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COLLECTIVE INSIGHT

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Who's got the power?

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COLLECTIVE INSIGHT

Collective Insight is a collaborative initiative published quarterly by the Financial Mail. The articles included here were selected by an independent Advisory Committee to reflect some of the best insights from investment professionals, practitioners, and academics in relation to selected financial challenges.

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First word

THE PERIMETERS OF POWER

This marks Collective Insight's first appearance in the FM. In the past, Collective Insight provided a forum for critical debates for investors about what financial service products and services could, or could not, achieve. Now, in its new home, it widens its scope to include discussions about the extent to which our financial services industry can be expected to address the broader environmental, social and governance issues of SA.

These new requirements are nothing short of radical. International agencies and investors are appealing to SA to collaborate regarding sustainable development goals, climate change and the stability of global financial markets. Locally, South Africans who have entrusted their savings to the care of our financial services industry are asking important questions about the viability of our retirement savings model and the extent to which issues of fraud (governance), society (jobs and job security) and the environment are really being addressed under its fiduciary care.

With so many demands and agendas, the critical question becomes: who has the power here to direct or implement these radical shifts for the industry?

The articles that follow try to flesh out an answer from a number of perspectives. Collectively, they provide the reader with insights about the role of each of the players in the financial value chain in shaping these changes. What are the basic perimeters of power that should be expected from each of the players? What is within their power, and what isn't?

The narrative thread here takes the reader through the new challenges that confront the financial regulator, the Financial Sector Conduct Authority, and looks at what the government could and should achieve far more rapidly through a more co-ordinated policy approach.

It then steps back and asks questions — about the role of regulation in markets; the distinction between principles, guidance and stewardship; the duties of fiduciaries; and the role of professionals and control of their conduct.

Then it identifies how easy it is to create unintended consequences when policy decisions are made in sector silos or without regard for competing agendas.

Finally, it shines a spotlight on the voices that simply aren't loud enough: those of the pension fund members whose finances the industry safeguards.

All South Africans have a say in how this trans-formation unfolds

Are the perimeters of power between players totally clear? Most definitely not — and that's why many of the players in the value chain often hold back and wait for some other entity to take the lead.

The most powerful message that comes from this collection of articles, then, is that all South Africans have a say in how this transformation unfolds. We all have a voice. And unless we start exercising it from our own "perimeters of power" and collaborate with all the agents in the financial value chain, the transformational goals will never be achieved. x

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Kershia Singh

Market conduct regulation and sustainable investment

WHAT THE REGULATOR MUST DO

The Financial Sector Conduct Authority is working on a roadmap to support sustainable investing in SA

Scenes of heavy smog, dead cattle and crops, poisoned water sources and people eking out a living as waste-pickers are not commonly found in presentations made to financial sector regulators. Generally, the Financial Sector Conduct Authority (FSCA) deals with statistics and trends to identify risks and put in place measures through regulation and supervision to manage them.

Yet such stark images bring home the very tangible impacts of climate change, environmental degradation and social inequalities around the world, including in SA. The need to address these risks is of ever-increasing importance and requires all those involved, including financial sector regulators, to consider the roles we have to play.

Since its formation as part of the Twin Peaks regulatory architecture in 2018, the FSCA has placed great emphasis on its role in steering the financial sector to produce the best possible outcomes — for the economy and for the customers it serves.

Our role in relation to consumers is relatively simple, namely, to put in place frameworks and rules to ensure that financial institutions are fair in their treatment of customers; that financial products and services are designed to meet customer needs, are transparent and understandable; and that the customer's voice is heard and addressed when problems arise.

However, ensuring the best possible outcomes for the economy is a more nuanced consideration. The financial sector is a linchpin in driving economic growth and development. One of the key roles it should play is in efficiently and effectively allocating capital.

More and more, questions and concerns are being raised about whether the sector is performing this role in a way that sufficiently supports the societies it operates in. For one thing, customers are increasingly asking questions about how their money, held in pension funds and other savings vehicles, is being used not just to produce financial returns but also to support sustainable future outcomes for the societies they live in. Corporates are also under pressure to demonstrate their contributions towards imperatives such as the UN sustainable development goals and commitments to net zero carbon economies.

It is within this context that financial sector regulators worldwide are assessing the role they have to play in making sure markets meet this need and operate efficiently and cost-effectively in delivering these outcomes. There will be serious long-term consequences if the market does not function properly.

For the FSCA, supporting the real economy by not just managing risks but ensuring that markets allocate capital effectively to attain better societal outcomes is a multifaceted issue. It requires considerations of factors far beyond those that are typically in the purview of financial sector regulators.

For example, how can products that claim to meet environmental, social and governance objectives be assessed to ensure that they are fairly delivering on these very technical outcomes — whether it's the reduction of carbon emissions, transitions to greener technologies or addressing structural inequalities? How do we ensure investor protection that balances financial returns with measurable nonfinancial objectives? And how do we best keep pace with innovation and the rapid pace of change?

Globally, there is a strong focus on strengthening climate-related financial disclosures and green finance taxonomies. The aim is to ensure that markets acquire the necessary data and information to allow for well-informed decisions to be taken by investors. Standardising the data will go a long way towards supporting comparability and the flow of funds to contribute to climate change-related outcomes.

In SA the Climate Risk Forum (CRF), chaired by the National Treasury, was formed in 2020, bringing together financial sector regulators, policymakers and industry representatives to develop a joint approach to meeting the country's net zero target.

Two critical aspects emerging from the CRF are the development of a "green taxonomy" — to define which investments and assets are green — and the provision of technical guidance for disclosures. This guidance is based on international best practice as developed by the Task Force on Climate-related Financial Disclosures. Taking into account the output from the CRF, financial sector regulators such as the FSCA will consider publishing guidance on a green taxonomy and disclosure framework, which will form the basis of future regulatory requirements for the industry.

But more focus must be given to other sustainability objectives, particularly in the SA context. The country aims for a "just transition", acknowledging that any efforts to address the challenges of climate change cannot come at the expense of social considerations like the protection of vulnerable citizens and of incomes. We should also asses how we can use investment funds in our economy to achieve these sustainable outcomes.

As regulator, the FSCA must continue to ensure that markets have enough depth and breadth to facilitate the full array of funding mechanisms required. Market participants can and should manage the risks of moving to a more sustainable economy and capture opportunities to benefit customers.

The FSCA is working with all parties to increase our local financial sector capability rapidly to respond to social and environmental challenges, including through relevant regulatory guidance and oversight. That means producing a roadmap for the sector this year that will set out our approach to supporting sustainable finance and investment in SA. ■

More focus must be given to attain other sustainability objectives, particularly in the SA context

Singh is head: market, customer and inclusion research at the FSCA

Adrian Saville

Who really has the power to drive economic change?

LAYING THE FOUNDATIONS

Investors are not the sole players driving a sustainable agenda: government policies are crucial, too

In recent decades business and social leaders have come to appreciate that profit is not the be-all and end-all. After all, what is the point of extracting huge value if society and the community are crumbling? This view underpins the philosophy of the sustainable investing movement.

The power wielded by investors has given rise to the terms “impact investing” and “ethical investing”.

Unlike environmental, social and governance investing and corporate socially responsible investing, which have generated concerns about greenwashing and box ticking, the explicit purpose of impact finance is to take the economy, society and the environment to a better place while delivering concrete benefits to shareholders, capital allocators and capital providers.

This is a tall order for win-win outcomes that cannot be laid at the feet of investors alone. While capital can influence the direction in which companies and countries choose to transition, investors are not the sole players driving a sustainable agenda. Success hinges on political will.

Laying the sustainable groundwork

There are some compelling examples of entire countries that have transitioned impressively thanks to an enabling environment.

Costa Rica in the 1990s ranked as a poor and extractive agricultural economy with the lowest per capita income in Central America. Today it is a middle-income country with the highest standard of living in the region. Unemployment has dropped from 25% to 5%, and, as a manufacturing cluster developed, Costa Rica began exporting products into global value chains and developing services sectors. Participation by women in the economy ballooned.

There are a few important ingredients in Costa Rica’s story, starting in 1948, when the standing army was abolished. The funds released from the military budget were funnelled into primary health care and basic education. The country also extracted core value from its strategic partnership with key private investor Intel, the US chip manufacturer, and it worked with bodies such as the World Bank.

A trickier example is Chile. A stressed military transition under Gen Augusto Pinochet does not stand up to scrutiny in its social impact, but in two decades the economy stabilised its financial system and modernised its important mining sector, which provided the basis for growth in its industrial platform and in employment and incomes. This spilled over into new sectors, which has reduced the country’s high copper dependency by building wine, fish, financial services, air transport and fresh fruit export industries.

Several noteworthy policy changes shifted the balance of power. A stabilisation fund was established to protect the country’s revenues in the event of falling commodity prices. A rainy-day fund was created which continues to provide a fiscal cushion during tough economic times. Instituting a Tobin Tax — to dampen speculative financial inflows by providing incentives for moving “hot” foreign capital into more stable, long-term investments — was also key.

Together, these policies transformed a volatile economy into an investor-friendly destination with stronger social fabric and industrial resilience.

However, many of Chile’s people were left behind during this time, leading to social unrest. The country is now starting a new period under Gabriel Boric’s left-leaning government and as a result the future of many of these transformations is unclear.

Yet even amid policy uncertainty there is always space for agile businesses and impact investors to steer a course towards win-win outcomes. It’s a lot harder, but innovation and disruption are always possible.

The power to pivot

Just consider the biggest mortgage originator in the US, Rocket Mortgage. At worst a lending organisation can be predatory and extractive, but Rocket Mortgage has shown it is possible to change the behaviour of a lending organisation completely into something collaborative and inclusive but still profitable. The originator uses data analytics to identify changes in consumer behaviour that might indicate financial fragility. It then works with clients to support them rather than waiting until they stumble under the weight of financial stress.

In SA the Renewable Energy Independent Power Producer Procurement (REIPPP) programme has been characterised as “the most successful public-private partnership in Africa in the past 20 years”, in a 2014 World Bank assessment.

Since 2011 the REIPPP has pulled in more than R209bn in investment from the private sector, created jobs and local community opportunities, reduced carbon emissions, and, due to increased competition, dramatically brought down the cost of solar and wind energy. Despite delays in rolling out the fifth round of proposals, investors continue to wait in the wings for an opening in this transformative win-win policy setting.

In all these examples sustainable transformation is a complex mixture of addressing social needs, using innovation to tackle challenges, instituting intelligent policies and extracting value from core partnerships.

The main contributors have largely been the big, booming voices of business and government, but increasingly, impact investors are having an important role to play in amplifying the voices of individuals and communities.

This could shift the current power dynamic and drive the uptake of sustainable principles globally. x

The purpose of impact finance is to take the economy, society and the environment to a better place

Saville is an investment specialist at Genera Capital and professor at Gibs

Rob Rusconi

Making financial markets work effectively

FOUR PATHS TO SUCCESS

For markets to function, all players — state, regulator, intermediary and customer — must pull together

Financial markets play a major role in facilitating interaction between the entities that form an economy, be it the global village or its remote local equivalent.

Financial markets create the medium of exchange between entities of various kinds, over space and time. They allow us to leave cash in a safe place, accessing it when we need it. They give us the means to defer consumption to enjoy it later, as with retirement savings. They enable the pricing, pooling and management of risk. They allow us to lend to and borrow from one another.

All of this is made possible through intermediaries. Banks and insurers, stock exchanges and burial societies, mortgage providers, foreign exchange dealers and microlenders make it possible for these markets to work effectively. Since they are intermediaries, their role is to act between economic players.

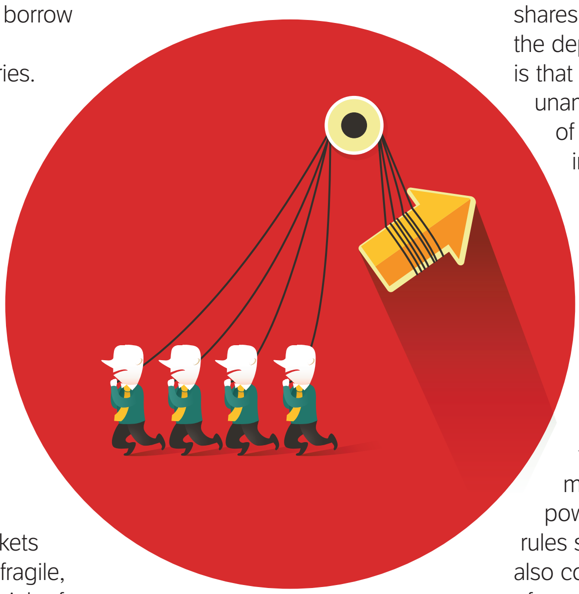
Market complexity

Financial markets are not just becoming more complex, they are becoming increasingly interlinked. When Opec pauses for thought, oil prices rise and markets around the world respond. The US announces surprising employment figures and the central banks of 200 countries need to reconsider their strategies for managing their own market risks. So financial markets are indispensable and complex, but they are also fragile, famously compared to a pyramid of sand on the brink of dramatic change as particles are added.

The purpose of the regulator is to ensure that the potential for disaster is kept as low as possible.

To do that, the regulator needs to understand the types of failure that might occur. The collapse of a significant intermediary, such as a bank, is an obvious failure, not least because such a collapse, like that pile of sand, can lead to widespread difficulty. The regulator takes steps to ensure that intermediaries are soundly managed, meet minimum capital requirements and report their financial position honestly and publicly. We call this prudential regulation.

Other types of market failure are more subtle and perhaps more dangerous. Intermediaries may misrepresent their products or services, leading customers astray. They may use their pricing power, or their knowledge of market intricacies, to charge their customers in hidden ways, or they might misrepresent that pricing in various ways. They may make side deals with third parties concerning the distribution of products that ultimately hurt their customers. These are also market failures because they distort the way in which efficient markets are supposed to operate, bringing entities to an arrangement in a fair and transparent manner. We call the intervention that addresses this problem market conduct regulation.



Financial markets are indispensable and complex, but they are also fragile

Who ensures market effectiveness?

Any power to effect change must come with commensurate responsibility. We consider a few parties.

- The policymaker. The regulator receives its power and mandate from the government, the policymaker. Every regulator is subject to founding law. It reports, under the terms of that law, to a defined entity and ultimately, through the processes of parliament, to the people of the country. The responsibility for policy, in the case of SA's financial markets, vests with the National Treasury, but it shares this with others such as the SA Reserve Bank and the department of trade & industry. What is clear though is that success can only be achieved through unambiguous objectives, supported by clear measures of progress. This is a critical challenge when so many interests diverge. But we're making progress.
- The regulator. The regulator can only issue regulation within the framework set for it by the policymaker. We may want to hold the regulator to account for the state of our financial markets, but if policymakers aren't clear about their priorities and those priorities aren't publicly available in law and policy, we can't expect intervention to take place.
- The intermediary. Entities providing services in financial markets also have the power to ensure market effectiveness. They typically regard this power — and its responsibility — as limited to the rules stated under the law by the regulator. They may also consider themselves to be bound by an ethical code of corporate citizenship to do more than this, erring in favour of their customers when the rules are opaque, for example, or directing assets to socially responsible initiatives. A soundly functioning market would encourage this, giving to intermediaries the goal to do right even when it is not required of them. The customer pays for bad service, dishonest conduct or poor investments. In the long term, this leads to a smaller market, for which intermediaries will also pay.
- The customer. Customers have the right and responsibility to see that financial markets work effectively. They have the right to receive what they were promised at an appropriate price, but it is also in the long-term interests of themselves and all other market participants if they hold intermediaries to account. A market with weak customers is typically unfair and ineffective.

Financial markets are not only complex because of the enormous variety of transactions that they sustain. They are complex also because of the nature of interactions between participants, typically referred to as principal-agency interaction. When the goals of the principal and the agent conflict, and they frequently do, a market failure results, thanks to the absence of some mediating influence. Regulators have a great deal to consider concerning their role as mediators, but everybody else has a part to play as well. x

Rusconi is an independent researcher and consultant

Bernard Peter Agulhas & Michael Judin

When the bough breaks

WHY A RESPONSE TO ESG IS NO LONGER OPTIONAL

Wrecking our natural environment poses a direct threat to humans now, and for future generations

In a 2019 analysis of 500 of the world's biggest companies by market capitalisation (G500) the Climate Disclosure Project found just under a trillion dollars ($970bn) at risk if they do not develop a response to climate change.

Over half of these risks were reported as "likely/very likely/virtually certain" and are likely to materialise in the short to medium term (about five years or earlier).

But why does climate-related information matter, and who cares anyway?

Let's put it in simple nonboardroom language. When we refer to "the environment", the first thought that enters the mind is the natural world. But the environment is basically everything that surrounds us — the biophysical alongside society and the economy, with all three interdependent. All these elements — ranging from the air that we breathe, to water, sustenance and security, culture and our sense of belonging — have a direct impact on human welfare.

Any changes to this environment may present direct threats to human welfare, unless the risks are managed, for ourselves and for future generations.

Yet human beings and corporates continue to exploit the natural environment they depend on. How much more pressure can the environment withstand before it finally succumbs?

Since every human being and corporate is dependent on the environment, it is up to us to manage what happens next. By "us" we mean individuals, governing bodies in corporates, regulators, standard-setters and the state, among others. Last year, the King committee on corporate governance issued a guidance paper which highlights the responsibilities of governing bodies specifically in relation to climate change.

To really get traction, however, the state would have to identify this as a top priority. We welcome the new Climate Change Bill introduced in the National Assembly in October 2021, which recognises that a "nationally driven, co-ordinated and co-operative legal and administrative response is required ... as well as the need to develop a legal and institutional framework for the implementation of the republic's national climate change response".

This means that regulators would have the wherewithal to enforce compliance and implementation of measures to slow down the demise of our valuable environment.

It is also heartening to know that international accounting standard-setters have made progress in recognising that a universally adopted framework under which climate-related information can be reported in a consistent and comparable manner has to be prioritised.

A universally adopted framework is a step in the right direction, but any reporting under such framework will only be useful once external assurance on the information can be expressed to increase its reliability for decision-making purposes.

Enter the international assurance standard-setters. Kudos to them for already having issued standards which deal with providing assurance on specific engagements such as greenhouse gas statements, but the world continues to wait with bated breath for more standards which focus on providing assurance on environmental, social and governance (ESG) matters.

The advance of integrated reporting has also recognised for some time that users' needs for information go way beyond financial data. Investors and investor groups, such as Climate Action 100+, signatories to the Principles of Responsible Investment and the UN Environmental Programme Finance Initiative, which represent trillions of dollars of assets under management, are demanding that entities they invest in demonstrate their commitment to ESG issues. This may require that business enters into the necessary partnerships to make the change.

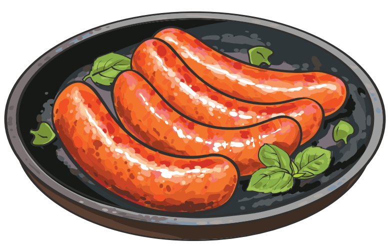
If the environment is, indeed, "everything around us", then corporates and governments can no longer pick and choose whether to prioritise economic, societal or environmental issues. To remain relevant, they must recognise their responsibility to respond to each of these elements.

In meditation, the state of consciousness is often compared to the tension between a bow and arrow just before the arrow is released. Let us not wake up when it is too late but let our response be guided by our state of (ethical) consciousness — and conscience. x

The advance of integrated reporting has also recognised that users' needs for information go beyond financial data

Agulhas is chair of the King committee subcommittee on climate change; Judin is a partner at Judin Combrinck Inc Attorneys

Rowan Burger



Making laws is like making sausages

FORMING A FEAST OUT OF CHAOS

We need far more collaboration if we're to make better financial products

The question of who has the power to influence the savings industry in SA is a complex one.

Much like our political landscape, this influence changes with the dynamics of the prevailing environment.

A useful statement to quote is Germany founder Otto von Bismarck's declaration: "Laws are like sausages, you should never watch them being made." It illustrates the chaotic, messy and sometimes unappetising nature of bringing about changes for good.

Politicians direct the legislators (the National Treasury), which in turn ensure that the laws are enforced by the regulators (the Prudential Authority and the Financial Sector Conduct Authority). These govern the financial service providers (the manufacturers, for example) who service their clients, often through some intermediary (an adviser) or interest group (a union, employer forum or trustee board). When politics and profit collide there are loud and competing interests that are not always easy to resolve.

Let's try to get to the nub of these competing interests. On one hand, we are making increasing demands on private long-term savings to address societal and political needs, whether those are climate change, social protection, transformation, targeted infrastructure development or good governance. On the other hand there is a need to have a robust financial services industry that can compete globally in delivering value for money to clients. For example, in the retirement fund space, forcing consolidation means only the largest players can provide the scale to deliver, which stifles the emergence of new black players.

It is often thought that financial services are purely profit seeking and will operate with this as their sole objective. But there are significant costs to setting up the infrastructure to run a financial services company in terms of systems, staff and capital. Long-term sustainable profit is required to fund this; it is not a "quick buck". Financial services companies get rich when their clients do.

It means that all players need clear, long-term guidance about the operating environment. Most are slow to react to sudden disruption. While smaller players may be more nimble, additional costs to make changes could be prohibitive.

What about the customer?

Clients, who are often thought of as helpless, actually have far more sway than they probably realise. The advent of social media has provided platforms where disaffected clients can easily vent their dissatisfaction and find like-minded individuals ready to rally to their cause. This is no longer an insignificant influence. Recently a tweet from a widow complaining that her husband's death claim had been repudiated was retweeted by celebrities, which led to the entire life insurance industry changing the way pre-existing conditions were treated in the event of accidental death.

The problem is that the inherent complexity of financial services leads inexorably to high levels of information asymmetry, which confuses the consumer. Low levels of financial literacy mean that many consumers don't understand the products they are invested in; and many providers don't work hard enough to foster greater understanding. This then leads to poor levels of coverage and product outcomes.

Consumers of financial services products are reputed to make lower advocacy efforts than other consumer groups, and complexity ensures that it stays this way. And while unions, for example, are there to represent members, sometimes their interests are subsumed into broader political agendas. The other issue is advisers are too often allied to the providers.

Studies such as the Edelman Trust Barometer survey suggest that employers are among the most trusted sources of advice for employees and should do more to safeguard their staff. But here again come the dynamics of unintended consequences. The shift to defined contribution and multi-employer umbrella funds have made many employers step away from this role, even as the atrocity of an event such as the one at Marikana should demonstrate to any employer the consequence of the financial exploitation of employees.

And then there's fintech, which may leapfrog all these agendas if our industry and our policymakers' best intentions do not deliver on client needs.

These are times that demand far more collaboration in the industry if we want to get it right. There should be more who contribute and invest their time on considering the longer-term direction.

The National Economic Development & Labour Council is a critical platform for this debate, but discussions can often be derailed by grandstanding. The workshopping of ideas needs to happen before the debate reaches this point.

To its significant credit, the National Treasury signposts intended changes well ahead of time. But often detailed discussions at the point of promulgating laws are rushed.

Much like in the case of sausages, there are many different ingredients that need to go into the mix. To achieve the best possible product, we need the perspectives and inputs (ingredients) from all the role players in appropriate proportions.

We must also recognise that SA has its own unique challenges and circumstances. We may be able to consider recipes applied in foreign places, but we have our own custom-made sausage — boerewors — that is a great blend of competing flavours with a myriad varieties that is much loved (though pretty much only here). x

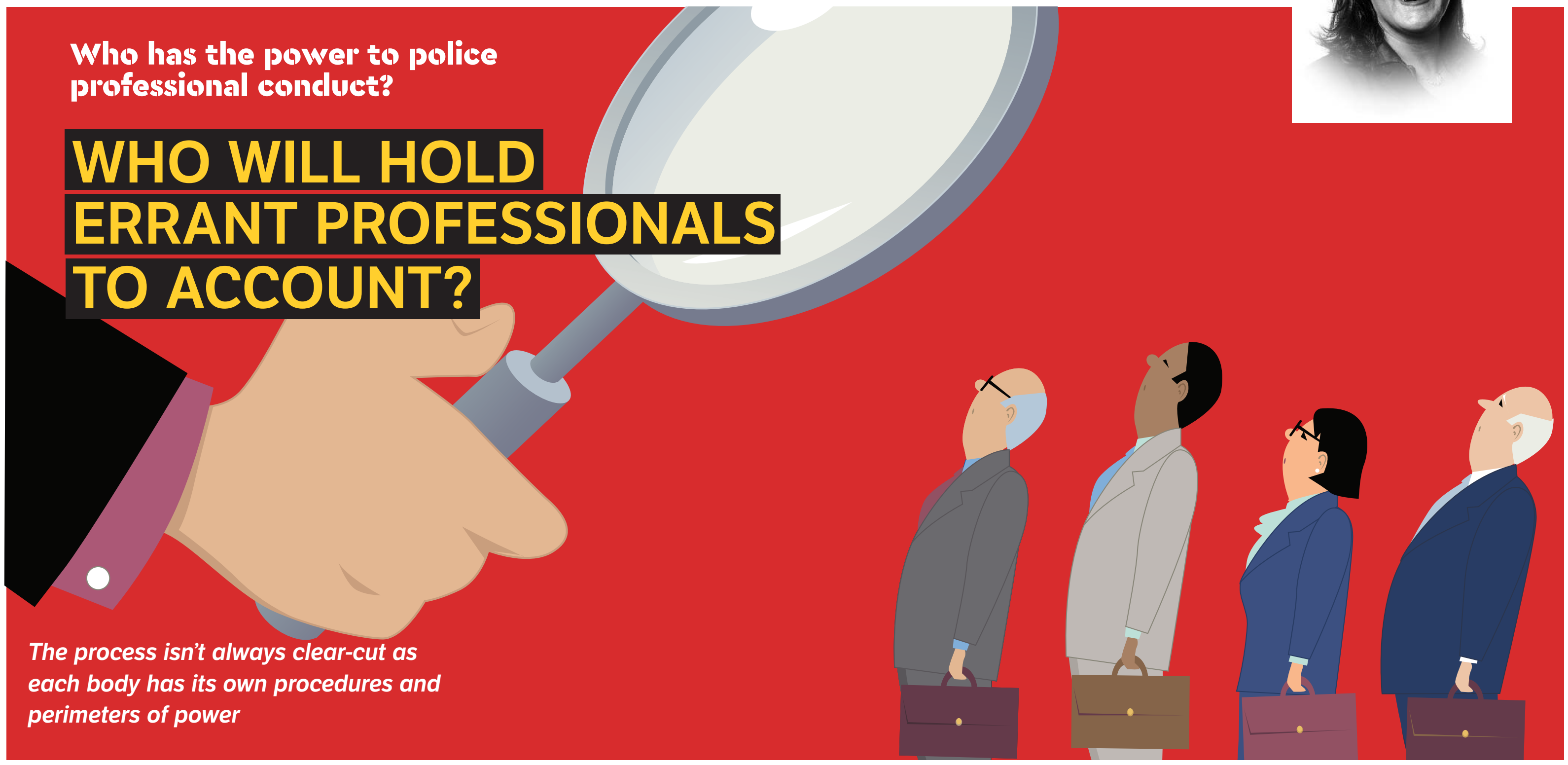
When politics and profit collide there are competing interests that are not always easy to resolve

Burger writes in his personal capacity

Lelané Bezuidenhout

Who has the power to police professional conduct?

WHO WILL HOLD ERRANT PROFESSIONALS TO ACCOUNT?



The process isn't always clear-cut as each body has its own procedures and perimeters of power

The notion of professional conduct is very much in the spotlight these days. We all have dealings with professionals: attorneys, auditors, tax practitioners, actuaries and financial planners. So who sets the professional standards governing these professions, and has the responsibility to ensure that the people we rely on are competent to do their work?

The answer, in theory, is simple: there are a range of professional bodies mandated to do just this. We have regulators as well as professional bodies tasked with oversight of the skills, ethical conduct and professional standards of each profession. They all seek to ensure that the public maintains its trust in the various professions, by holding their members accountable against a specific code of conduct. But quite how they do this varies considerably.

On the skills side, some of the professional organisations work with accrediting bodies such as the SA Qualifications Authority to link educational requirements to those of the jobs market, while others depend on international accreditation standards.

Professional bodies regulate their members, but their decisions can always be challenged in court

SA has both statutory professional bodies — such as the Independent Regulatory Board for Auditors (Irba) and the Estate Agency Affairs Board — and nonstatutory bodies, such as the SA Institute of Chartered Accountants (Saica) the CFA Society SA and the Actuarial Society of SA.

The difference is that a statutory professional body is formed by an act of parliament and you need a licence to practise, while a nonstatutory professional body is formed by the industry, and membership is voluntary.

This is where it gets complicated, since the main thing people want to know is: where does the power reside to discipline wayward professionals? How far can disciplinary processes go? And do nonstatutory professional bodies have the power to enforce their rules on members?

The answer, clearly, should be yes — because even though membership is voluntary, the member and professional society have a contractual relationship.

But surely in some cases (think of an errant auditor), "discipline" needs to go beyond simply removing someone from a practitioners roll.

It all depends on the perimeters of power of each professional body, their procedures for dealing with disciplinary matters, and whether they are integrated with other agencies that have the power to go further and actually prosecute cases.

Sadly, this isn't always as clear-cut as it should be.

Take accountants. Under Saica's disciplinary process, if a complaint is received against a member who is also a member of Irba, that complaint is *also* referred to Irba. In a case like this, the accounting bodies need to partner to effectively protect consumers and uphold the reputation of the profession.

In some cases, professional bodies also battle to discipline members since they don't have prosecuting powers themselves, and depend on other agencies. These bodies also deal with the conduct of individuals, rather than companies, which sometimes makes it harder to see where the fault lies — with that person or in the company's processes.

Take Saica's disciplinary process against former Steinhoff CEO Markus Jooste. In May 2021, Saica hit Jooste with four charges, but the case has dragged on, as the accounting body can't subpoena people or compel co-operation. Saica is also waiting to see what the regulator, the Financial Sector Conduct Authority (FSCA), finally decides about the Steinhoff fraud.

But thanks to the courts, we do at least have some clarity about the reach of these organisations' powers.

In a case going back years, the Financial Planning Institute of Southern Africa (FPI) found one of its members, Elizabeth Coetzee, guilty of breaching its code of ethics and terminated her membership. Coetzee appealed the case to the Supreme Court of Appeal, and lost.

But this was a significant ruling, as it created case law confirming that a nonstatutory professional body has the power to govern the conduct of its members, as members agree to peer-to-peer reviews when they first join that body. After that case, the FSCA's predecessor, the Financial Services Board, barred both Coetzee and her mother from practising.

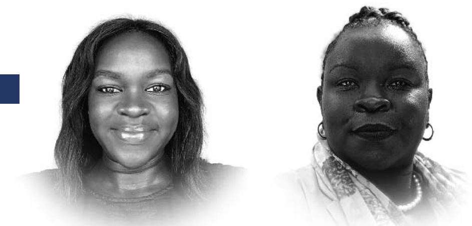
Of course, litigation is expensive, but professional bodies often have to go this route to protect the reputation of the industries they serve.

The FPI case also underscored the fact that while professional bodies regulate their members and set the standards, their decisions can always be challenged in court.

So if you ask who has the power here, the answer is both SA's courts and the individuals who have the power to appeal to the rule of law. x

Bezuidenhout is CEO of the FPI

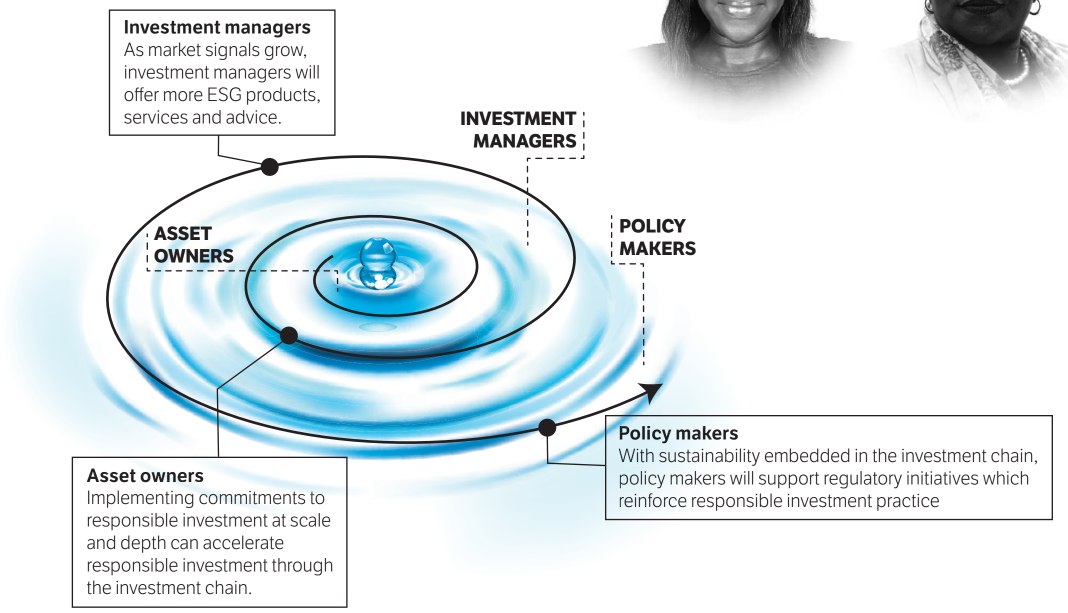
Beatrice Chandia & Jolly Mokorosi



Who's got the power to drive sustainable principles?

ENSURING ESG IS IMPLEMENTED ISN'T SO SIMPLE

SA policymakers must address the economic disparities of the past while keeping an eye on the future



Source: (UNPRI 2016)

As a child growing up in the Eastern Cape, August became imprinted in my mind as the month of the first rains. You were guaranteed a cold, wet school uniform. Today I live and write from a rainy Joburg that is a far cry from the Eastern Cape in many ways — except that now weather patterns throughout SA have become crazily unpredictable. God help our farmers!

Walking home decades ago, I could not have imagined that issues concerning the environment, society and governance (ESG) would be something that would consume my everyday life. Yet it affects what I pay for food and if I have electricity, transportation or any kind of government service. Gone are the days when "sustainability" and "climate change" were just buzz words from an activist fringe.

Perhaps we as trustees do not all use the lingo, but as Deloitte's Kristen Sullivan and Veronica Poole put it: "Increasingly empowered consumers and more activism-oriented investors are pushing organisations to address ESG issues concretely and transparently. They are looking for organisations to put purpose at the core of their operations, caring for the issues that concern their employees, communities, industries and the world at large. They are fuelled by the transparency afforded to them in the digital age and they are increasingly putting their money where their values are."

While the term ESG was only coined in 2006 in a report by the UN Principles for Responsible Investment (UNPRI), the concept of ESG investing goes back to the 1950s, when electrical and mining industry trade unions began investing their pension contributions into affordable housing and health facilities.

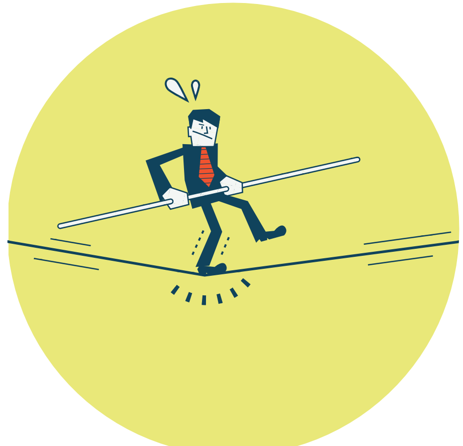
Today, the UNPRI has become the voice of responsible investing, with 3,826 signatories and $121-trillion in assets under management by March 2021. At the same time, there is a growing sense of urgency around ESG principles, which has put pressure on policymakers and regulators to act.

So, who has the power to drive sustainable principles and regulations related to ESG?

Though regulation is a powerful tool, getting it right is a balancing act. Policymakers must set regulations that aren't too prescriptive. And in doing so, they must be aware of two possible challenges: first, creating unintended consequences; and second, introducing unviable cost increases to the overall investment process. But regulators also know that if market forces aren't enough to force adjustments, they need to have the power to do more than simply nudge.

Their impact would just be one element in a complex array of interacting agents in the financial ecosystem

Here in SA, policymakers have additional challenges. For a start, they must address the social and economic disparities of the past while keeping a keen eye on the future. If the loudest voices are focused on climate change but our policymakers act on this alone without considering the broader imperatives, we may simply exacerbate existing economic problems.



This is where ESG is particularly important.

The role of asset owners is essential to driving better outcomes for themselves and for creating a more sustainable economy and better life for those they represent. Asset owners can send signals to the market on what is important and what is not.

For example, they can send:

- Direct investment signals around the weight given to responsible investment and ESG, as well as around the appointment of investment consultants and managers, and the conditions included in mandates;
- Indirect investment signals, through the adoption of investment principles, policies and statements that let the market know what really matters; and
- Policy signals. Where, for example, does the market need more than a "nudge"?

So, in the final analysis, who has the power to drive sustainability principles and ESG regulation?

The short answer is those with the resources — but not in isolation. As a collective, asset owners have the power to influence change. But their impact would just be one element in a complex array of interacting agents in the financial ecosystem.

Today, in my capacity as a trustee, I have files in front of me outlining the problems facing a number of mostly emerging black farmers. These files detail how these farmers could not repay loans, as the crops that provided the loan surety had failed. If I read between the lines, it often boils down to unpredictable weather and the inability to afford crop insurance.

Most of them will have one or two shots to make this "farming thing" happen. Though this is fundamentally a commercial transaction, this does not take away from the fact that this is also partially an opportunity for social redress and securing a more food-secure and sustainable future for all of us.

Do you now see the challenge I face as a responsible investor? x

Chandia is operations manager and researcher at Mokorosi Financial Consulting; Mokorosi is MD of Mokorosi Financial Consulting

Tracey Davies

Are SA's asset managers living up to their promise on sustainability?

MORE EFFORT NEEDED ON CLIMATE-CHANGE RISKS

There was a strong theme around avoiding any appearance of 'taking sides' with activist groups

Two recent surveys highlight the reality that local asset managers are failing to use their power to drive effective environmental, social and governance (ESG) practices in the SA market.

At the end of November 2021, RisCura released a report, *Moving the Needle: Stewardship in SA*, which focused on proxy voting and engagement by 52 private-sector asset managers, representing about R3.9-trillion in assets under management.

Two weeks later, my organisation, Just Share, released our own *SA Asset Manager Climate Risk Survey*, assessing the approach of 31 of this country's largest asset managers to climate risk.

Some of RisCura's main conclusions are that "stewardship practices are improving", and that "managers rate their stewardship capabilities very highly". Yet that report almost immediately throws cold water on its respondents' self-assessments, when it says that "managers may rate themselves highly, but SA is falling behind".

Our report found that while there are some encouraging signs of local asset managers adopting the necessary approaches to effective climate risk integration, relatively few of them demonstrate excellence when assessed against international best practice standards. In fact, many of the managers' responses to us demonstrated a confidence in their effectiveness that was not borne out by their answers to specific questions on climate risk integration.

There appears, in other words, to be a pervasive overestimation by asset managers of their ESG-related capabilities, and insufficient assessment of whether engagement is having real-world impact.

In particular, it doesn't matter how many "ESG engagements" a manager has with investee companies if those engagements do not result in positive shifts in corporate behaviour.

The fact is, we have not seen the kind of shifts one would expect to see if managers were as good at stewardship as they think they are.

There are few countries that have both a sophisticated financial market as well as the vast array of social, economic and environmental challenges that characterise SA. This means asset managers here have huge power to contribute to shaping a more sustainable and just economy — yet they seem reluctant to exercise this power.

In my view, there are two main reasons for this gap between the levels of ESG-related competence reported by asset managers, and their lack of impact in the real world.

The first is the widely acknowledged reluctance by asset managers to take public action to hold companies accountable.

The second, clearly demonstrated in the responses to the Just Share survey, is a widespread failure to set firm goals and timelines for engagement with companies, with specific trigger points for escalation if that engagement fails to result in behavioural change.

The responses to the RisCura survey are astonishing in their candidness about their preference for "behind-closed-doors engagement". The report says that "managers don't like going public, but a lot happens behind the scenes". But very little evidence was provided that showed any causal link between those "behind-closed-doors" engagements and positive shifts in corporate behaviour.

This is unsurprising, when you consider that more than one respondent indicated that taking any public stance would "antagonise" corporate management, harm relationships and potentially have an impact on the share value of a company.

There was also a strong theme in the responses around avoiding any appearance of "taking sides" with activist organisations like my own.

We are expected to accept on faith that these private meetings between investors and management are changing the world. The same corporate ESG improvements (most of which, at this stage, relate only to improvements in *disclosure* of a company's ESG impacts, rather than improvements in the *impacts* themselves) are attributed by each asset manager to its own engagement.

Most fail to recognise the role that other investors have played, and some take credit for shifts in corporate behaviour that have self-evidently occurred as a result of public activist pressure.

Needless to say, asset managers *aren't* supposed to have cosy relationships with management. As stewards of other people's capital, they should be tough when the circumstances demand it.

They should also be willing, when engagements do not show results, to take concrete steps to escalate the issue, like voting against director reappointments. When necessary, they should be willing to do so publicly, and collaboratively.

That is part of their fiduciary duty (in relation to which, asset managers say in the RisCura survey, rather alarmingly, that "much more clarity" is required).

Across the globe it is clear that institutional investors have the most impact when they collaborate in their engagements (with other investors and with activists), set clear goals and timelines for escalation, and have a carefully planned public messaging campaign to communicate objectives and maximise impact.

Up to now, unsubstantiated claims about the "robustness" of ESG integration might have sufficed to convince a relatively unsuspecting public that its money is being responsibly managed.

But as the climate, biodiversity and inequality crises escalate, and clients start to demand evidence that their investments are not making it worse, local asset managers will have to radically up their game. x

There appears to be a pervasive overestimation by asset managers of their ESG-related capabilities

Davies is executive director of Just Share

Ryan Short & John Oliphant

A deafening silence instead of action

USING WORKER POWER TO CHANGE ASSET MANAGEMENT

Workers already own a large part of the economy but do not realise how they can leverage this

As Covid eases its grip, the pressure is on the government to jump-start the economy. But it's important to remember that SA should, as far as possible, aspire to inclusive growth — especially when it comes to ordinary workers, who have been hard hit by the pandemic.

Since 1994, black workers have been taking more ownership of the economy. More than 150,000 SA workers now own at least part of the company they work for. The most recently available reports, from 2017, show that institutional investors — including pension funds, insurance funds and investment schemes — account for 52%-58% of the JSE's top 100 companies. This is by far the largest category of local investment, overwhelmingly representing the interests of black workers, as workers' pension funds have 83% black membership.

The latest research commissioned by the JSE and the National Treasury in 2017 found that 20%-23% of shares in the JSE's top 100 companies are owned by black workers — about half directly and about half of that (11%-13%) indirectly through funds. A more recent study reported that just under 25% of JSE-listed companies are black owned. This is a foundation on which to build further transformation of the economy.

If black worker ownership is clearly progressing, why don't workers use the rights of ownership to push for more reform in corporate SA?

Consider board diversity. About 80% of CEOs and about 70% of board chairs of the JSE's top 40 companies are white men. While this percentage is improving, it is still far from being demographically representative.

Why don't workers, as owners, press companies for more racially diverse leadership? Why, for that matter, don't they demand higher standards of corporate governance, better environmental performance or the adoption of shared-value business models that could ensure that businesses help solve society's challenges?

The answer lies in the complex intermediary relationship between worker capital and the listed companies it is invested in.

The way it has traditionally worked is like this: Workers collectively hold savings in institutional funds. They delegate oversight of their investments to institutional trustees, half of whom are nominated by workers. These trustees are often workers themselves, elected from the shop floor or through a union. They are not professional investors and rarely have access to financial or commercial networks. And the truth is, they often don't have the necessary investment, economic or fiduciary training to be effective trustees.

Because of this, they delegate most decisions to an asset manager — and the asset manager industry is still being transformed. A 2021 survey by 27four Investment Managers found that assets under management by black-owned asset managers account for just 13.5% of market share, and that there are only 55 black-owned asset managers.

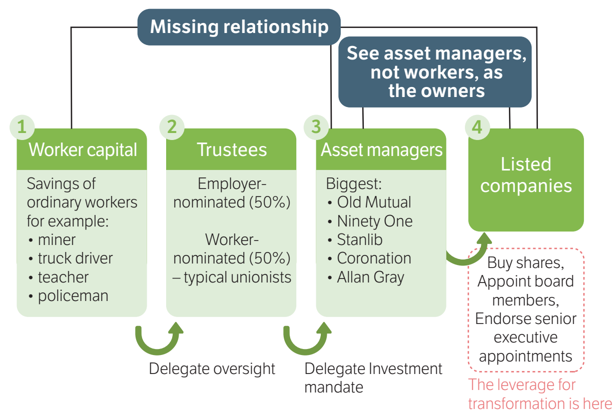
The result is that predominantly white-owned and white-controlled asset managers retain de facto control in deciding where capital should be allocated and who should be appointed to boards or endorsed for executive roles. These asset managers have networks in finance and commerce that are still largely white, so they tend to make appointments from these networks. It is the outcome of a segregated history that makes us more comfortable with those who look, talk and live like us. There is little incentive for a white fund manager to challenge the status quo if this is not being demanded by clients or members.

There are several ways to break this cycle.

First, worker pension funds could organise and vote collectively on investment mandates for an agenda they believe in. They could establish a central co-ordinating body and common guideline positions for trustees.

Second, trustees need more training, so that a larger number of professional black worker trustees can become available.

FINDING THEIR VOICE



Third, trustees should be encouraged to hold asset managers to account for nominating and electing directors and for creating a meaningful environmental and social impact strategy in every company they invest in. The UN-backed Principles for Responsible Investment already provide a model investment mandate that trustees can use. Fund managers should be expected to engage more actively with companies about how to solve social and environmental challenges.

Fourth, business associations could be proactive in creating platforms for white and black asset managers to identify talented black managers and executives, meet them and build relationships of trust with them.

This is vital. Workers already own a large part of the economy — ownership gives them both great power and responsibility to make a difference. x

Short is partner at Genesis Analytics; Oliphant is founder and executive chair of Third Way Asset Management Group. They write in their personal capacity

Fran Troskie

You have the power

GETTING TO GRIPS WITH A 'TWO POT' SYSTEM

A proposed change is meant to help people obtain some of their savings before retirement more easily

There is still a prolific amount of jargon to wade through, which only makes things less transparent

In the 1980s The Pointer Sisters had a hit with the song *We've Got the Power*. The sisters might have made some questionable fashion choices, but they did have a point (excuse the pun), and we as retirement fund members should have the power as well.

This brings me to the subject of agency — the ability to make choices appropriate to our circumstances.

The reality is that asymmetric information — where one party has an information advantage over the other — detracts from our ability to make the right choices, and thus diminishes our agency.

Take the example of fees. One of the longstanding gripes with the retirement industry is the lack of transparency about fees and costs, processes and accountability.

Now, it is true that the industry has made some headway on this score — fund members have more ready access to information than has been the case previously.

But there is still a prolific amount of jargon to wade through, which only makes things more opaque and less transparent. Ongoing retirement reforms, even if they were made with benign intentions, have only added to the noise.

One of the recent developments in the retirement reform process is the proposed implementation of the "two pot" system. As the saying "Knowledge is power" suggests, we ought to empower retirement fund members to understand what this new system will mean for them.

Without covering all the details, here is the core of this specific proposed reform.

The two pots are the following:

- A pot with a lid: the preservation pot, which is intended to improve ultimate retirement outcomes; and
- An open pot: members are allowed partial access to retirement funds to see them through a time of financial distress.

So what does this all mean? First, why do we even need such a thing as a "preservation pot"?

In a nutshell, the preservation pot aims to create a safety net for retirees and restore some sense of agency to their retirement outcomes.

At the moment members of SA pension or provident funds can withdraw the full value of their fund when they are retrenched or if they resign from their post. Between 2018 and 2021, The SA Revenue Service reports that more than 700,000 people cashed out most, if not all, of their pension fund savings before their retirement date.

However, withdrawals before retirement are taxed heavily, and the bigger the withdrawal, the higher the tax rate. For example, any withdrawals above R990,000 attract a whopping 36% tax.

So the reality is that people who cash out early usually face a double whammy once they eventually retire: they haven't saved as much as they initially envisaged, and they paid a substantial cut to the tax authority. Effectively they're left without sufficient money to sustain themselves.

Financial security and financial independence are important aspects of agency. The proposed legislation means that at least a portion of savings will be preserved, simmering under the lid of the first pot.

So why a second, more flexible, pot?

Here, the government is recognising that in times of financial distress people have to be able to access at least a portion of their pension fund savings. At the moment the only way they can do this is by resigning from their jobs or by withdrawing 100% of their pensions.

As a result they're left with little to no safety net to see them through retirement.

The two-pot system will allow members to preserve a large part of their retirement savings, but also get access to a portion of their accumulated pension savings (the second pot) in a responsible way.

So how will it work practically?

The proposal is that the first pot should consist of two-thirds of a person's pension contributions and be accessible only on retirement. The remaining third should remain in the second pot and be kept in an accessible retirement fund account, which can be used at any time. It is likely that withdrawals from the second pot will be allowed only once a year, though there is no finality on this yet.

However, the fact that pension fund members know that at least a portion of their funds will be readily accessible is likely to empower them to make better choices. If members are also able to have access to simple, understandable advice about how to secure the best possible outcomes given their specific constraints, all the better. Arguably, this type of education should either be offered for free or be covered by the pension fund provider.

Importantly, the government has called for public consultation about this proposed two-pot system. The initial request was for any submissions relating to this proposal to be made by the end of January 2022. However, this was made public only on December 14, so role-players lobbied for, and secured, an extension of the deadline.

The public perception is that only an exclusive group of individuals typically weigh in on these types of discussions. In truth, our collective input — as retirement fund members and citizens — is what is being called for.

Our knowledge allows us to contribute to the discussion: what are our concerns? And how might this proposal serve society better?

The Pointer Sisters hit the nail on the head. We do have the power. x

Troskie is an investment research analyst at RisCura