What are Pension Fund Trustees' Investment Responsibilities today?

Up to 1996 the duties of retirement fund trustees fell under the aegis of the common law. Their duties were codified, however, in the Pension Funds Amendment Act of 1996.

Under section 7 of this Act the object of the board of trustees was to direct, control and oversee the fund and ensure that the interests of members were protected.

The duties of the trustees are good faith, care, skill and diligence and a duty to be aware of the legislation impacting on a pension fund. Also, to be aware of Guidance Notices such as that issued by the FSCA that trustees should take account of how a company has dealt with ESG issues before investing their beneficiaries' money in the equity of that company.

They have the duty to administer the retirement fund and to invest the funds' money in the best interests of the fund and its beneficiaries.

Legislation makes it clear that trustees can delegate but they cannot abdicate their responsibilities. In this regard most trustees delegate the administration of the trust to a life insurance company and the investment of the beneficiaries' money to an asset manager.

The Principles of Responsible Investment internationally call for careful consideration of the ESG factors because investors have learned, for example, that if there is child labour used in the supply chain this would affect the value of equities in the final consumer company which could be listed on the London Stock Exchange. The equity of that company could have been bought by a pension fund.

That is why the board of trustees should interrogate every report from a sub-committee including its asset manager. It should ensure that the mandate to the asset manager makes it clear that they have to not only do a financial audit on the company but also an ESG audit.

Ocean Tomo, in its financial analysis of the S&P 500 in the last quarter of 2020 showed that only 9% of the make-up of the market cap of iconic companies listed on that exchange were reflected as tangible assets in their balance sheets. The other were intangible or so-called non-financial assets. It is in this area that ESG funds have grown exponentially over the last three years.

Consequently, an asset manager has to have a mandate today which requires him or her to do a due diligence on the environmental, social and governance issues in a company and how the company has made its money. If it has made its money being subsidized by society or the environment then the directors of that company, acting as a collective, have not made decisions in the best long-term interests of the health of that company. It must be remembered that the duty of directors is owed to the company whereas in a pension fund the duty of trustees is owed to the beneficiaries.

Businesses are at the junction of the three critical dimensions to be taken account of in sustainable development, namely the economy, society and the environment. In the due diligence by an asset manager, questions must be asked as to whether the company has or is trying to have a positive impact on all three critical dimensions. A company could be improving its bottom line but its activities or its product are so adverse to the environment that holistically it is destroying value for society. The question of success being increased profit, dividends and share price is no longer the test. The test is, is value being added to society?

The asset manager must also test in its due diligence if the company has a strategy to deal with the positive and negative impacts of the company’s product or service. It must look at not only value creation but also preservation and erosion and how the company is dealing with that. On the question of governance, there was a focus on the primacy of the shareholder. Because of the special circumstances in South Africa in 1992 when the first King Report was issued, we developed a new model. Learn and understand the needs, interest and expectations of your stakeholder groupings but always make decisions in the best long-term interests of the company. Today in a resource constrained world where companies have used and are using natural assets faster than nature is regenerating them the focus is on enterprise value creation.

During the pandemic SDG 17 collaboration really came to the fore. There was huge collaboration in an endeavour to find a vaccine to stop the spread of the virus. For years the IIRC, through the establishment of the Corporate Reporting Dialogue had tried to get the many framework providers in the ESG space to harmonise their standards. I described their looking at themselves as competitors in dealing with public interest issues as a social outrage, in London, in March 2019. I am told this galvanised them into action and the pandemic, where there was huge vaccine collaboration, really got these framework providers, where their standards were causing clutter and confusion for preparers and users, to start collaborating.

Firstly, there was the World Economic Forum working with the Big 4 which issued metrics for ESG reporting of which 60% were made up of GRI Standards. Then there was the announcement of the Group of Five that they would collaborate, namely the CDSB, CDP, SASB, GRI and the IIRC.

The IFRS Foundation issued a Consultation Paper which ended on 31 December 2020. There were positive responses as a result of which the IFRS has announced that it will be establishing an International Sustainability Standards Board (ISSB) where, on a building blocks basis, they will try and harmonise the standards of framework providers in that space. The IFRS intend to announce the establishment of a SSB in Glasgow in November to sit alongside the IASB and have non-financial standards with the same consistency and rigour, which the financial standards have, all being under the oversight of the IFRS Foundation. The latter, of course, will have to change its name.

During the first decade of the 21st century sustainability was looked at only through a civil society lens, in other words trying to fulfil the Bruntland definition of sustainable development, namely the impacts which a company's activities, its product or services were having on the three critical dimensions of sustainable development, namely the economy, society and the environment. In the second decade of the 21st century it started to be accepted that in turn those three critical dimensions were having impacts on companies. For example, the failure of Lehman Brothers had an economic impact on companies worldwide; the pandemic of 2020 from a social point of view has had a huge impact on companies and environmentally climate change has had and will have a huge impact on companies. These impacts started affecting the financial condition of a company (the balance sheet), its operating performance (income statements and cash flows) and also its risk profile (the cost of capital and its market capitalisation). Enterprise value creation, preservation and erosion became important in valuing a company and also in endeavouring to ascertain whether it had a business model which as a matter of probability would result in the long-term health of a company, which would be in the long term best interests of all its stakeholders. There was a movement away from the primacy of the shareholder to taking account of the needs, interests and expectations of stakeholders but always making decisions in the best long-term interests of the health of the company.

Reporting became outcomes based through integrated reporting, inputs, to activities, to the product itself having an impact on the three critical dimensions and having outcomes as a result of these impacts. Later in 2015 the SDGs were established which were all outcomes based with SDG 17 being collaboration. The question started to be asked shouldn't governance be outcomes based? In finalising the King IV Report, we asked that question and sought input over two years from iconic companies and academics worldwide. We concluded that it should be outcomes based. What were the outcomes that the external stakeholder would perceive in order to rationally draw the conclusion that the company was practising quality governance? We concluded that there were four outcomes. These are they:

1. Enterprise value creation in a sustainable manner;
2. Internal controls which were adequate and effective;
3. Trust and confidence by the community where the company operated;
4. Ethical culture with effective leadership.

In a due diligence the asset manager should be asking questions as to whether the company has achieved these four outcomes so that a conclusion can be drawn that the company is practising quality governance on a mindful basis and not merely a mindless checklist approach to well-known practices such as the audit committee, nominations committee, remuneration committee, etc.

In South Africa, the Code for Responsible Investment (CRISA) is being revised and will include matters based on enterprise value creation, in other words looking at how the three critical dimensions impact on the balance sheet, operating performance and the risk profile of companies. Enterprise value creation will be at the heart of the proposed SSB. At the same time the European Commission is working on its non-financial directives. Gratifyingly the EC and the collaborators are working together in an endeavour to align their standards.

The SSB will be created without having reinvented the wheel but having taken the years of learning from the Group of Five and the other entities in the ESG space, such as the TCFD. Trustees will have to ensure that company leaders have complied with these standards, which will be in assurance friendly language. The collaborators are working with the IAASB to try and have a reasonable assurance of a sustainability report and an integrated report.

A4S is developing a framework to assess how climate change affects the risks and opportunities for a company and impacts on its value.

Trustees or their mandated asset managers should ask critical questions of the executives of companies in which they are about to invest their beneficiaries' money. Trustees should interrogate their asset manager with the following line of questions which the asset manager should have asked the executives:

1. How has this company made its money?
2. How is it planning for the long-term health of the company in a sustainable manner?
3. Does it have a business model in which are embedded the SDG's pertinent to its business which evidences an endeavour to ensure the long-term health of the company?
4. Are the customers of the company paying up on due date?
5. What could really hurt the company in the next few years?
6. How is the company doing relative to its competitors?

7. If the CEO were headhunted tomorrow, who would assume the position of CEO?
8. How is the company going to grow – either organically or by acquisition? If by acquisition, how is it going to be financed?
9. Is the company living within its means?
10. How much does the CEO get paid having regard to the inequality gap between the tone at the top and the beat of the feet at the bottom?
11. Is there variable remuneration with one third of a bonus aligned with the economic outcomes in the fiscal period ahead? The second aligned to eradicate or ameliorate the negative impacts on the environment and the last third of the bonus having targets to reach in regard to social issues such as health and safety.

12. Do the board of trustees and its asset manager really understand what is going on in regard to the company and can it really make an informed assessment about the company having a value creation process in a sustainable manner and dealing with erosion and preservation?

13. The most important risks to companies in this century are cybersecurity & climate change. What are the strategies of the investee company to deal with these risks?

In regard to stewardship the revised Code for Responsible Investment will deal with the stewardship of assets and the company's leaders need to act as if those assets were their family's assets.

Remember, it is more onerous to be a trustee than a director of a company. This is so because the statutes provide that a trustee should take greater care than he or she would take if the assets were his or her own.