



Investments

Stewardship report

Reporting from 2021/2022
Executive summary



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Ann Leepile
Chief Executive Officer:
Investments

Executive Summary

In times of economic uncertainty, asset managers play a vital role in helping to maintain the integrity of financial markets.

As the largest multi-manager in South Africa, we acknowledge the fiduciary duty we have to investors and we recognise the influence we have as an organisation in the asset management industry. The good news is that there has been growing recognition of the value that identifying ESG risks and opportunities can have for investment outcomes. But this is not to say that responsible investing (RI) and ESG are strangers to doubt. Recently, there has been increased scepticism around the merits of responsible investing and ESG and the benefits that they purport to yield for both investors and society. However, we do not see the attacks as justification for doubling down on responsible investing.

Periods of rapid growth and change are naturally subject to pessimism because they include practices that were not part of the status quo. But new problems need new solutions. And they need better questions asked – and answered.

As long-term supporters for responsible investing, we still hold the belief that incorporating ESG considerations into investment processes has an impact on investment performance and a wider impact on society.

But in order to know where we need to improve as an industry, we need to have a clearer view of where we are today.

As a result of both continuous engagement and a conducted survey, we have gathered insights from participating asset managers on their views on a wide range of matters concerning responsible investing and ESG integration.

This report provides details of the outcomes of our due diligence engagements with asset managers, including ESG themes that they have considered to be material to their business, the ESG risks and opportunities that key players in the industry have

identified, and consequently, how they either manage them or leverage them – respectively – in their investment portfolios and ultimately, within our portfolio solutions.

Our survey revealed a range of perspectives from different types of asset managers, culminating into insights that provide the most comprehensive overview of the South African responsible investing landscape.



Engagement statistics:

Coverage

17 asset managers

R5.5 trillion
in assets under management (AUM)

30+ investment strategies

8 asset classes

Organisational type: small, medium-sized boutiques • large, well-established asset managers

Participants:

Chief investment officers • Chief executive officers • Portfolio managers • Analysts



Meeting insights

In wanting to better understand the incorporation of RI practices and ESG incorporation, we set out to get manager insights on eight themes of interest:

Theme of interest	Discussion	Insights
Strategy and leadership	Strategic investment goals	Managers have created structured guidelines around voting, monitoring and reporting. The Investment and ESG goals that managers respectively set differ depending on how long a manager has considered ESG factors or integrated them into their investment approach.
	ESG-related employee training	There is a general consensus that ESG matters cannot be ignored owing to their evolving complexity and growing importance. While investment professionals do require immediate training in this regard, it should not be limited to a once-off course.
	Growing and creating relevant skillsets	ESG skillset is needed within investment teams to ensure that nuances and implications are understood. This ESG-specific skill is needed at various levels throughout an organisation.
	Responsibility for ESG views	In larger, structured entities, the board of directors of the entity - together with the executive committee - have ultimate accountability for setting the strategy for ESG considerations.
	Remuneration and key performance indicators (KPI)	Most asset managers have opted for holistic compensation packages that include ESG-aligned targets.
	Corporate and audit	The big four auditors are reasonably well skilled to address a changing dynamic. Mandatory audit firm rotation and the ability to hold organisations with poor reporting outputs accountable will improve overall corporate and ESG reporting.
Philosophy and process	Philosophy	No managers have openly stated that they have not constructed an ESG belief system or investment approach.
	Process	We have identified a 3 - 4 stage process of ESG integration: 1) Research 2) Portfolio construction 3) Stewardship 4) Collaboration These different stages provide a robust structure for us to assess a manager's ability to efficiently integrate ESG factors.
	Policies and disclosure	The following reports/policies were used by managers to guide their RI operations: ● Proxy voting guidelines ● ESG/stewardship reports and policy frameworks ● Climate reports ● Treating Customers Fairly and Conflict of Interest policies
	Timeline	Progress in RI should be considered in light of RI practices, codes, regulatory improvements and asset class application simultaneously evolving over time.

Theme of interest	Discussion	Insights
ESG research coverage	The 'ESG unicorn'	The question that investors and consumers are asking is whether anyone has identified the 'ESG unicorn' – the one service provider who incorporates ESG factors with a high standard of efficiency, and achieves all investment and RI outcomes due to the right use of data, research and ESG themes.
	Local, global or both?	To supplement ESG data limitations that asset managers are facing, they use both local and global service providers to provide them with international perspectives of best practice, and case studies and research that can be applied to the local context.
	Use of data and new technology	The use of artificial intelligence has a role in combing through databases to gather uniformity and patterns in data, which can support effective decision making in the investment process.
	Data consumption	Managers have responded that the flow of ESG information and data is used across teams from the analyst level to the executive level.
Materiality and measurement	Risk and return	Managers still believe that ESG integration assists in creating the best environment for a business' longevity and its long-term growth potential. They have cited research papers that provide evidence that suggests a combination of the below occur: ● Long-term improved financial performance ● Downside protection during social and/or economic crises ● Improved disclosure.
	Materiality	Most managers have reported that they use a qualitative materiality approach to provide context to the quantitative data available. Analysts consider materiality in their evaluations to maximise opportunity without taking on excessive risk.
	Reporting frameworks	The Global Reporting Initiative and the Sustainability Accounting Standards Board frameworks are suggested as essential and complementary given that the former addresses externalities and the latter addresses financial materiality. The Johannesburg Stock Exchange Sustainability and Climate Disclosure Guidance followed by the International Sustainability Standards Board are expected to be the next foundation in improving disclosure and identifying greenwashing practices. The Task Force on Climate-related Financial Disclosures is useful for climate risk disclosure.
	ESG scoring and ratings	ESG rating frameworks for individual shares are less preferred. The use of numeric or alphabet scoring serves as a primary indicator of risk or opportunity. ESG analyses and considerations are getting increasingly critical as they lead to an enhanced understanding of companies and the extent to which they make a sound long-term investment opportunity.

Theme of interest	Discussion	Insights
Stewardship	Engagement	Some issues listed by asset managers that they believe require extended engagement include: ● a lack of data consistency in companies' sustainability reporting ● sustainability reports that have more information on a company's achievements compared to their sustainability limitations or detailed risk analysis ● the amount of information against the actual value of reporting and insights deduced ● encouraging companies to increase their ESG disclosures.
	Voting	Engagement and resolutions that are constructive, continuous and proactive are preferred over routine voting at general meetings which might lead to little or no positive and meaningful outcome.
	Fixed income	Engagement in fixed interest is more complex as issuers are often state or parastatal entities. In the case of corporates, they can engage through their equity teams at annual general meetings where they hold the share. To ensure fairness in engagements, managers have noted that while the JSE debt-listing rules have improved to appoint a debt officer to protect bondholder interests, there is more work to be done around the responsibility and independence of such an officer.
Transparency	Corporate sector	We found that asset managers have been accurate in highlighting sector-specific materiality matters when interpreting data. The measurement of risk, and the resultant engagement strategy, within the company is necessary.
	Benchmarks	Managers have suggested that, when advocating for bespoke metrics or imposing mandate restrictions of any kind, the same is required for the traditional benchmarks that they are being measured against.
Regulatory landscape	The need for balance	We are seeing an ever-increasing regulatory environment as market complexity increases with some market players using regulation as a tool to police participants into compliance.
	Public policy participation	Asset managers have cited that participating in public policy regarding ESG-related frameworks and initiatives is in their best interest.
The evolution of investment management	The ESG competency	ESG and niche skills will be required to discern the growing landscape. Systems will be required to capture and report ESG inputs and outcomes.
	ESG reporting in financial statements or separately disclosed?	Placement of the ESG-related material is irrelevant. Meaningful information is needed whether metric-based or qualitative.
	Elevated expectations	Company practices will continue to be under scrutiny as society places increased pressure on businesses.
	ESG becomes traditional finance	There will be an increased focus on ESG in company analysis. Market cap-weighted benchmarks have to evolve for impact measurements.

Key findings

As collaboration is one of the Principles of the PRI, we wanted to gain a better understanding of the affiliations landscape in the industry.

Our investment affiliations:



United Nations Principles of Responsible Investment (UN PRI)



Code for Responsible Investing in South Africa (CRISA)



United Nations Global Compact

United Nations Global Compact (UNGC)



Association for Savings and Investment South Africa (ASISA)

A snapshot of affiliations in the South African investment industry

Committed AUM

Code for Responsible Investing in South Africa (CRISA)		R5.1trn
Principles for Responsible Investment (PRI)		R4.8trn
Task Force on Climate-related Financial Disclosures (TCFD)		R4.4trn
Climate Action 100+		R4.4trn
Association for Savings and Investment South Africa (ASISA)		R4.2trn
Carbon Disclosure Project (CDP)		R3.7trn
Sustainability Accounting Standards Board (SASB)		R1.8trn
King Code IV		R1.8trn
Global Reporting Initiative (GRI)		R1trn
International Integrated Reporting Council (IIRC)		R1trn
Global Impact Investing Network (GIIN)		R647bn
Southern Africa Venture Capital and Private Equity Association (SAVCA)		R280bn
United Nations Global Compact (UN GC)		R280bn

All figures have been rounded

Observations

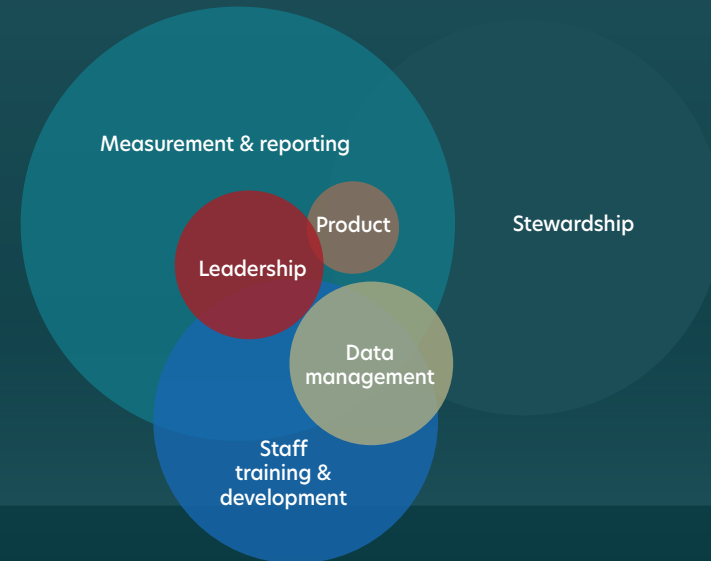
From the outcomes from our engagements, we can identify four distinct patterns:

- 1 Compliance** – Ongoing participation toward any affiliation can become a compliance exercise, with the pledges used to show the credibility of a manager or their ESG competency.
- 2 Balance** – Asset managers are considering the practicality of being affiliated to an industry body and balancing out the responsibility that it requires.
- 3 Research** – Organisations that are well-funded or have a subscription model that provides them with access to a global investor client base tend to produce relevant, applicable responsible finance research for their signatories to use.
- 4 Size** – AUM is a strong indicator of the number of affiliations an asset manager can endorse.

Strategic focus areas

We sought to understand what ESG focus areas were seen to be the most material for asset managers. After consolidating the feedback we received, we identified six areas that were deemed as significant.

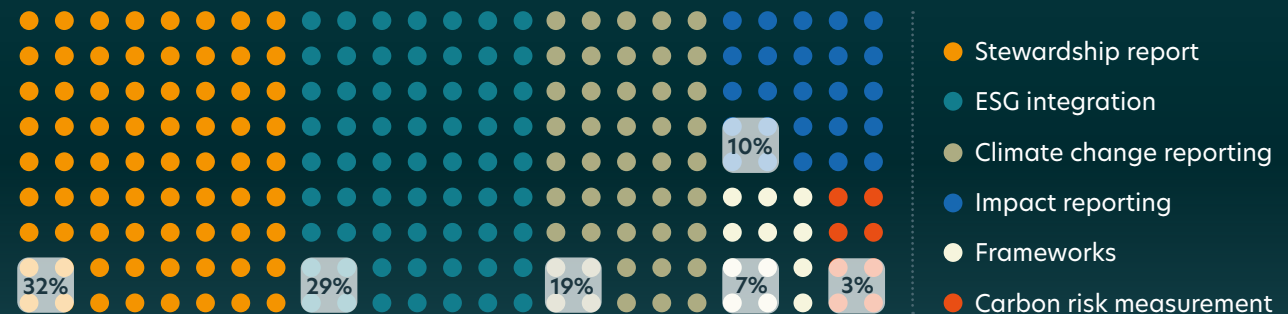
The graphic on the right displays six overlapping circles in varying sizes that are proportional to the number of responses per category, therefore indicating their relative importance, where measurement and reporting are the primary priorities, and product the least one.



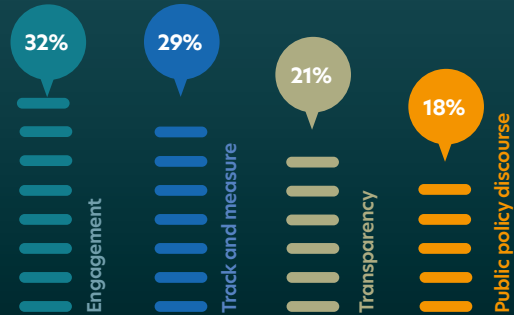
30% of the responses relate to measurement and reporting, making it the category with the most responses identified as a key focus area.

32% of these responses referenced a stewardship report or an active ownership report as an active workstream that supports transparency and accountability efforts. 29% of these responses mention ESG integration, specifically in how it is being managed to fortify the managers' investment processes, which we view as a positive outcome in the drive for increased integration of ESG factors.

Measurement and reporting (30%)



Stewardship (27%)



Nearly a third of the responses speak to stewardship, indicating the proven importance of this topic. In an effort to further break down stewardship, we sub-categorised asset managers' feedback into four active ownership practices.

Engagement

The majority of engagement practices include:

- issuing letters to the top 100 listed companies,
- reporting shortcomings related to climate,
- improving disclosure related to ESG issues,
- setting clear sustainability or ESG-related objectives at board level,
- addressing ESG skillsets at board level, and
- promoting considerations of social risks facing companies.

Track and measure

29% of responses related to measuring and tracking:

- ESG gaps in small and mid-cap companies,
- incentive structures for senior management, and
- corporate governance disclosures.

Transparency

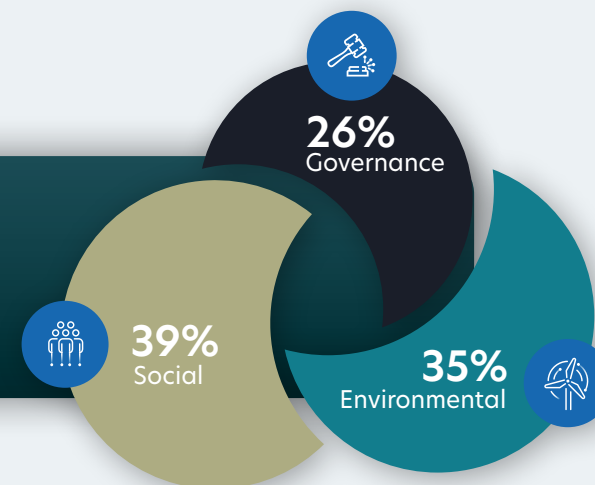
This refers to efforts to report and disclose a managers' RI framework, ESG policy and voting records through a stewardship report or other publications.

Public policy discourse

Public policy discourse refers to managers using their affiliations or signatory status to help engage on national or industry-specific policy development.

Structural ESG themes

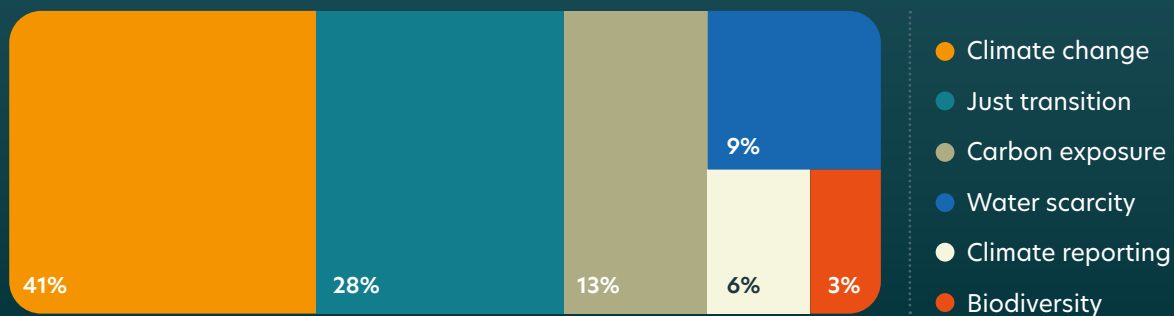
To better understand the specific themes and sub-themes that asset managers view as being material, we explored the ESG themes that asset managers have categorised as a priority:



Responses appear to show a surprising balance of environmental, social and governance considerations. It is important to note that it does not suggest, at this stage, how themes relate to the magnitude of risks that may arise from them.

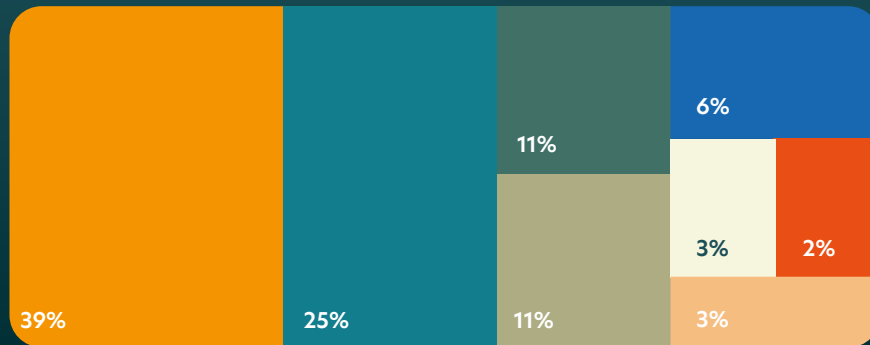
We narrowed down the specific ESG risks and opportunities that asset managers considered in their investment processes and the extent of which the respective ESG themes were considered, relative to each other:

Environmental



The themes stated within these categories include net-zero emissions data, Sustainable Development Goals (SDG) and the looming shift to cleaner energy generation.

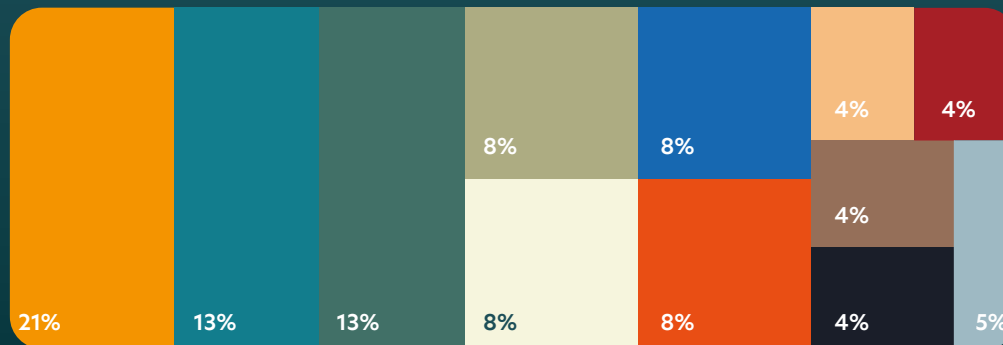
Social



- Social change
- Diversity
- Health and safety
- Just transition
- Say on pay
- Inequality
- Inflation
- Education

- The specific responses under these categories relate to transformation or B-BBEE, socio-economic upliftment of lower income communities, achieving the targets set out in the SDGs and the National Development Plan, diversity and inclusion and gender equality.
- Two of the most pressing issues we face - inequality and education - received low responses. This is a surprising finding which could indicate that they do not have a significant bearing on investment outcomes and processes.

Governance



- Remuneration & KPI
- Board composition
- Board oversight
- Board competency
- Board diversity
- Board independence
- Ethical leadership
- Overall corporate governance
- Conflict of interest
- Anti-competitive behaviour
- Shareholder rights
- Capital allocation

- Remuneration, KPIs and the combination of the board-related factors (composition, oversight, competency, diversity and independence) comprised majority of the responses. This finding is expected as it can be verified through the voting activity of the asset managers.
- We have found that there is a belief that value creation for investors is closely associated with how the board is composed as well as how the executive members are evaluated and compensated.
- Asset managers are also greatly concerned with the overcompensation of board members and if it is proportional to the members' performance and output.

Evaluation of top ESG risks

In evaluating the ESG integration aspects in asset managers' processes, we requested them to identify their top ESG risks of their respective investee companies, where we then categorised them for materiality and valuation.

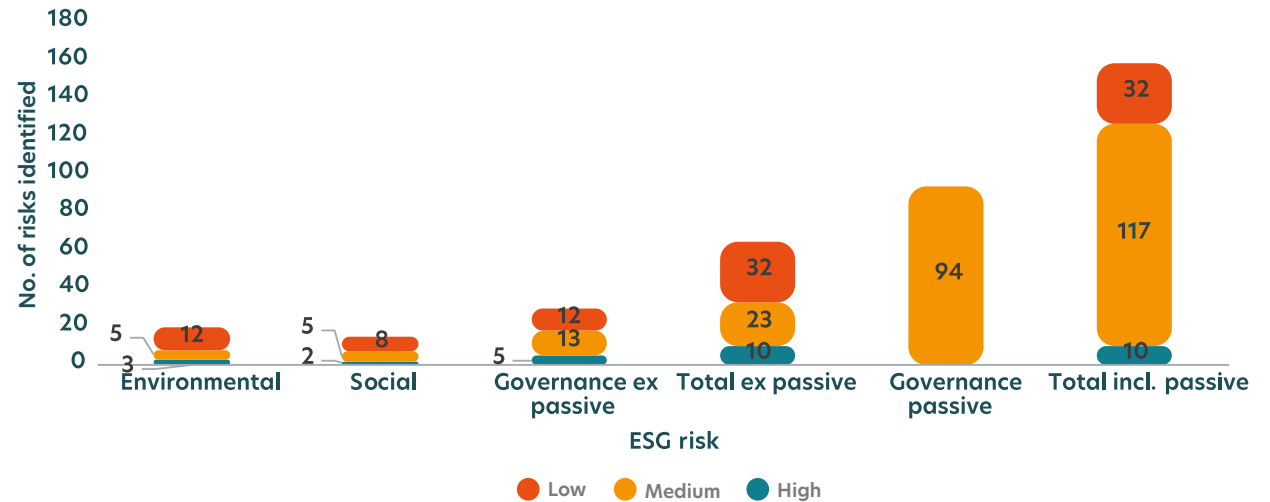
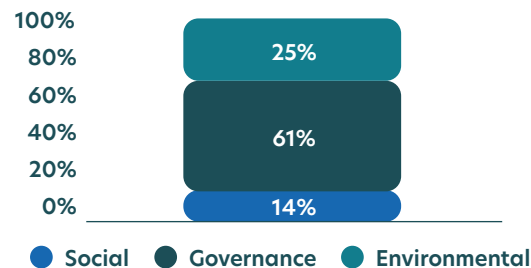
We gathered a total of 159 ESG risks that we have categorised from low-, medium- and high-risk and separated them between active and passive portfolio management, given that stewardship efforts and their portfolio actions will differ respectively.

Key insights include:

- Medium risks dominated the total risks due to passive governance-related risks
- Governance risks feature strongly across low-, medium- and high-risk categories
- Environmental and governance risks dominated the high risks identified.

Total asset manager engagements with investee companies

ESG engagement breakdown



- Engagement with investee companies is strongly centred on governance factors relative to social and environmental factors. This is not surprising given that governance affects all companies, in that environmental and social issues are not as uniform and they have different levels of impact on companies in different sectors. Additionally, governance disclosure on all companies is a regulatory requirement in some respects, and it is relatively better understood by investors.

Top focus areas in each category

Environmental coverage	Social coverage	Governance coverage
Climate change strategy	Social change	Remuneration and KPI
Carbon exposure	Just transition	Overall corporate governance
Just transition		Board balance and related shareholder rights

Stewardship action taken	%
Engage management or investor relations	71
Engage the board or chairperson	27
Formal letter to the board	2
Total	100

- The above data suggests that most of the engagements have occurred within the management and investor relations division of investee companies.
- Some managers have cited that, depending on the size of assets invested, the relationships and size of the company, investors may have different avenues of communicating the issue they are trying to resolve.

We also sought to understand how ESG risks were managed, how they affected ESG incorporation and what portfolio actions were taken with an evaluation framework. From the top 10 risks identified, we



risks tabled were part of the shares in the asset managers' top 10 holdings (through the shares they held in their investment portfolios).



risks tabled were not held in their invested shares - they had a zero holding.



risk tabled was prevalent in a small holding in their investment portfolios.

ESG reporting

There is a growing body of research that indicates the materiality of ESG factors on investment portfolios. Additionally, ESG reporting could potentially unlock significant information on the management of ESG factors and their role in achieving long-term value creation. To this end, we have reported on three ESG metrics - climate change (carbon metrics), gender diversity and ESG integration - to measure ESG performance in some of our portfolio solutions, namely:



Performer

AF High Growth

Stable Focus

Conservator

AF Houseview Income Target

AF Real Return Focus

AF Accelerator



Climate change

We have adopted the Weighted Average Carbon Intensity (WACI) metric to report the carbon intensity of the aforementioned portfolio solutions.

The equity component of our domestic portfolios reflects a WACI range of 220 - 450. The equity component of our global portfolios can be split into a developed market allocation which reflects a range of 90 - 160 and an emerging markets allocation which reflects a range of 260 - 340.

For comparison - we have found that a WACI measure around 450 means a portfolio is highly vulnerable to carbon-related risks and a measure around 90 indicates that it is relatively protected from carbon-related risks.

Over the past six months, we note that domestic WACI across all our solutions has marginally weakened. This is due to our appointed managers increasing their exposure to the resources, construction and chemicals sectors relative to the FTSE JSE ALSI and the FTSE JSE Capped SWIX Index due to the heightened demand for platinum and fossil fuels such as coal as a result of the Russia/Ukraine conflict.

These exposures have contributed to positive portfolio performance over the period, but have undoubtedly contributed negatively to the portfolio WACI ratings in the short term.

Portfolio solution	WACI score
Performer	355
High Growth	326
Conservar	343
AF Real Return Focus	407



Gender diversity

We are pleased to note that South African companies have embraced female representation on boards and our portfolios reflect this positive outcome. Locally, our portfolios are in line with female board representation being close to the 30 - 35% range, broadly in line with the FTSE JSE All Share Index. Both our local and global portfolios are in line with their respective benchmarks. Globally, the diversity metric being reported by Mercer is approximately 50 - 55%. This is the percentage of companies that meet the 30% or more diversity target. In our conversations with Mercer, we understand that the global investment manager universe and investable companies have a long journey ahead in improving diversity.

Portfolio solution	Female representation
Performer	31%
High Growth	30%
Conservar	30.6%
AF Real Return Focus	35%



ESG integration

Our investment process is focused on assessing asset managers on their approach towards integrating ESG considerations into their respective investment decision-making processes. These ratings apply to the full scope of the investment strategy and its underlying assets, not solely to equities.

The portfolio ratings represent a weighted average of the ESG ratings of individual managers within a given portfolio as determined through our due diligence processes. ESG 1 signifies a leader in the integration of ESG factors and it goes down to ESG 4, indicating little integration of ESG considerations.

Overall, most of our portfolios have higher-rated portfolio ratings relative to their respective benchmarks.

Portfolio solution	ESG integration rating
Performer	2.3
High Growth	2.7
Conservar	2.6
AF Real Return Focus	2.5

Proxy voting analysis

In 2021, we voted over 20 000 resolutions through our appointed asset managers across locally-managed equities.

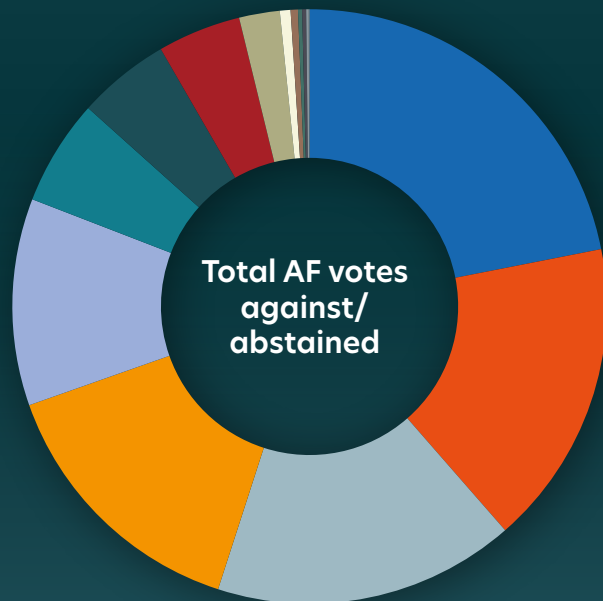
We provide proxy-voting guidelines to our appointed asset managers that they use to vote on our behalf. Managers disclose the outcomes of their engagements to us periodically through submissions, report back meetings and through ad-hoc meetings that we use to engage on ESG matters within our portfolio solutions.

The table below gives a breakdown of the total number of resolutions and how many votes were used *for* and *against*:

No of resolutions 20 408

No of resolutions voted for 17 738

No of resolutions voted against 2 670



- Remuneration policy 21.91%
- Other 16.66%
- Election of directors 16.41%
- Issuance of shares 14.63%
- Directors remuneration 11.26%
- Shares under director control 5.76%
- Appointment of auditors 5.03%
- Loan/financial assistance 4.53%
- Share buybacks 2.21%
- Share option scheme 0.58%
- Political donations 0.40%
- Accept financial statements and statutory reports 0.22%
- Climate policy and disclosure 0.26%
- Dividend related 0.14%

From our evaluation of their engagements and the subsequent data they provided, we have found that most of the dissenting votes relate to:

- remuneration and remuneration implementation policy,
- election of directors,
- appointment of auditors, and
- the capital structure aspects of South African companies.

Remuneration policy

From the total number of proxies, remuneration policy received a substantial number of all *against* votes. In combination with directors' remuneration, it constituted 33% of all our proxy votes. Remuneration structures of the executive and senior management teams are linked to both KPIs and company strategy, making them key material considerations for engagement.

Election of directors

Many of these votes were used to vote against the re-election of directors that are not independent or are members on a number of other boards.

Issuance of shares

A base view by managers on the category of the issuance of shares is to vote *against* in an effort to prevent the dilution of shareholder capital.

Loans and financial assistance

The votes against these resolutions relate to the provision of financial assistance to the company in terms of sections 44 and 45 of the Companies Act where a loan is provided to directors or subsidiaries of the group.

Managers have cited that the companies they vote *against* on this resolution generally do not provide adequate rationale for the financial assistance provided.

Share buybacks and share option schemes

Managers have voted *against* these transactions when the terms of transaction, quantity or limit is not provided.

Climate policy and disclosure

Whilst these votes do not appear to be significant compared to other resolutions, it is a relatively new category of resolutions added to traditional governance-related ones. The assessment of votes *for* and *against* suggests that views around progress made by companies vary. Our engagement with managers has shown that they do not want to impede the initial climate policy and disclosure from companies as that alone has been an improvement on recent engagements with them.

Other

We have bundled the range of smaller resolutions including, but not limited to, matters concerning:

- audit,
- risk,
- social,
- ethics,
- transformation,
- property and investment,
- human resource and sustainability committees.

We have found that managers have lost confidence in the various committees' ability to function independently due to a board member having a long tenure on the committee or a member being in too many committees. The combined percentage of votes against certain resolutions is significant and we continue to monitor the rationale for *against* votes in this respect.



Global stewardship

While we had a large focus on conducting our engagements with local asset managers, we also wanted to share the global stewardship activities of our strategic investment partner, Mercer Investments.

Their manager engagement survey analysed

120+ asset managers

200+ investment strategies

170 investment strategies across

130+ funds



Focus areas included:

- General approach to stewardship
- Climate change
- Human rights and labour practices
- Diversity, equity and inclusion (DEI)

The engagement breakdown was as follows:

380+ Climate-related engagements provided by managers **77%** of managers had engaged specifically on climate change with company management

220+ Diversity-related engagements provided by managers **88%** of managers had a diversity policy in place, the vast majority of which include metrics and targets

210+ Human rights-related engagements provided by managers **56%** of managers have conducted engagements specifically regarding labour practices and human rights.

Source: Mercer ISE Stewardship Report 2021



Proxy voting highlights

As a shareholder of publicly listed companies, Mercer Investments has the right to vote at shareholder meetings. The statistics below represent the aggregated results of voting activities across all their segregated mandates.

Summary statistics across all their segregated equity funds:

509 109

Total proposals available

99.3%

% of proposals voted on

12 967

Total unique meetings voted at

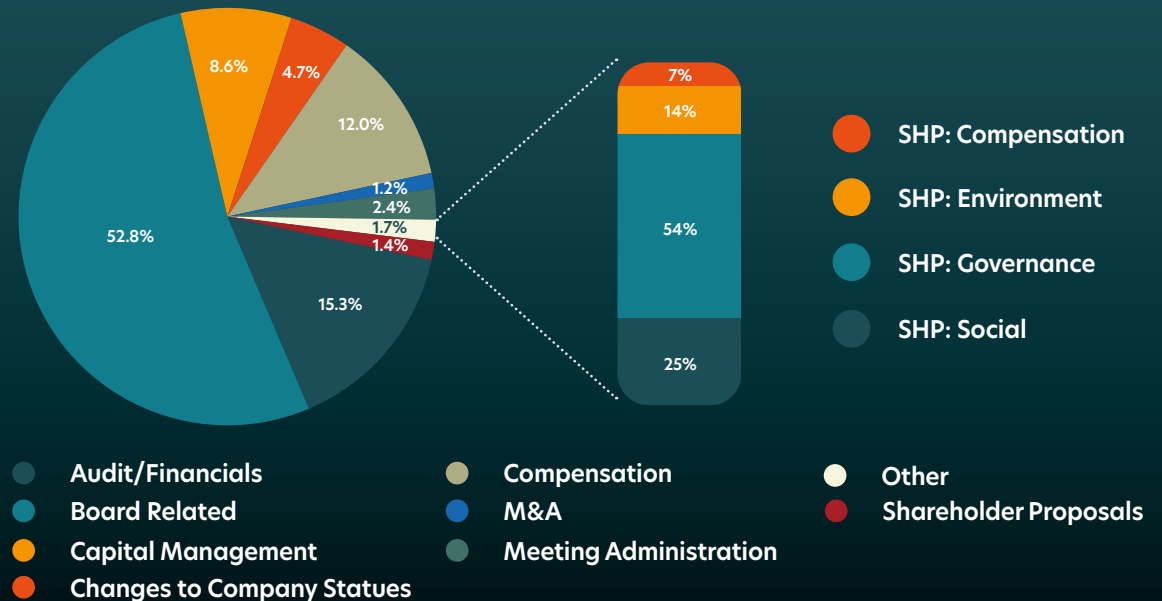
76

Total countries voted across

Source: Mercer ISE Stewardship Report 2021

Proposals by topic:

Board-related proposals represent over half of all proposals voted on with shareholder proposals (SHP), only making up 1% of all proposals.



Source: Mercer ISE Stewardship Report 2021

By including global views on stewardship, we are able to complement local ESG themes with themes playing on the global stage.



We believe that, while we all work towards a more sustainable future, we have different roles to play and different advantages to leverage. One way that we practice active ownership and stewardship is by leveraging our broad networks and influence in the industry.

I hope this report provides greater clarity on the state of responsible investing in South Africa and illustrates both the opportunities and the shortcomings that managers are experiencing in their respective responsible investing journeys and how we can collectively achieve meaningful engagements and outcomes now, and into the future.

Access our full
stewardship
report here.



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The value of a portfolio can go down, as well as up, as a result of changes in the value of the underlying investments, or of currency movement. An investor may not recoup the full amount invested.

All policies issued or underwritten by us are linked policies, under which no guarantees are issued. The policy benefits are determined solely on the value of the assets, or categories of assets, to which the policies are linked.

Past performance is not necessarily an indication of future performance. Forecasts and examples are for illustrative purposes only and are not guaranteed to occur. Any projections contained in the information are estimates only and are not guaranteed to occur. Such projections are subject to market influences and contingent upon matters outside our control, so may not be realised in the future.

Please be advised that there may be supervised representatives.

Company registration number: 1997/000595/06.

Pension Fund Administrator number: 24/217.

Insurer number: 10/10/1/155.

Postal address: PO Box 786055, Sandton 2146.

Physical address: 115 West Street, Sandown 2196.

Telephone number: +27 (0) 11 505 6000.

The complaints handling procedure and conflict of interest management policy can be found on the Alexander Forbes Investments website: www.alexforbes.com