MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

ADDRESS AT THE LAUNCH OF THE CODE FOR RESPONSIBLE INVESTMENTS IN SOUTH AFRICA (CRISA)

MINISTER OF FINANCE PRAVIN GORDHAN
19 JULY 2011

Honoured guests

Allow me to begin by expressing my appreciation to the Institute of Directors, the members of the King III Committee, as well as the asset managers and asset owners involved in bringing about this important Code. The launch of this Code for Responsible Investing in South Africa (CRISA) makes South Africa only the second country in the world to have a code for institutional investors (the other country being the United Kingdom), and that should certainly make South Africa and the financial sector proud.

As long-term investors, institutional investors have the responsibility to ensure that they invest in a way which promotes long-term sustainability. While there is progress in terms of documents like CRISA, there are also formidable challenges in our fast-changing world, especially after the financial crisis. The origins of ethical investment campaigning lie with the seminal campaign challenging companies trading with apartheid South Africa, and exposing sweatshop conditions in the supply chain of multinationals. So South Africa features in respect of CRISA in an interesting way, with campaigning for ethical investing having its origins in the time of strong disinvestment campaigns against South Africa in the 1980's.

As CRISA is launched, an important factor to consider is how to ensure that the term ‘responsible investing’ begins to incorporate as wide a set of considerations as possible. In the South African context that would mean beginning to understand and appreciate the challenges that our own history has left us, particularly in respect of economic and social infrastructure. Education and training has to play an important role in our society if we are to overcome the legacy of our past and position country and economy differently in order to progress along the economic value chain.

Climate change and the challenges of adaptation and mitigation also pose formidable challenges to business and government, and more importantly to the millions of ordinary people across the African who have to cope with the effects. We need to reengineer our mind-sets to anticipate challenges that will emerge from climate change, and also make the right investment decisions in the long term that will enable South Africa and the African continent to cope with those challenges.

Rural development for example, in South Africa and other parts of Africa, is a challenge; on the one hand we do not want the continuous migration of people to urban areas that are not yet equipped to handle those inflows, and on the other it is also the intention of government to develop rural areas so people find better livelihoods in those areas instead of leaving them. Work that the Department of Rural Development and Land Reform and others are engaged in relating to this could open up new ‘out of the box’ manners in which to think about investment.

In South African context, microfinance and the financing of young entrepreneurs are also key issues. If we are not able to create jobs fast enough within the domestic and the global economy, generating entrepreneurship, especially among our young people, and ensuring effective access to microfinance is going to be an important challenge for all of us to cope with.

We do have, in the vein of developmental and sustainable thinking, an example in South Africa. The Government Employees Pension Fund (GEPF) recently launched its Developmental Investment Policy, which highlights the commitment to invest in a way that will benefit members of the fund in the long-term, while also contributing to addressing pressing challenges that the country and continent faces. Through the

DI Policy, the GEPF is committing 5 per cent of its assets (totalling about R45 billion) to pursue opportunities identified, with investments to be made through the Public Investment Corporation's Isibaya Fund. Investments will focus on four pillars: economic infrastructure, social infrastructure, sustainability projects, and enterprise development and broad based black economic empowerment. As at 31 May 2011, investments in these four pillars totalled R1.4 billion in disbursements with a further R3.3 billion in undrawn commitments.

Developmental investments such as these provide long-term investment opportunities that can yield good returns while contributing to a sustainable future. Such investments are also a good form of investment diversification, with returns uncorrelated to global market volatility. Business and institutional investors should take the lead in securing a sustainable future, in the wider sense of the word, and are urged to follow the GEPF / PIC example.

As we take account of investing in a way that addresses some of our country's challenges, we should also work together as a continent; business should be encouraged to think regionally and continentally. South African companies operating in other African countries should look at ways to contribute positively to these countries, and to uplift the communities in which they operate, thereby raising living standards across the continent. Opportunities on the African continent are significant and increasingly recognised by investors across the globe. This should create an opportunity for companies operating on the continent to work towards shared benefits.

The area of shared benefits is one which the world will increasingly begin to focus on: not just how to achieve growth in GDP terms or in terms of returns on investment, but how to achieve growth in a way that benefits all stakeholders in society. As we, through CRISA and similar projects, begin to look at the notion of responsible investing, the importance of transparency and integrated reporting, and the impact analysis of the investment we undertake, we must also reflect a lot more on how to get shared benefits in societies. If we don't have shared benefits, we give rise to social tensions that can make countries unstable and give rise to situations such as those seen in Tunisia and Egypt recently.

Another area as part of shared benefits approach is illustrated in some of the work done through a UK NGO looking at the 'value chain', from the saver and investor to the corporates in which investment take place. This chain needs to be looked at more closely, to ensure that the principles outlined in CRISA are making an impact, and resulting in significant transparency and changes in behaviour which results in benefits for all concerned in society. A contention is made by the NGO that a significant proportion of the population would like to see a portion of their retirement assets and other savings and investments designed to deliver a blend of social, environmental and financial returns. In the South African case, this could be extended to wanting to achieve developmental returns too. The key challenge is how to achieve this blend; how do we ensure financial sustainability, and at the same ensure that our mind-sets also allow us to focus a lot more on what this generation can do to make a difference to the next generation?

In this context, and particularly after the financial crisis, there is a great deal of concern about the culture of short-termism versus a long-term approach to investment. This short-termism played a crucial role in the recent financial crisis. The pursuit by company directors and investors of short-term performance and returns, contributed to the actions that plunged the world into the deep financial crisis we are still trying to emerge from. If our institutional investors and companies chase short-term returns and gains at the expense of our environment and the wellness of society, then society as a whole suffers. Some hundred million people lost their jobs around the world; a million people lost their jobs in South Africa. The revenue lost in our case was just over R60 billion as a result of the recession; the tax to GDP ratio fell to about 25% of GDP from 28.5% before the recession. It will take us another three to four years to recover from the impact of the recession. At the heart of the Code being launched today is the recognition of the importance of integrating sustainability issues, including developmental, environmental, social and governance issues into long-term investment strategies.

Government recently put environmental, social and governance (ESG) matters at the heart of investment decision-making with the new amended Regulation 28 of the Pension Funds Act. The new Regulation 28 requires pension fund trustees to consider ESG factors and broader developmental factors that may affect the sustainable long-term performance of an asset before making investment decisions.

An appeal I would make is that the current form of ESG might not adequately cover the range of developmental challenges we need to address as a country, and should be expanded.

Over and above the challenges of climate change, and how to ensure that South Africa and Africa can respond to it, we will find that the rest of the world is ready to invest in their own country and own technology, seeing the 'green economy' as a new opportunity for growth in their own economy. This could lead to a repeat of the historical anomaly where those countries that have particular needs, in this instance those arising from climate change, are subject to the innovation, R&D and technological capabilities of the developed world; the poorer countries will have to buy the technologies to cope with climate change from the developed world. The challenge for the investment community, as we approach our hosting of COP17 in Durban later this year, is to build a competitive R&D environment and create the technological capacity in Africa and South Africa, and ensure our relationship with the world in terms of how we cope with climate change doesn't leave us as second best as traditionally the African continent has been left. Surely, in the category of environmental factors affecting investment decisions, should make an impact on how we look at investment and returns in the African context.

However, responsible investing is not just about monitoring and engaging our investee companies; it is also about getting business to innovate. Finance and investment is critical to help our transition to a low carbon economy. If more people invest in greener and low carbon solutions, it lowers the cost of capital, making these projects more likely to succeed. Similarly, if more firms are implementing low carbon solutions, then the risk of *not* doing so rises, and the risk and cost of taking early action falls. We have yet to see innovations in finance and markets that could support low carbon growth. For example, a firm can easily get finance for a car or truck, but not for equipment that might lower their electricity usage.

The concept of the green economy is in fact shifting to that of the 'greening' economy. As we gear up to COP17, greening the economy and looking at new ways of construction and generating power and heating could take us into a different league, if we use COP17 as the motivation for demonstrating our own levels of innovation. This requires the investing community to have the imagination and courage to support efforts linked to this, and understand that greening the economy is an important part of future economic growth.

Some of the concerns that the CRISA process and debates post the crisis raises are about how beneficiaries' voices are heard effectively. Traditional notions of accountability, transparency and reporting are not always adequate to ensure that savers, pensioners, and investors can clearly understand where their money is going, how it is spent, how returns are derived and what the impact of business models we are working with have on other parts of society. There are also challenges to giving better meaning to the notion of accountability, which often becomes ritualistic. In a true democracy, we must find better ways of communicating to the ultimate beneficiary what is being done with their funds and whether it is being used for the long term benefit of their society.

Another issue arising, in South Africa and elsewhere in the world, is that of executive remuneration and pay disparities. In the context of your discussions and work being done promoting CRISA, the opportunity should be taken to reflect on this matter – what is the benefit to the few versus the cost to many? What is the cost of huge pay disparities within a society, and if we are concerned with long term sustainability, what is the sustainability cost of these disparities? This is becoming an increasing focus in the international community too. It will be useful if, in the same way that proactive steps were taken to develop CRISA, a proactive approach was taken to considering a different framework within which executive remuneration and pay disparities are dealt with.

An issue arising from our recent past is a lesson from the financial crisis which is not being debated enough; the crisis has challenged and, in the eyes of some completely debunked, the efficient market thesis. Increasingly around the world, there is a greater sense of urgency to find another paradigm within which to work.

There are significant challenges to finding the right balance between government regulation and self-regulation. Light regulation and abandoning government's role has had huge costs which the whole world had to bear. In South Africa, it would be useful to also have similar debates, not in the context of market versus government, but in a search to find a better and different paradigm within which to work. Given our talent in South Africa for foreseeing things that are going to happen, we should anticipate the fact that the efficient market thesis is not going to return in its old form, and ask what form should regulation take? If we are not going to get self-correcting mechanisms, how do we self-regulate in a way in which we have a higher level of openness to the signals around us and the ability to self-correct based on those signals before one is forced to do so.

A lesson from the crisis is how greed and the short-term approach can have devastating effects both on the industry involved and the wider system as a whole. Within a corporate governance environment, the way in which incentives are set does not necessarily combat and try to pre-empt the greed and short-term factor adequately. As partners between government and the private sector we should try and find solutions to these issues.

There is also concern around the world about volatile capital flows and the impacts they are having on various economies. Some economies are happy to have those flows leave them, while others like Brazil and South Africa, are concerned about the impact of the volatile flows. These flows are linked to the short term approach. They result in asset bubbles, and under the thesis of returns to safe havens, once there is a little bit of a scare, these flows retreat and there are huge volumes of money flowing out and reversing the capital inflows. In the context of discussions at the G20 and IMF, we are still trying to understand where the excess liquidity comes from; but there is a better understanding that it is due to the fact that there are not adequate returns in the developed world as there are in the developing world to saving; savings don't hold long term investment prospects. One of the challenges in terms of sustainable investment is how to encourage the investment community in South Africa and globally to decrease the volatility of capital flows and engage in longer-term investments, and in particular in an African perspective, to have an understanding that investors should invest in long-term infrastructure development, and not in the short-term context that gives rise to the vagaries of volatile capital flows.

These are some of the areas of concern that I hope you as a constituency will engage in, and between the various stakeholders represented here today and ourselves in government we can more actively debate the fast changing world we are living in and the adaptations we will have to undertake in terms of the traditional paradigms within which we work and begin to evolve, in partnership, different ways of looking at issues that CRISA addresses and that the industry is concerned with on a longer-term basis.

Some may question the efficacy of a voluntary code such as CRISA. I hope that through the debates that take place, we can emphasise and utilise the value of a voluntary code and understand where South Africans can go in the next ten years in this particular area. If the relevant people take ownership of them, voluntary codes can work perfectly. If we do not take ownership and don’t demonstrate in our actions an understanding of the spirit and letter of the code, and demonstrate a significant impact on the environment, we will have to look for other solutions. This Code will demonstrate a pro-active approach on the part of industry to concerns being raised. As a society, we must move to a state of taking responsibility for our decisions and actions, without the need to always be compelled to do so by law. CRISA will be a success in South Africa if you make it a success, and I look forward to the benefits it will bring for the country and the continent. The responsibility lies with you and those you represent to give CRISA meaning and momentum so the hard work that went into its development will be seen in action.

Let me conclude by quoting President Nelson Mandela who celebrated his 93rd birthday yesterday: “Sometimes it falls upon a generation to be great. You can be that generation”. In the context of generation, clearly you are that generation – you’re only the second country in the world to draw up such a Code. Ladies and gentlemen, let us ensure we are that generation who will make sure that the world we inherited from our parents, is a better world to be inherited by our children.

Thank you.