

Government Employees Pension Fund (GEPF)

Responsible Investment Implementation: Active Ownership

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1 Overview

This implementation document provides Government Employees Pension Fund (GEPF) members, peers in the investment community, the GEPF's asset manager the Public Investment Corporation (PIC), entities the GEPF invests in, and broader stakeholders in South African society with an understanding of the actions the GEPF will take to encourage better corporate management of ESG issues through active ownership as per its Responsible Investment Policy Statement. The document is especially relevant to publicly listed companies seeking to inform themselves of the GEPF's intended actions as the initial focus of the GEPF's active ownership efforts will be on this asset class. In the spirit of Principle 5 of the United Nations-backed Principles for Responsible Investment (PRI), the GEPF and the PIC, both being signatories of the PRI will work together to enhance their efforts in implementing the Principles for Responsible Investment. For this purpose the GEPF and the PIC will establish an ESG Working Committee.

2 Active Ownership

The GEPF understands active ownership as the practice of using a range of formal and informal ownership rights¹ to signal, encourage and request change in the behaviour of entities the GEPF is invested

¹ Formal ownership rights include such rights as participating in annual general meetings, voting shares, and lodging shareholder resolutions. Informal ownership rights refer to the right of owners to engage less formally (e.g. through correspondence or meetings with management) with entities in which they are invested.

in towards approaches that favour delivering long-term investment value. The GEPF is of the opinion that ownership rights have an intrinsic economic value, and the execution of active ownership strategies is an inherent element of the responsibilities the GEPF has to its members. Through active ownership the GEPF and the PIC will seek to enhance performance in ESG areas by entities in which it is invested in ways that protect and enhance investment value over the long term.

Active ownership involves thorough investment analysis and engaging in constructive relationships with the entities in which it invests, and from there selecting appropriate ways to signal, encourage and request change if deemed necessary. Relationships, issues and reactions to requests will vary from entity to entity and inform the most appropriate actions. Active ownership largely focuses on discussions between shareholders and directors and managers appointed to run businesses to ensure that strategy is aligned to the mutual objective of value creation. Active ownership is orientated to supporting and encouraging boards in their leadership and governance of business, rather than prescribing what companies need to do or attempting to interfere in the management of companies.

The approach followed by the GEPF and the PIC to active ownership includes two main activities, namely engagement and strategic voting:

- Engagement

Engagement involves investor interactions with company managers and directors to signal concerns, understanding how concerns are being managed, and communicating steps deemed necessary for improvement. Engagement interactions can range from relatively informal telephone calls and emails to sending letters and meeting with managers or directors. The nature of calls, meetings and letters will vary according to the level of concern the GEPF and the PIC may have and the extent to which the GEPF and the PIC perceive a company is responding to requests.

Should informal engagement activities be unsuccessful, other more public approaches could be considered, bearing in mind the spirit of constructive collaboration expressed in the GEPF's Responsible Investment Policy, and the desire on the part of the GEPF to protect long-term investment value. These more public approaches could include engaging collaboratively with other investors, voting strategically, issuing public statements, and organising shareholder resolutions. In the worst case scenario, if the required change does not occur, the GEPF could choose to entirely divest from a company. This type of action, however, is not the desired objective.

Finally, although not strictly an element of conventional active ownership practice, the GEPF in collaboration with the PIC will also consider engagement with government departments and regulators to influence policy direction where appropriate.

- Strategic voting

Voting at annual general meetings and by proxy is an important element of the GEPF's duty to its members. Voting must be informed by thorough investment analysis of companies as well as by engagement activities that may already be underway. Most voting put to investors involves approving capitalisation structures, dividend issuances and other issues related to corporate governance. It is an important element of an investor's duty to consider issues put to them and to vote in a considered fashion. Strategic voting differs from regular business-as-usual voting activities in that it involves strategically voting in a manner to specifically signal or encourage change in a company. Strategic voting is an essential element of active ownership and involves using voting rights to emphasise concerns and requests for change that may have already been signalled to companies through engagement activities

By executing engagement and strategic voting the GEPF and the PIC will communicate with companies beyond issues formally put to the vote at annual general meetings. In this manner the GEPF and the PIC are enlarging the range of issues they can signal, encourage and request corporations to effect change on. Voting is largely concerned with capitalisation and corporate governance, and there is little leverage for the GEPF and the PIC to signal changes to corporate behaviour it wishes companies to effect on environmental and social issues. As such the GEPF and the PIC will strongly rely

on engagement to bring forward the changes they deem necessary especially when concerning environmental and social issues.

As very large investors the GEPF and the PIC are sensitive to potential destruction of value and unnecessary market reaction that can result from confrontational active ownership, and therefore have a preference for a constructive and collaborative approach to these activities. As such the GEPF and the PIC will try wherever possible to take a discreet approach to communicating their concerns to companies.

The GEPF is one of the largest pension funds in the world and the PIC is one of the largest investment managers and as such has significant investments and leverage to communicate with major South African companies to encourage them to implement practices that enhance and protect investment value over the long term. Given the GEPF's responsibility to protect the interests of thousands of members, it believes it is particularly important to, in collaboration with the PIC; take a strong role in active ownership and to embrace the system of checks and balances at its disposal. As an asset owner, the GEPF takes its responsibility to execute ownership rights very seriously. As such, in order to ensure that the GEPF's actions appropriately capture the intentions of protecting and enhancing value over the long term, the GEPF Investment and Actuarial team together with the PIC will execute active ownership practices. Moreover, the GEPF believes that its active ownership activities will be most effective if executed through the ESG Working Committee.

Active ownership is an evolving discipline. Consequently, as understanding develops in this area, the GEPF's implementation

strategies may evolve. As per the GEPF's Responsible Investment Policy Statement, implementation will be reviewed on an annual basis, and updates to this document may occur as necessary.

The GEPF will take the following actions to implement active ownership as per its Responsible Investment Policy Statement.

2.1.1 On the basis of the research described in the GEPF document titled: "Responsible Investment Implementation: Integrating ESG issues in investments", the ESG Working Committee will undertake in-person engagements with the directors or managers of companies listed on the stock exchange. These in-person engagements will form the first level of active ownership activities and will have the objectives of developing further understanding and facilitating the exchange of ideas and be constructive in nature.

2.1.2 A second level of active ownership activities, where deemed necessary, will involve further engagement meetings with companies and signalling, encouraging and requesting change towards approaches on specific ESG issues in favour of long-term corporate performance and value.

2.1.3 The manner in which companies respond to engagements will serve to inform the GEPF on elements of its planned passive index re-weighting.

2.1.4 In 2007 the GEPF endorsed the Corporate Governance and Proxy Voting Principles². This provides a framework for regular business-as-usual voting. The PIC currently makes the GEPF's regular business-as-usual voting decisions and votes for the GEPF as per the endorsed Corporate Governance and Proxy Voting Principles. Through the ESG Working Committee, the PIC will continue to execute this role in a spirit of close collaboration with the GEPF. The ESG Working Committee may decide on voting decisions in order to vote strategically to support and reinforce any specific GEPF engagement activity.

2.1.5 A third level of active ownership activities the GEPF and the PIC may undertake is benchmarking. This involves engaging, on a sector-by-sector basis, in a manner that may assist all entities in that sector to improve ESG management.

2.1.6 The GEPF and the PIC may also engage on an economy-wide basis to inform entities it invests in of its views on ESG management regardless of the sector in which they operate. For example, the ESG Working Committee will communicate with companies listed on the JSE on ESG and sustainability reporting standards.

2.1.7 The GEPF and the PIC will maintain detailed records of all engagement activities. Furthermore, the GEPF will publicly disclose how the PIC has cast votes on behalf of the GEPF. Furthermore, subject to the GEPF Board of Trustees

² For more information on the Corporate Governance and Proxy Voting Principles visit the PIC's website at www.pic.gov.za.

approval, the GEPF will publicly report on its active ownership activities, including some elements of engagement.

2.1.8 The GEPF will review its active ownership process on an annual basis and seek to identify areas for improvement.

3 ANNEXURE 1: Corporate Governance Guidance

The following guidelines provide stakeholders and companies with a high-level understanding of active ownership stances the GEPF will take in relation to corporate governance. Guidance is high level and aligned to the GEPF-endorsed PIC Corporate Governance and Proxy Voting Principles as well as other international and South African best practice.

3.1 Our position on board composition, expertise, balance, ability and duty:

As long-term investors it is our concern that the board of directors of any given company and its subsidiaries are in a position to be efficient in their abilities to act in the best interests of all shareholders. We believe the efficiency of a board can be encouraged by the board composition, expertise, balance and ability to perform duties. We believe appropriately composed and balanced boards are most efficient. Boards of directors should comprise non-executive, and preferably independent, directors, as well as executive directors. The board must have appropriate expertise to carry out its duties effectively. In support of these views we favour:

- A minority board composition of executive directors³ who have in-depth knowledge of the financial and operational situation of the company in question, as well as any emerging short- and long-term risks and opportunities faced by the company.
- A majority board composition of non-executive directors⁴ who should have knowledge of the challenges and opportunities of the sector in question, preferably with expertise in one or more of the business activities of the company in question.
- A majority of independent non-executive directors. By independent we mean free of conflicts of interest. An independent director's loyalties to shareholders cannot be compromised by any other interests. An independent director is free from any business, financial or any other relationships that may bias their capacity to act in an independent manner.
- An appropriate balance of director expertise, skills and experience. We believe the balance of a board's expertise should be determined by the best interests of shareholders. The professional credentials of each director and understanding of how this relates to the oversight and strategy of the company in question should be assessed. Directors must have appropriate skills and experience to ensure no party or parties dominate decisions made at board level. Directors must be deemed fit and proper and should not be disqualified from being directors by the JSE Listing Requirements, the Banks Act, the Companies Act

³ Executive directors are involved in day-to-day management and are full-time salaried employees of the company in question or its subsidiaries

⁴ Non-executive directors are not involved in day-to-day management nor are they full-time salaried employees of the company in question or its subsidiaries

and the Financial Advisory and Intermediary Services Act or any relevant regulatory provision that governs the appropriateness of directors. Furthermore, we believe companies should endeavour to provide information where there are gaps in director expertise.

- An annual review of the effectiveness of the board collectively and individually. We believe board members must be accountable. This annual review should include an assessment of whether the directors are able to make the necessary time commitments to fulfil their obligations. It is critical that directors attend all board meetings. This process should focus on evaluating the need to change board membership to ensure that the board as a whole is effective.
- Board composition that is sensitive to race and gender biases and is aligned to South Africa's social transformation duties.
- Separation of chairperson and chief executive officer. We believe one of the roles of the board of directors is to oversee management. It is not good practice for a chief executive officer to take the role of chairperson. There needs to be a clear distinction between the roles of management and the supervision of management, between setting the strategy and executing the strategy. The chairperson should preferably be an independent, non-executive director.
- No concentration of power. The chairperson should be competent and able to fulfil their role of providing overall leadership according to the principle that an appropriate balance of power

and authority exists such that no one individual or group of individuals can dominate decision-making processes.

3.2 Our position on appropriate delegation of responsibilities:

We are of the view that in order to avoid conflicts of interest there are certain responsibilities that the board of any given company and subsidiaries should delegate to appropriately composed sub-committees. In particular we believe it is appropriate for the board of directors to delegate the responsibilities of director nomination, remuneration and auditing. We believe decisions pertaining to director nomination, remuneration and auditing need to remain independent from the influence of the board. This separation of roles will enable the board of directors to be more effective and avoid any potential conflicts of interest.

3.2.1 Our views on the need for and role of an audit committee:

The audit committee deals with compliance with legal requirements, accounting standards and financial reporting, and should be chaired by and composed of independent non-executive directors who are selected by the board. Management can attend committee meetings by invitation only. The chair of the committee must not be the chairman of the board. The audit process must be rigorous and independent to maintain the confidence of the market. Committee members should have financial experience. Audits must be in compliance with the law and independently conducted. Auditors must be competent. Transparency on process and the way the committee performs its functions is needed.

3.2.2 Our view on the need for and role of a remuneration committee:

The remuneration committee determines executive and board of director remuneration. The committee should be chaired by and composed of non-executive directors determined by the board. The majority of these must be independent. Management can attend committee meetings by invitation only.

As long-term shareholders we believe remuneration is key in determining the effectiveness of non-executive and executive directors of any given company and its subsidiaries. We believe remuneration must be appropriate in the sense that it reflects a fair market value of the expertise, experience and time commitments of the relevant directors. We believe this is important as it will attract and retain the directors necessary to direct and manage the organisation effectively. We equally believe that remuneration must not be excessive. In addition to being market related, it must be balanced with the salaries and increases of the relevant organisation's general workforce. We believe that deciding on remuneration is not a role of the board and advocate a remuneration committee. These views are explored in further depth below.

- Remuneration must be linked to corporate and individual performance; it must reward achievements. We favour fair remuneration that reflects the expertise and time of executives and, we believe fair remuneration is the key to the effectiveness of executive and non-executive directors. We support stock

grants as appropriate compensation, as these can align director interests with the long-term interests of the shareholders.

- We support detailed disclosure of director compensation and share ownership. To help shareholders understand whether senior executives are fairly compensated and how that compensation relates to corporate performance, companies should disclose total compensation for each senior executive for whom such disclosure is required under the applicable securities legislation in the financial statements. We support a formal process to review the CEO's performance and compensation. The CEO's past performance and future performance expectations, as well as related incentive-based compensation, should be reviewed annually by the board or its remuneration committee. It is important that there is some significant relationship between executive compensation and performance. In order to ensure this relationship, compensation should be linked to meaningful performance targets which are disclosed in the company's proxy circular.

3.2.3 Our view on the need for and role of a nominations committee:

The nominations committee makes recommendations to the board on new board appointments. Such a committee should have a minimum of three members that are independent non-executive directors. The chair of the committee can be the chairman of the board provided he or she is independent. The committee should make appropriate nominations based on required skills and gaps in expertise on the board, as well as additional skills that could make the board more efficient.

3.3 Our position on reporting:

Companies should comply with all applicable accounting standards. Aside from traditional financial information, we expect companies to report on sustainability and ESG issues without exception. The range of ESG issues companies report on may vary from company to company. We support the Global Reporting Initiative (GRI) guidelines framework for reporting on these issues. Further we consider it good practice for companies to report on their organisational integrity and code of ethics. Companies are expected to report on their commitments to transformation and Broad-Based Black Economic Empowerment (B-BBEE).

3.4 Our position on shareholder rights:

We believe companies have a responsibility to embrace opportunities to engage with investors who finance their activities in a constructive and open manner. We believe companies and their directors should embrace concerns investors may have in a proactive manner, as this is part of good corporate governance. Companies should encourage voting by internet and by proxy. Voting by a show of hands only is not conducive to broad participation. We believe all shareholders should have the ability to vote – internet-based voting favours this. We support majority voting rules and support the disclosure of voting results. We oppose dual equity capitalisation structures with preferential voting rights.

3.5 Our position on ESG issues:

We believe companies need to take ESG issues into the heart of their operations. We support policy making around ESG issues particularly those that are deemed to be material to the company in question. We believe policy making on ESG issues demonstrates a real dedication to managing these issues in a strategic manner in order to protect and enhance long-term value. We favour boards that embrace their duty to manage material ESG risks and who have set up extensive policies, strategies and reporting structures to manage ESG issues appropriately.

Companies should refer to the GEPF's "Responsible Investment Explanatory Memorandum" for further understanding of our views on ESG issues. The memorandum provides an understanding of the rationale, objective and scope for the Fund's establishment and implementation of a strategy to integrate ESG issues into investment decisions and ownership practices.

4 **ANNEXURE 2: Frequently asked questions**

- What is active ownership?

Active ownership is the primary manner through which investors can have a say in the business operations and societal activities of companies. Active ownership is the practice of using a range of formal and informal ownership rights to signal, encourage and request change in the behaviour of entities investors own or part

own. Active ownership includes voting at company annual general meetings.

- Why is active ownership important?

By taking active ownership positions that are informed by a thorough knowledge of financial and ESG risks and opportunities, the GEPF can encourage the entities it invests in to adopt behaviour beneficial for long-term performance and the value of investments. By influencing companies to make more environmental and social disclosure and manage these ESG issues better, the GEPF will contribute to better corporate performance in South Africa and Africa.

5 **ANNEXURE 3: Terms of Reference of the GEPF / PIC ESG Working Committee**

1. Definitions:

- Committee means the ESG Working Committee
- ESG means environmental, social and governance issues
- GEPF means the Government Employees Pension Fund established in terms of the Government Employees Pension Law, Proclamation 21 of 1996;
- PIC means the Public Investment Corporation established in terms of the Public Investment Corporation Act, Act 23 of 2004;
- PRI means the United Nations Principles for Responsible Investment

2. Introduction:

In the spirit of the PRI, which encourages signatories to work together to enhance efforts in implementing the Principles for Responsible Investment, the GEPF and the PIC have established an ESG Working Committee to enhance both parties effectiveness in dealing with ESG matters.

3. Purpose:

The purpose of the ESG Working Committee is to discuss ESG issues pertaining to listed companies in which the PIC is invested on behalf of its clients.

4. Membership:

4.1 The membership of the Committee will be determined by mutual agreement between the GEPF and the PIC but at least the following persons will be members of the Committee:

4.1.1 The Head of Investments and Actuarial of the GEPF;

4.1.2 The ESG Manager of the GEPF;

4.1.3 The Executive Head: Investment Services of the PIC;

4.1.4 The Senior Corporate Governance Specialist of the PIC.

4.2 The Head of Investments and Actuarial of the GEPF shall be the Chairman of the Committee.

4.3 The Senior Corporate Governance Specialist of the PIC shall act as the Committee Secretary.

4.4 A quorum of the Committee shall consist of one member of both the GEPF and the PIC.

4.5 The Committee may invite experts with experience in the ESG field to participate.

4.6 The Committee may delegate any of its duties to an individual member, who shall regularly report on the delegated assignment to the Committee.

5. ESG Working Committee Meetings:

5.1 The Committee shall meet at least quarterly or more frequently as circumstances dictate. Any member of the Committee through the Chairman may call meetings.

5.2 The Committee may request the presence at any meeting of any other staff or board member of the GEPF or the PIC or any other expert or consultant who the Committee believes could contribute to the meeting.

5.3 The Committee Secretary shall ensure that proper minutes of all meetings are held. These minutes shall be reviewed and approved by the members of the Committee and the Chairman will sign the minutes.

5.4 The Committee Secretary, in consultation with the Chairman, shall establish the agenda for Committee meetings and shall ensure that all meeting documentation is circulated to members with sufficient time for review prior to the meeting.

6. Duties and Responsibilities:

6.1 Subject to the powers and duties which the GEPF Board or the PIC Board may bestow on the Committee from time to time, the Committee will perform the following duties:

6.1.1 Overseeing the implementation of the GEPF Policy on Responsible Investing;

- 6.1.2 Overseeing the implementation of the PIC Corporate Governance and Proxy Voting Policy;
 - 6.1.3 Implement the management of ESG matters as approved by the GEPF and the PIC Boards and thereby ensuring that the ESG objectives of the Boards are met;
 - 6.1.4 Application of the PIC Corporate Governance Rating Matrix and company engagements;
 - 6.1.5 Conduct research on key material ESG issues and amend policies where necessary;
 - 6.1.6 Decide on sustainability reporting for purposes of the GEPF and the PIC annual integrated reports;
 - 6.1.7 Draft an annual sustainability report that will report on ESG engagements with companies in which the GEPF and the PIC, on behalf of its clients, are invested.
- 6.2 All resolutions taken by the Committee will be tabled at the GEPF and the PIC Investment Committees.