the promotion of broader board diversity and disclosure of material risk factors.

All these progressive moves indicate that sustainability themes are indeed gaining the needed priority. In this context we are well positioned as a responsible investment manager to take a competitive advantage of the opportunity these developments in the SA market. And we will continue to drive a pro-active stewardship strategy to ensure our clients win by investing with a strong ESG lens in the current volatile political and economic environment.