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Climate-proofing South Africa’s retirement funds

FASKEN ClientEarth

What is the problem?

Climate change poses a systemic risk to people, the environment and the economy. Temperature increases above 1.5°C have the potential to change life as we know it in South Africa completely. The Paris Agreement on climate change recognises that there is an **urgent need for a fast and just transition** to a resilient low-carbon economy that will drive job creation, reduce inequality and build social stability.

But this will not happen without urgent collaborative action from all of us.
In South Africa, our law supports strong action by institutional investors like pension funds to tackle climate change and drive inclusive economic prosperity. **But pension funds have not yet risen to the challenge: they need to do much more, much faster.**

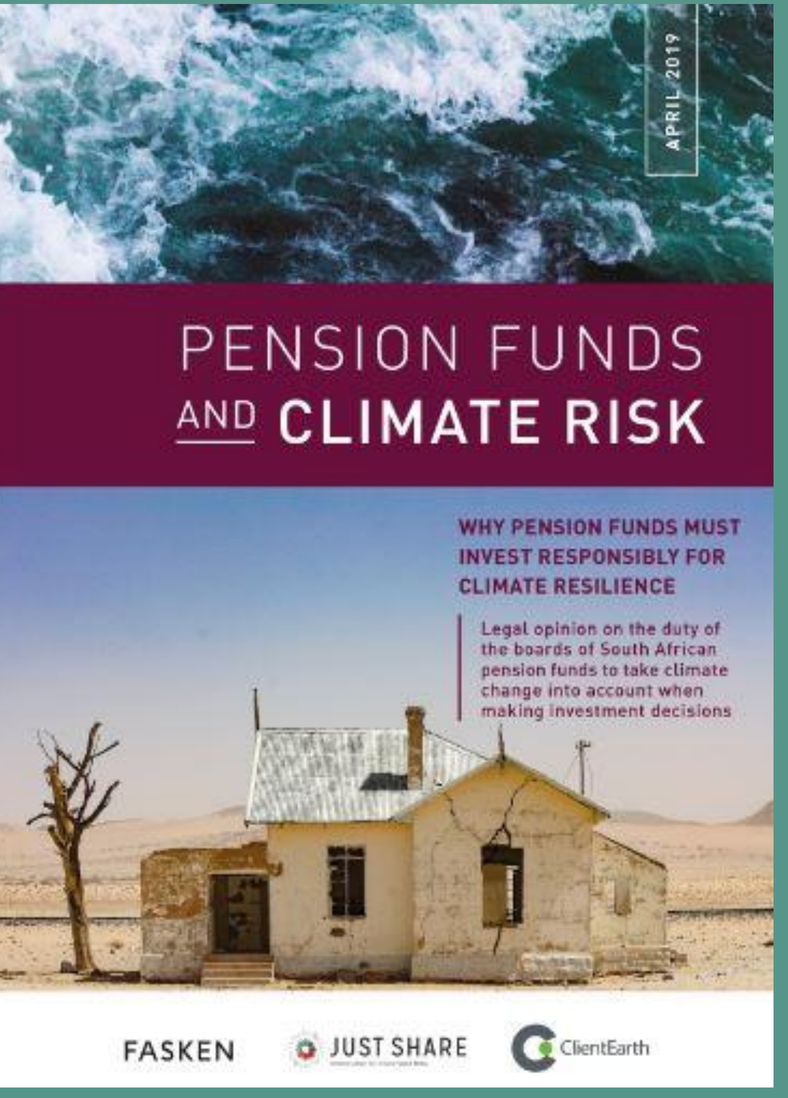
Fiduciary duty & climate risk

Just Share, together with international environmental legal NGO **ClientEarth**, commissioned a legal opinion from **Fasken** on the question:

Are the boards of pension or provident funds required under South African law to take into account climate-related risks & opportunities when making investment-related decisions on behalf of their funds?

Yes!

The legal opinion is unequivocal.



Fiduciary duties are owed to the fund

- The trustees of a fund owe their fiduciary duties to the fund, which is a legal entity.

- While section 7C(2)(f) of the Pension Funds Act says that the board of a fund has '*a fiduciary duty to members and beneficiaries in respect of accrued benefits*' and '*any amount accrued to provide a benefit*', this must be be understood in the context of steps taken in the direction, control and oversight of the fund. So a fiduciary duty to members is a duty to members as a whole. *City of Johannesburg v South African Local Authorities Pension Fund & others* [2015] ZASCA 4 at para 13.

Fiduciary duties are owed to the fund

- A pension fund is not established for the benefit of only its current members. It is a long-term vehicle intended to provide benefits to future members and their dependants too. *Sutherland v Hudson's Bay Company* 2007 CanLII 30293 (On SC) at para 163

- Trustees are not entitled to act on 'mandates' from those who appointed or elected them. – they must exercise an independent discretion. *PPWAWU National Provident Fund v Chemical, Energy, Paper, Printing, Wood & Allied Workers' Union* 2008 (2) SA 351 (W) at para 24 & following.

What a fiduciary duty to a fund is

- A fiduciary duty = a duty of loyalty

- Duty of loyalty = duty to protect interests of the principal

- Interests of the principal (the fund) = the fulfilment of its objects

  Merchant Navy Ratings Pension Fund Trustees v Stena Lines Ltd & others [2015] EWHC 448 (Ch) at para 228

Nature and objects of a pension or provident fund

A. It is a special purpose, 'not for profit' savings vehicle

B. It is a vehicle for collective economic empowerment and risk sharing

C. If it is an occupational fund, it is also a vehicle through which an employer rewards its employees for their services

D. It is not just for current members – it must be managed in a way that should ensure that it is resilient and sustainable over the long-term

Nature and objects of a pension or provident fund

E. If contributions paid to the fund and/or benefits paid by the fund receive special tax treatment, it is a vehicle for the delivery of state-subsidised social security.

(In South Africa-

- *Social grants were paid to approx **17,6 m people** each month in 2017, at a cost to the fiscus of approx **R170 billion** or **approx R9500.00 per person per** year*
- *Tax deductions on contributions to retirement funds were enjoyed by approx **3,17 million taxpayers** in 2017, at a cost to the fiscus of **approx R73 billion** or **approx R21 500 per person per year)***

So it is important to all of us, including the State, that pension funds are operated properly and responsibly

Climate change poses significant risks

Climate change entails serious financial risk to pension investments in the short, medium and long term.

It also poses risks to fund members and their dependants. In particular-

- High carbon assets may suffer **substantial depreciation in value** and this may jeopardise the value of the retirement savings intended to sustain them in retirement;
- It may result in **social, economic and political instability**

Low carbon economy → investment opportunities

At the same time, the transition to a low-carbon economy presents **significant investment opportunities** that can help to mitigate the broader economic risks posed by climate change and boost pension funds' long-term returns.

Trustees are now in a very privileged position: You have the power to change the direction of the economy and thereby safeguard the interests of your funds, their members and beneficiaries, the country and the region!

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Low carbon economy → investment opportunities

Just Share has **written to pension fund boards across SA** setting out the findings of the legal opinion, as well as steps that pension funds must take now to make sure they are complying with their legal duties and fulfilling their mission .

PENSION FUNDS AND CLIMATE RISK

WHAT MUST TRUSTEES DO?

Ensure that they are "climate competent"

Assess the carbon footprint

Develop a clear climate policy

Communicate your climate policy

Pursue active stewardship and engagement with companies in high-carbon sectors

Develop an investment strategy with clear, measurable targets

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WHAT MUST PENSION FUNDS DO?

Ensure that they are "climate competent", i.e. take appropriate advice, analyse and fully understand the climate risks and opportunities in relation to their funds.

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WHAT MUST PENSION FUNDS DO?
Develop a clear climate policy which explains the fund's understanding of climate risk, and how the board identifies and manages it.
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WHAT MUST PENSION FUNDS DO?

Communicate this policy to asset managers and consultants who manage the fund's investments on its behalf, and make sure that they are appropriately mandated and incentivised to implement the policy.

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WHAT MUST PENSION FUNDS DO?
Develop an investment strategy with clear, measurable targets to remove portfolio carbon risk and leverage low carbon opportunities.
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WHAT MUST PENSION FUNDS DO?

Pursue active stewardship and engagement with companies in high-carbon sectors, including by setting clear voting policies and engagement escalation timelines; and regularly disclose to members how they are managing climate risk.

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WHAT MUST PENSION FUNDS DO?

Assess the carbon footprint of their fund's portfolio, and identify investments which identify investments which are vulnerable to climate risk and those which can contribute to a just transition to a low-carbon economy.

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The full legal opinion and factsheet is available online:
https://justshare.org.za/pension-funds-climate-risk

If you have any questions, feel free to email:
info@justshare.org.za

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