

Keynote address at the official launch of the Code for Responsible Investing in SA by John Oliphant, GEPF's Head of Investments and Actuarial and Acting Principal Officer

19 July 2011

Finance Minister Pravin Gordhan;

Chairperson of the UNPRI, Wolfgang Engshuber;

Deputy Chairperson of CRISA and CRISA committee members;

Chairpersons of pension funds;

Chairpersons and CEOs of various institutions present here;

Ladies and gentlemen,

It gives me great pleasure to address you on this historic day as we officially launch the Code for Responsible Investing in South Africa which is set to revolutionise the way we invest our members' assets in our country.

To me, this day marks the ushering in of a new epoch in the pension fund industry and, coincidentally, the launch of CRISA is happening exactly a day after the country and the world at large celebrated Mandela Day in honour of the birthday of our iconic revolutionary, Nelson Rholihlahla Mandela, to whom we owe so much as the citizens of the world.

As was the birth of Nelson Mandela in the small village of Mvezo 93 years ago, little did we know that his life would years later be a vessel for justice, reconciliation and freedom. Similarly, I believe, as we strive to build a more

sustainable world, generations to come will look back on the birth of CRISA today and thank us for our pioneering spirit and for daring to be different.

Ladies and gentlemen, many historians argue that the period between 1880 and 1910 saw the emergence of radically different ways of organising and carrying out economic activity. In this period, we saw the single most important legal invention: the modern concept of a company. There are two features that make organizing an institution as a company more attractive, they are:

- 1) The ability to marry investment capital with entrepreneurs and the idea of attracting outside investors into a venture; and
- 2) The invention of limited liability which allows individuals to organise a commercial venture without personal bankruptcy risk. In this scenario, managers could take risk and the maximum they would lose in case of failure is other people's money.

These are the two concepts of a company that are thought to have facilitated the explosion of innovation and entrepreneurial activity of the early 20th century. Although the concept of limited liability is hugely beneficial, because of limited downside risk, together with misaligned incentives for executives, it is responsible for almost completely reversing the gains made during the 20th century.

In the first decade of the 21st century alone, the world economy experienced two major financial crises: the Dot-Com crash of the year 2000 and the 2008-2009 financial meltdown. In both cases, we learnt that company failures no longer only lead to just financial losses but could also lead to systematic failures that could ultimately threaten the overall financial system.

For example, the Dot-Com crash lopped an estimated US\$5trillion of market capitalisation from American companies while the economic effects of the 2008-2009 financial crisis are still being felt today.

Market crashes have become more frequent and pronounced than in the past, this clearly indicates that there is something fundamentally wrong with the system.

The 2008-2009 financial crisis, in my opinion, has been a powerful reminder against an arrangement where suddenly the rug is pulled out from under the masses of people who have worked very hard to secure their houses and families' financial futures, only to face an uncertain future as the result of our practices. Our approach to investment as an industry is too short-term focused and there is a general lack of appreciation for long-term sustainability issues.

As fiduciaries and custodians of people's savings, we need to think more about sustainable returns. We need to ensure that we deliver on our promise of long-term prosperity through investments.

Our economic activities should not undermine the integrity and resilience of communities and lead to increased hardship for those already struggling with poverty, but should be about increasing opportunities and value creation.

There is no doubt that the activities that led to the recent financial crisis undermined the integrity and resilience of communities and, as a result, created increased hardship for those already struggling with poverty. Investment should be about long-term value creation and not the opposite.

The route to a sustainable future lies not in idealism or in Capitalism vs. Communism, but in innovative responsible investment practices that encourage innovative business practices. Innovation is one of the key

requirements for a sustainable future, as it allows society to continuously create and better share its prosperity within the carrying capacity of the natural environment.

There is no doubt that the capacity of the natural environment has also been stretched beyond limit as a result of the great acceleration in human activity over the last century. For example, between 1950 and 2000 the world population more than doubled from 2.524 billion to 6.149 billion and is currently estimated to be 6.8 billion. In the same period, global consumption of five key metals (copper, lead, nickel, tin and zinc) increased almost four-fold, from 7 to 27 million tons per annum as a result of urbanization.

On the other hand, world total energy consumption increased nine-fold, from 1.1 to 10.2 billion metric tons of oil equivalent, leading to increased greenhouse gas (GHG) emissions. The global GHG emissions due to human activities have grown since pre-industrial times, with an increase of 70% between 1970 and 2004. There is incontrovertible scientific evidence that the earth's surface is warming as a result and this will have progressively significant effects on economies, societies and markets. The current climate change due to economic activity threatens the basic elements of human life on this planet as we know it. As the global surface temperature rises, scientists predict that this will lead to:

- Significant decreases in water availability in most areas of the world, the basic ingredient for life on earth;
- Falling crop yields in many areas of the world, heightening the problem of food security;
- A weakening ecosystem, as a rising number of species will face extinction due to unfavourable climate; and

- An increase in extreme weather-related events.

In 2010 alone we experienced droughts, crop failures and significant heat waves in South Africa, Russia and some parts of the US - all economically damaging and consistent with what has been predicted by scientists.

We can no longer afford to continue as if it is business as usual because if we do, we will compromise the ability of future generations to meet their basic needs.

As long-term investors and fiduciaries, we have the responsibility to ensure that we invest in a way that promotes long-term sustainability.

It is against this background that a group of institutional investors approached the then King III committee with a submission that called for a “Code for Responsible Investing in South Africa”. This group of investors recognised that in a market such as ours, which is predominantly driven by a non-mandatory market-based code of governance for companies (the King Report on Governance), as opposed to legislation, the Institutional Investor has, by virtue of its share-ownership, the ability to influence and encourage the companies in which it invests to apply sound governance principles and to care for the environment in which they operate.

This group of investors was also aware of our current failure to exercise active ownership. A recent study by Jimmy Winfield indicated that:

- Proxy voting in South Africa is underdeveloped;
- There are very few sources of quality research relating to active ownership and voting items; and

- The majority of asset managers appear to treat proxy voting as a box-ticking exercise, without giving thought to ways in which responsible voting can create value.

Ladies and gentlemen, a lack of active ownership is a clear contradiction of what is expected of us by the real owners of the assets: members of pension funds. The owners of these assets are the very same workers that are currently on strike, they also include miners, truck drivers, policemen, teachers, nurses, and etc.

Their voluntary and compulsory savings, when combined, represent about R2 trillion. They may not be individually rich, but combined they have the power to sway the country's economic fortunes. They are the grassroots tycoons and collectively they own 15% of Anglo American, 40% of Impala platinum, 25% of Arcelor Mittal, 36% of Standard Bank, and they have a sizeable interest in every company listed on the JSE.

The grassroots tycoons, leaders of the unseen revolution, are our new bosses and the question is: what do they expect from us, their servants? I insist that we are their servants because there is a general lack of understanding of this in the market, in political debates and amongst the owners themselves as to who owns who and how much of who? As such, this blurs the lines of accountability. Ownership has changed but the system of accountability is still lagging. We need to address this in order to be able to account better to our new bosses.

To this end, the CRISA is aimed at aligning the system towards long-term thinking and better accountability. In summary, through CRISA, Institutional Investors commit themselves to:

- Principle 1: Incorporate sustainability issues, including ESG, into investment analysis;
- Principle 2: Demonstrate active ownership by putting in place policies that deal with share ownership responsibilities;
- Principle 3: Collaborate with other shareholders to effect change;
- Principle 4: Manage conflicts of interest pro-actively; and
- Principle 5: Be transparent about our policies and how they are implemented.

We believe that these principles would create an environment for us as intermediaries and custodians to engage and hold companies to account to the demands of the new capitalists. Ladies and gentlemen, a new era of responsible investing has arrived, please don't miss the boat.

I thank you.