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Address at the launch of the Government Employees Pension Fund (GEPF) Policy Statement on Responsible Investment

Delivered by Lesetja Kganyago on behalf of:

Pravin Gordhan

Minister of Finance

Honoured Guests,

Chairperson of SCOF, Mr Thaba Mafumadi,

Chairperson of the GEPF, Mr Arthur Moloto,

Allow me to begin with a word of appreciation for the wisdom of the first board of the GEPF, who planted the seeds that led to our dinner tonight. Chairman Martin Kuscus and his board's investment committee recognised the need to situate the investment strategy of the Fund in a broader frame of reference, and identified the United Nations Principles of Responsible Investment as an appropriate benchmark.

The decision in 2006 to register the GEPF as a signatory to the UN Principles was the start of a process, the outcome of which we are able to celebrate this evening.

The UN principles are necessarily formulated in broad terms, taking into account the great diversity of environmental, social and governance challenges faced by the global family of nations. The Board of the GEPF has rightly engaged with these principles not as a set of norms to be uncritically implemented, but as a point of departure for developing a framework suited to our own context, our own history and our own development challenges. That it has taken several years to reach this point is no doubt in part a reflection of the ponderous nature of board committee deliberations, but it is of course also a consequence of the complexity of the task – and of the need to reflect deeply on the particular circumstances and priorities of an investment mandate in our times, and in our environment.

Indeed, it is hard to think of any single decision process with quite the same importance for South Africa's long-term growth, quite the same potential impact on people's lives, as the GEPF's investment strategy.

It is not just that this is a large pension fund by international comparison, with a membership base of some 1.5 million, and funds under management equivalent to over a quarter of South Africa's GDP. It is not just that the GEPF now has a well-diversified portfolio, with substantial equity investments and a growing property portfolio, whereas twenty years ago it was almost entirely invested in government bonds. This is an unusually large fund, but there are other countries with substantial social security or public sector retirement funds. What is unique, however, is our investment environment, and the special challenges of economic and social transformation that we face.

And so the GEPF Board has quite correctly sought to locate its investment strategy within a set of internationally tested principles, but has also rightly set out to interpret these for our own circumstances and to provide a frame of reference that addresses South Africa's growth and development path.

SA is a member of the international community. We can't just adhere to international principles. We should continue to shape these principles as they evolve.

Our growth path is not a fixed and determinate road map, and similarly the GEPF's investment policy statement is really the start of a journey and not the destination.

It is not a journey that the GEPF can undertake alone – indeed, the Government Employees Pension Law specifically recognises that the Fund's investment strategy as a responsibility that is shared with the Minister of Finance. It is important to understand that the Government's pension promise to civil service employees is in effect a promise made on behalf of taxpayers. And so the Minister of Finance, as custodian of the public finances, has a very special interest in both the administration of the fund and the investment of its assets. This is given effect in an agreed investment mandate, which in turn is implemented by the Public Investment Corporation.

The Minister has recently met with the chair and members of the Board, and agreed that we will hold further discussions on the development of a new investment mandate, drawing on the experience already gained but also geared to a new growth and development path for a more prosperous and a more just South Africa.

The GEPF Statement of Responsible Investment provides an important frame of reference for this mandate, but the course has still to be charted in detail. There will no doubt be different views on some of the choices to be made. This is for the good: robust debate is better than blindly following a course. The principles and our policy statement are there to guide the debate, but not to determine the outcome. So there is still hard work to be done – and indeed I am sure that in a few years' time we will be ready to revise this statement, drawing on experience and insights gained in the period ahead.

When I say there is hard work to be done – Mr Moloto, I hope you will allow me to offer some thoughts that your Board might wish to take further – when I say there is hard work to be done, I don't just mean that the analysis is difficult; in truth that is invariably the easier part. What I mean is that it is not enough to have laudable aspirations, these must be translated into action. To put it bluntly, it is not enough to invest responsibly – we also have to take responsibility into the investment process, which means we have to boldly confront irresponsibility and short-termism.

And this takes courage.

It is worth recalling, for example, that one of the first recorded instances of responsible shareholder activism was a resolution brought against Dow Chemical in 1969 for its manufacturing of Agent Orange, at a time when US public sentiment was still dominated by Cold War thinking.

It is worth remembering that responsible investment campaigns gained their greatest momentum in the 1980s as a vehicle of active global opposition to apartheid – beginning with Reverend Leon Sullivan's code of conduct for American businesses, and ending with financial and trade sanctions that progressively strangled the apartheid economy.

So there is a history of social activism here, of bold public campaigns, of exposure of corporate greed and abuse, of courageous promotion of human rights in the face of powerful vested interests.

We now have a plethora of global initiatives aimed at raising the profile of environmental, social, human rights and governance concerns. The Principles of Responsible Investment, facilitated by the United Nations as a shared commitment by major institutional investors, is one amongst many such initiatives. Its signatories have increased from 50 in four years to about 700 now, representing almost US$20 trillion in assets under management.

The signatories to this initiative have committed:

1. To incorporate ESG issues into their investment analysis and decision making process
2. To be active owners and incorporate ESG issues into their ownership policies and practices
3. To seek appropriate disclosure on ESG issues by the entities in which they invest
4. To promote acceptance and implementation of the Principles within the investment industry
5. To work together to enhance their effectiveness in implementing the Principles
6. To report on their activities and progress towards implementing the Principles.

These are excellent commitments, and in adopting a responsible investment policy statement, the GEPF has taken an important step forward in meeting its obligations as a founding signatory to the UN Principles.

Yet this is not enough, and there is a risk here that our endorsement of a well-intentioned collective initiative will lead us into complacency about the hard work that social activism requires.

To give meaning to these principles, we must have the courage to be investor activists, even when it is awkward or inconvenient to do so.

We can all take pride in the fact that we have got off to a promising start. Under Brian Molefe's leadership the PIC has established an already impressive reputation as an activist shareholder, on behalf of the GEPF. As he leaves the PIC, commend his achievements in building that institution. He is leaving behind a very competent team that is capable to execute the new GEPF investment mandate. South African corporations know that the GEPF as a shareholder is interested in their commitment to corporate governance and their compliance with the King Committee principles. South African corporations know that the GEPF is interested in their progress towards black representation and appointment of women as directors and managers. South African companies know that the GEPF is interested in their remuneration policies and practices.

Yet there is more that has to be done.

- Most large companies now incorporate environmental considerations into their investment plans and reporting, and we are making progress in energy demand management and environmental management. But this is not enough. South African scientists have been at the forefront, internationally, of developing strategies for confronting climate change. We are now in the early stages of investing in major new electricity and liquid fuels projects that will shape our energy technology path for the 21st century. Responsible investment is not just about individual corporate compliance with agreed reporting standards, but far more importantly it is also about forging a national consensus about a long-run energy investment path consistent with our global carbon reduction commitments. The GEPF is by far the largest single investor in our main energy utility, Eskom. Does investor activism confine itself to equity investors and not bond lending? What do our responsible investment principles mean for the conversation we need to have with Eskom, and the Department of Energy, about the direction of our electricity generation strategy, and the electricity price adjustment path?

- Similar questions can be asked about our transport sector, or the communications and information technology industry, in which the regulation of competition between public and private sector players involves a range of difficult considerations. Again, the GEPF is a major investor, both in the public and the private sectors. What does responsible investment imply? Have we explored options for investment in our metropolitan bus rapid transport projects, for example? Can we play a role in financing the roll-out of broadband IT services in schools and rural areas? We have set aside funding for investment in a Pan-African Infrastructure Development Fund. Are we clear about our priorities for regional infrastructure integration – what kinds of investment will yield the most gains in trade and development promotion? Should we perhaps be pursuing partnership opportunities with the Development Bank of Southern Africa for investment in municipal infrastructure and services? Should we support investment by the private sector in addressing municipal service delivery capacity problems?

- A third area in which we need to enhance available vehicles for financing development is that of enterprise development, broad-based empowerment and employment creation. This covers a wide range of activities, in which several development finance institutions and agencies are already active players. The GEPF has set aside funding in its *Isibaya Fund*, which has invested about 2 per cent of the total portfolio in supporting small-sized BEE companies. But the kind of expertise that is needed to manage venture capital partnerships and ensure that financial risks are appropriately managed is highly specialised. Too many South African investors with interesting ideas tell us that South African banks and fund managers are not forward-looking enough, are not bold enough in supporting entrerpreurial risk-taking. This is therefore an area in which we should be building partnerships with the wider banking sector and development finance institutions – so that as we step up our commitment to enterprise investment and job creation, we do so as part of a network of development agencies, capable of pooling risks and drawing on the best available expertise. This is not as easy as it sounds: private sector players are in competition with each other and are rightly constrained in their capacity to collaborate with one another. It therefore falls to the public sector enterprise development agencies, and the GEPF as a major source of development capital, to construct an appropriate platform through which enterprise development can be financed on reasonable and sustainable terms.

- I need to draw attention to a fourth arena of social responsibility in which the GEPF has a key role to play. Our social security arrangements are both fragmented and inefficient. Comprehensive social security reform proposals were tabled in the report of the Taylor Committee of Inquiry eight years ago. If we are to make more rapid progress in implementing these reforms, we need to address the institutional divide between public and private sector arrangements, which is a legacy from a previous industrial relations era. As part of a comprehensive and integrated social security and retirement system, we now need to bring the GEPF under the full jurisdiction of the Pension Funds Act and the Financial Services Board. We need to align the public and private sector arrangements for unemployment insurance and compensation for occupational injury. We need to find a common approach to funding and subsidising health insurance. There are debates in progress on these matters, there are forums through which ideas can be exchanged and tested. It is time for the GEPF to be heard.

- Fifthly, we should remind ourselves that financial and corporate governance face very special challenges in our circumstances. Our financial institutions have stood up well in the past four years, despite the immense turbulence of the global financial crisis. Our stock exchange is modern and well-run, and South Africa is well-respected for its accounting standards, governance protocols and audit capacity. But there is no room for complacency. We need to achieve greater transparency around procurement processes, and we need to step up the fight against commercial crime and corruption. So we need to ask what role the GEPF can play in improving financial governance in our country – as a responsible investor, but also as a retirement fund with its own administrative and governance challenges that need to be addressed forthrightly.

These are some of the challenges ahead, Mister Chairperson and Board Members. I would be remiss in my duties if I didn't also remind you that we have a fiduciary and joint responsibility to ensure that the Fund invests prudently and wisely, because the wellbeing of our pensioners and employees depends on sound and sustainable financial returns. This also means that we are required to keep down the costs of fund management and administration. As your actuaries will be able to explain more exactly, unnecessary costs of active fund management are the single most important drain on future pension entitlements – even if this operates indirectly through the annual inflation adjustments in a defined benefit scheme such as ours.

If I have set out a rather daunting agenda of further work, allow me to conclude by pointing out that there is a wider community of stakeholders who share the investment responsibilities we have discussed. Much of this belongs on the agenda of the Financial Sector Charter forum, which also provides a platform for exploring aspects I have not touched on – housing finance, and access to financial services, for example. If these are challenges for the GEPF, these are equally challenges that need to be addressed by the fund management and investment industry more widely. To give practical content to this objective, we need a conversation which brings investors, development finance institutions, organised labour and key government and private sector stakeholders together. Responsible investment is a collective undertaking, informed by appropriate principles, but also implemented through appropriate processes of engagement. This joint engagement is the challenge to which we must turn in the period ahead, informed by both the United Nations principles of responsible investment and by a deeper understanding of South Africa's particular social development and economic growth imperatives.