Financial Sector
Conduct Authority

FSCA COMMUNICATION 1 OF 2019 (PFA)

Guidance Notice: Sustainability of investments and assets in the context of a retirement fund's investment policy statement

14 June 2019

1. PURPOSE

The purpose of this Communication is to inform stakeholders that a Guidance Notice relating to sustainability of investments and assets in the context of a retirement fund's investment policy statement (the GN) has been published on the website of the Financial Sector Conduct Authority (FSCA).

2. BACKGROUND

International and local developments in sustainable finance and investments

2.1 Numerous key international trends and developments from international bodies[1] as well as work of international governments is focussing on delivering sustainable development goals and mitigating or adapting to climate change. Globally financial systems are also being reformed to form and integral part of the solution towards a more sustainable economy, complementary with mobilising public and private financial resources for the foreseeable future and to address key sustainable development challenges.

2.2 Integral to this approach, and also to ensure the resilience of the financial system, is the integration of environmental, social and governance (ESG) risk factors into risk management systems, and ensuring environmental and social risks is identified and mitigated in existing and future portfolios.

2.3 In line with international trends, the South African Government is also fully committed to addressing issues relating to sustainability and number of South African entities are signatories to the UN Principles of Responsible Investing and Code of Responsible Investing in SA.[2] In June 2016, National Treasury hosted a roundtable policy discussion among various South African stakeholders on the topic of sustainable and green finance to address environmental and social risks and opportunities. National Treasury is currently also in the process of spearheading a process with the objective of considering how issues relating to sustainable finance can be better coordinated and harmonised across the financial sector.

Developments in sustainable investments in the pension fund industry

2.5 In the retirement fund industry, Regulation 28 under the Pension Funds Act, 1956 promotes responsible investing of fund assets, based on a sustainable, long-term, risk

[1] For example, the European Union's (EU) High-level Expert Group on Sustainable Finance (https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en), the G20's 2018 Action Plan and Leadership Declaration (http://www.g20.utoronto.ca/2018/2018-leaders-declaration.html) and the Financial Stability Board's Task Force on Climate-related Financial Disclosure (https://www.fsb-tcfd.org/).
[2] In November 2016, for example, South Africa ratified the Paris Agreement on Climate Change and in June 2018, the Department of Environment Affairs tabled a Climate Change Bill.

aligned and liability-driven investment philosophy. Regulation 28(2)(b) of the regulations to the Act requires all funds to have an investment policy statement and Regulation 28(2)(c)(ix) requires that boards of funds consider ESG factors before investing in an asset.

2.6 In the context of Regulation 28, and in support of the international and local developments, the FSCA published a draft Directive relating to Sustainability and Reporting and Disclosure requirements for pension funds (draft Directive) for public comment in March 2018.

2.7 The intention of the draft Directive was to provide guidance in respect of some of the essential aspects, in the context of ESG factors, that must be provided for in a fund's investment policy statement, and the manner in which such content should be disclosed and reported on by pension funds.

2.8 Subsequent to the publishing of the draft Directive, the FSCA considered the comments received and refined the content of the draft Directive.

2.9 In August 2018, the Financial Sector Regulation Act, 2017 (FSR Act) was promulgated. The FSR Act specifically provides for the issuing of Guidance Notices.[3] After careful consideration the FSCA took the decision to convert the draft Directive into a Guidance Notice as it was deemed to be the most appropriate instrument in which to incorporate the content that was contained in the draft Directive. This led to the publishing of the GN.

2.10 The guidance approach will enable flexibility and is intended to assist funds with complying with the requirements of Regulation 28(2)(b) read with Regulation 28(2)(c)(ix).

3. PURPOSE AND CONTENT OF THE GN

3.1 The content of the GN is largely based on the draft Directive, subject to certain amendments emanating from the comments received on the draft Directive.

3.2 The primary purpose of the GN is to provide guidance to boards of funds on how it must comply with Regulation 28(2)(b) read with Regulation 28(2)(c)(ix), in particular how its investment philosophy and objectives, as reflected in its investment policy statement, seeks to ensure the sustainability of its investments and assets.

3.3 In assessing and enforcing compliance with Regulation 28(2)(b) read with Regulation 28(2)(c)(ix) by boards of funds, the FSCA will in particular apply the requirements set out in paragraph 4 of the GN.

3.4 The GN also sets out the FSCA's expectations regarding certain disclosure and reporting requirements relating to sustainability. Although the latter is guidance, the retirement funds industry is encouraged and advised, in the interest of transparency, accountability and the fair treatment of its members, to apply the principles set out in the GN dealing with disclosue and reporting.

4. FURTHER DEVELOPMENTS

4.1 It must be noted that developments surrounding sustainable finance and investments are ongoing, both from an international and local perspective.

[3] See section 141 of the FSR Act.

4.2 Various stakeholders that commented on the draft Directive called for more intrusive requirements[4] whilst others called for some flexibility.[5] Several stakeholders submitted that it is important that similar sustainability principles are applied across the other sectors, specifically in the asset management sector.

4.3 The FSCA takes note of these submissions and agrees that the requirements relating to sustainability, including disclosure and reporting of issues surrounding sustainability, require further refinement. The FSCA also agrees that a greater level of harmonisation of requirements relating to sustainable investments across the financial sector should be achieved. The FSCA will therefore continue to work on refining the regulatory framework insofar as it relates to issues of sustainability, and this could potentially lead to more detailed and refined requirements (specifically with regards to disclosure and reporting) being incorporated into prudential and/or conduct standards.

4.4 The FSCA is also of the opinion that the process that is currently being spearheaded by National Treasury, which is aimed at developing a national strategic framework on sustainable finance and investments cutting across all industries in the financial sector, is a very suitable platform to further the aforementioned work (specifically work relating to the harmonisation of requirements relating to sustainable investments across the financial sector) and to facilitate further discussions on the topic.

4.5 The International Organisation of Pension Supervisors is alo finalising guidelines on integrating ESG factors in the investments of retirement funds and the FSCA will be considering to what extent these guidelines should be incorporated into the retirement fund regulatory framework.

5. ENQUIRIES

For further information regarding this Communication and the contents of the GN please contact the FSCA by emailing Wilma Makupo at Wilma.Mokupo@fsca.co.za.

[4] Such as incorporating the Financial Stability Board's Task Force on Climate-related Financial Disclosure recommendations and the Principles for Responsible Investing reporting and assessment framework.
[5] In particular when it comes to smaller funds because of the cost implications.