MERGENCE ARGUES FOR GREATER CARBON DISCLOSURE IN SA

By INGI SALGADO

Mergence Africa Investments tried to rally fellow South African signatories to the UN's principles for responsible investment (PRI) last year to back a campaign that would press companies to disclose their environmental footprints. It got a response from just one risk management company.

"For all the talk around investors believing in understanding the risk of carbon, hardly anyone took it seriously," says Rowan le Roux, a portfolio manager at Mergence. He has taken on the task of calculating the exposure of investments to carbon risks.

The poor response was partly due to a similar initiative that was under way among emerging market signatories of the PRI. But that drive is also understood to have received minimal response from South Africa's investment community.

It reflects the generally poor attitude of South Africa's investment managers to environmental, social and governance issues. These are traditionally regarded as soft business issues that, at best, are nice to have and, at worst, detract from short-term profit.

Some investors and risk managers have been persuaded by the view that environmental damage, left unchecked, will destroy the very basis for future industry. They represent the minority, although some believe the tide is shifting.

Malcolm Fair, the chief operating officer of RisCura, says: "I feel the critical mass is not far off, but it may still be a few years." RisCura is a PRI signatory and the lone respondent to Mergence's call.

Brian Molefe, the chief executive of the Public Investment Corporation (PIC), the investment arm of the Government Employees Pension Fund (GEPF), says that of the PIC requirements with which many JSE-listed companies did not comply, environmental issues are the most critical.

"We can deal with issues like conflict of interest of directors, but when it comes to environmental non-compliance, it is much more serious. And South Africa's position as a polluter is actually deteriorating."

Molefe believes somebody has to "up the ante" for South Africa to reach the tipping point at which companies pursue environmental integrity adequately. "Perhaps we have to rely on regulation, either by the JSE or government. But certainly, institutional shareholders must also raise these matters, which is why the PRI is very important."

But there also needs to be a more "organised fashion" of dealing with environmental, social and governance matters. The PIC, he says, is looking to a more structured approach, but is still at the planning phase.

The PIC's corporate governance policy stipulates that companies should publicly disclose information in line with the Global Reporting Initiative's sustainable reporting guidelines, and do what has the most benefit or causes the least environmental damage at a cost acceptable to society.

The GEPF was one of the first South African signatories to the PRI when it was launched in April 2006. It was only after the PIC asked private asset managers who bid to manage a portion of its assets whether they were signatories to the PRI that local institutions began featuring with any prominence on the UN list.

RMB Asset Management, which is not a PRI signatory, regained none of its equity assets when the PIC reshuffled R65 billion in government pensions funds allocated to private sector asset managers in March.

This opportunity to manage billions of rands of state pension money is perhaps the reason that, according to the PRI website, South Africa, with Brazil and South Korea, displays the most "responsible investment momentum and investor interest" in the PRI.

The GEPF is the only South African asset owner signatory with the PRI.

In addition, there are 18 investment management signatories and four professional service partners.

The PRI principles require them, among other things, to incorporate environmental, social and governance issues into investment analysis and decision making; seek appropriate disclosure by the entities in which they invest; work together to better implement the principles; and report on their progress.

The call for collective action has thus far gone unheeded by most South African signatories.

Unless the owners of share capital put these issues on the table, company management will not feel the pressure. The most sensible approach would be a collaborative effort to seek answers from company management - but that is a tricky process to kick-start in the highly competitive world of asset management, compounded by fears that it could be perceived as competitive collusion as opposed to collaboration.

Le Roux nevertheless persisted with efforts to get access to data on carbon emissions - one of the more obvious environmental risks as a price on carbon is on its way - and managed to put together calculations that should be a wake-up call to institutions that focus solely on short-term profit.

Mergence signed the Carbon Disclosure Project (CDP) this year, giving it access to records of carbon emissions disclosed by 57 percent of the JSE's top 100 companies last year. Based on these figures, Le Roux found the exposure of Mergence's portfolio of assets, which are not particularly weighted towards heavy carbon emitters, to be "actually very big".

To estimate the emissions associated with Mergence's investments, he calculated a company's carbon emissions a share, and multiplied this value with average monthly holdings to estimate the monthly carbon exposure associated with the asset manager's investments. In February this amounted to 1671 tons for the Mergence Africa SA Equity Fund and 265 tons for the Mergence Africa All Equity Fund.

Carbon exposure was valued at 1.2 percent of the funds' annual market value.

David Couldridge, a senior investment analyst at Frater Asset Management, which was among the first signatories of both the PRI and the CDP, says computing the potential cost of carbon to South African companies is "quite difficult" because of uncertainty around possible global obligations.

"In the meantime, we have to be aware that there is an emerging cost," he says.

Couldridge hopes investors will start realising that not just financial risks were important, but social, environmental and governance risks too.

"The systemic risks have effectively been totally missed with the global financial crisis," he says. "Our hope is this may be the turning point at which institutional investors … really start taking all forms of risk issues seriously on behalf of their beneficiaries. Until that happens, we'll sit with a cycle of boom and bust, essentially seeing destruction of value every five years or so."

RisCura, which mainly advises pension funds, found that sensitivity to environmental issues among trustees varied widely. By and large, the issues were viewed as "fringe" items.

Published on the web by Business Report on May 7, 2009.
