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# Chief Executive Officer's

# **Foreword**



**Derrick Msibi**Chief Executive Officer

The past year was challenging for the global economy, driven by the ongoing standstill of many economic and social activities and stop-start attempts to return to normal as the pandemic evolved. Although South Africa

benefited from the commodity boom, navigating continued economic lockdowns was particularly challenging. The South African unemployment rate reached a record high of 35.3%, compounded by persistent higher inflation and tragic events, including riots and looting in KwaZulu-Natal. Globally, policymakers continued to grapple with balancing the protection of communities from the immediate health crisis and the economic fabric required to support income-earning opportunities. This meant a temporary shift in policy focus from the longer-term challenges such as climate change and protecting biodiversity.

Positively, 2021 was a milestone year for environmental, social and governance (ESG) investing. Globally, US\$649 billion was invested in government-mandated ESG funds in the first 11 months of the year, compared with US\$542 billion in 2020 and US\$285 billion in 2019. Increased investor appetite was driven by extreme weather, COVID-19, worldwide social challenges and injustices, and a heightened knowledge of the impact of consumer behaviour on biodiversity and ecosystems.

The formation of the United Nations Principles for Responsible Investment (UNPRI) in 2006 signalled a more formal acknowledgement of the importance of responsible investment. Today, the PRI has close to 5 000 signatories covering approximately US\$121 trillion in assets under management (AUM). In South Africa, an early adopter of responsible investing and signatory of the UNPRI code, ESG has



As stewards of our clients' capital, and with a fiduciary mindset, STANLIB focuses on developing with the industry to strive for responsible investment by considering how our capital allocation decisions impact stakeholders, the entities we invest in and the communities in which we operate. We believe that successful investment management stems from sustainable investments and adding value for stakeholders.

Over the years, informed by our commitment to responsible investing, we have deepened our ESG practices across all investment teams. Through the creation of impact funds such as our Khanyisa Impact Investment Fund (Khanyisa) and our Infrastructure Investing activities, we have applied our investment management skills to create investable opportunities to push responsible investing further into the mainstream. There is mounting evidence that ESG-related issues affect the performance of investment portfolios, impact an entity's earnings and prospects, and influence the broader economy. This is a risk which we, as

investment managers, should focus on mitigating. We are also acutely aware that South Africa faces unique challenges. Compared with its developedmarket counterparts, the nature, interrelatedness and complexity of its ESG-related issues are high. For example, the need for food and energy security must be balanced with environmental impacts which in some cases creates opportunities along with the known challenges. Our investment opportunities are fewer in South Africa than in developed markets. This highlights the need to drive change through active engagement instead of an exclusionary approach. This report will evidence the positive results from our ongoing active engagements where we have clearly set out a list of key items that form part of our annual ESG agenda.

Over the past several years, STANLIB made progress in growth and transformation as a truly South African asset management business.

We achieved a milestone in 2021 when we embarked on a strategic partnership with J.P. Morgan Asset Management (JPMAM). The partnership will enable STANLIB to leverage JPMAM's world-class investment capabilities and deliver a better investment experience to our clients. This will include sharing knowledge across our firms on ESG-related topics and investment activities.

The year to come will likely deliver further challenges to the socioeconomic landscape. The Russia-Ukraine crisis, for example, poses tragic environmental and societal consequences that extend beyond those borders. While the difficulties of 2022 remain unknown, we understand the importance of standing together and we will continue to support purposeful and impactful change for a better tomorrow.



# A note from our heads

of investments



Mark Lovett
Head of
Investments



Henry Munzara
Deputy Head of

In 2021, we deepened ESG integration across our investment teams, including revising our responsible investment policy. We also prioritised proof points to demonstrate progress in our preferred approach of engagement, as evidenced by several case studies in this report. Our Equity team led the charge by distributing its inaugural letter to companies, which formed a useful basis for engagement on specific topics. We will track and follow up on commitments made by companies. In the debt space, our Fixed Income and Credit teams increased engagements and revised their framework to engage state-owned entities (SOEs) given the deterioration in financial metrics and poor governance practices.

Impact remains an area of continued focus, given the tangible and direct nature of investment activities to societal, environmental and economic ends. The UN Sustainable Development Goals (SDGs) remain a useful framework to demonstrate impact in this regard. In this report, we showcase further investments made by our Infrastructure team, particularly in the renewables space, where we are a significant player. We also unpack investment opportunities in low-income housing, which are being pursued by our Credit Alternatives team, to demonstrate that financial returns and positive impact, or "doing good", are not mutually exclusive.

Also of interest, JPMAM released a thought leadership article on the journey to net zero and its practical implications. Much has transpired in the environmental space over the past year and a number of asset managers and financial institutions have been accused of "greenwashing" as their marketing and product claims failed to stand up to scrutiny. The Ukraine-Russia war has also thrown a curveball at environmental efforts agreed at the UN Climate Change Conference of the Parties (COP26)

in November 2021 as countries, especially in Europe, are torn between environmental targets and sustaining economies in the short term. Our position remains to advocate for a "just transition" – in developing economies such as ours, it is important to have a helicitic and

important to have a holistic approach to ESG. In many instances there are trade-offs to be made and pragmatic glide paths to be set. Our role is to consider the trade-offs, agitate for change and monitor and track progress.

#### Our 2022 activities will be directed at:

- Regulation and good practice: ensuring that our activities remain aligned to industry best practice as outlined by bodies such as the PRI and local regulators
- **2. Investment process:** continuing to deepen and entrench responsible investing activities across the investment value chain
- **3. Collaboration:** prioritising collaboration across investment teams, our strategic partners and industry participants, ensuring that, as a collective, we can have a more profound impact in driving positive change

#### 4. Disclosure:

- > We are committed to transparency and actively encourage companies to disclose ESG information in line with best practice to facilitate a better understanding of risks and opportunities
- > We focus on improving disclosures to investors, including aligning reporting and disclosure on climate-related issues to best practices outlined by the Task Force on Climate-Related Financial Disclosures (TCFD)

# STANLIB's principles for responsible investing

# Integration of ESG factors

STANLIB considers ESG factors in its investment processes to ensure an understanding of risks associated with investment opportunities.

# **Active engagement**

STANLIB's ESG approach is to actively engage business stakeholders to effect change. STANLIB believes engagement is a powerful tool to drive optimal client outcomes.

# **Collaboration**

STANLIB is open to collaboration where the collective efforts of all relevant stakeholders are more likely to result in a positive client outcome.

# **ESG** oversight

STANLIB monitors and challenges investment professionals on ESG issues. Governance structures ensure accountability, tracking and measurement.

# ESG is a material investment consideration

STANLIB believes that the consideration of ESG is essential to value creation and capital protection in driving risk-adjusted returns for clients.

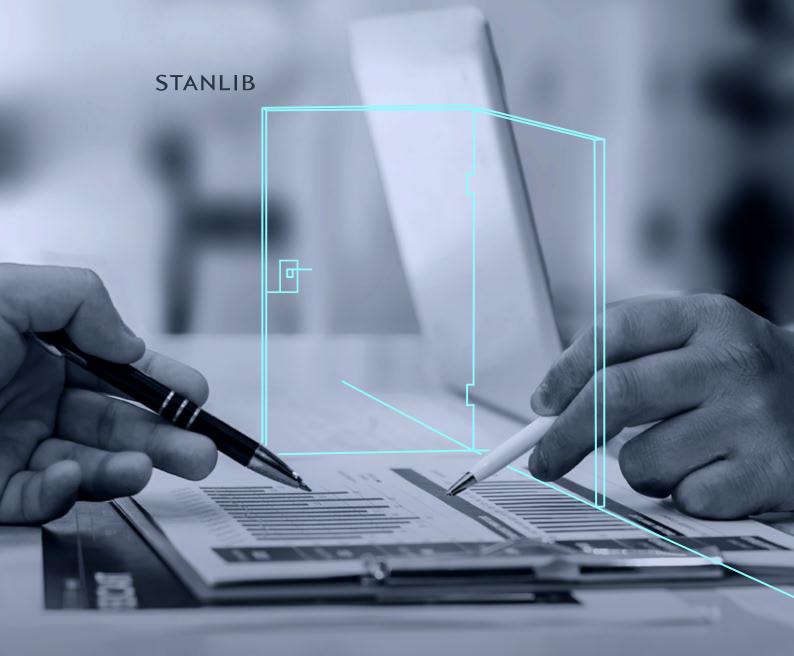
# **Ownership** rights

STANLIB exercises voting rights in the best interests of its clients. Voting guidelines appear in the proxy voting policy.

## **Disclosure**

STANLIB communicates its policies and responsible investing activities to its stakeholders.





# Active ownership and engagement

In this section, we report on our 2021 active ownership activities to demonstrate how we use our scale and shareholding as an opportunity to influence positive change.

STANLIB believes ESG is material to investment decisions. As such, we integrate ESG considerations into the assessment of the investment risk of companies in which we invest. This internal ESG assessment informs how we construct client portfolios and identifies ESG issues that could impact their long-term sustainability.

Our investable universe is small and concentrated, and we operate on a continent facing tremendous economic and social challenges. As such, we believe that an exclusion approach to ESG concerns is not the answer but rather that engagement is a powerful tool to drive change. We use engagement and voting as effective active ownership tools to influence companies to desired outcomes that ultimately benefit our client portfolios.

### **STANLIB'S engagement letter**

One of our focus areas in 2021 was distributing stewardship engagement letters to JSE-listed companies in our client equity portfolios. By sending these **51 engagement letters**, we hoped to proactively outline important ESG-related issues and inform companies why, as investors, we believe these issues are essential and should be addressed by management.

Our engagement letter introduced four main topics for discussion during the year.

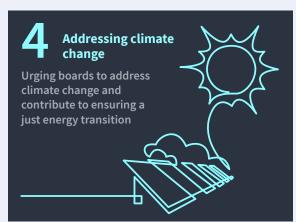
These topics were determined based on our assessment of common ESG risks across our client portfolios that could reduce portfolio risks associated with ESG factors relative to the broader equities index and drive sustainable business practices by aligning management interests with long-term incentives. These focus areas guided our voting during the 2021 annual general meeting (AGM), and were applied across our investment holdings in all industries.

#### The four topics we identified were:







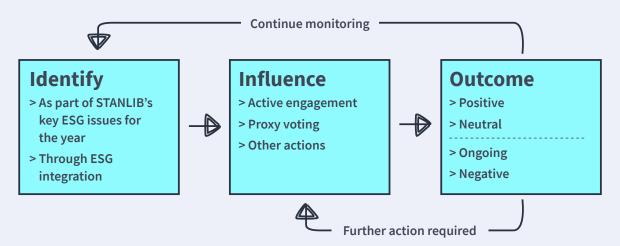


# Showcasing engagement and voting activities

In the section to follow, we detail some responses to the 2021 engagement letters. Our active ownership overview for 2021 demonstrates that remuneration and board independence were key themes in our engagements and voting activities.

We expand on these themes and provide practical examples, with brief case studies. Finally, we emphasise the multi-year nature of active ownership with an update on two ongoing engagement case studies focusing on governance and climate change.

## Our approach to active ownership



# Our active ownership activities are derived from two sources:

#### 1. ESG committee

STANLIB seeks to drive key ESG issues as determined by our ESG committee at the beginning of each year. As part of this process, we identify ESG-related issues that drive collective and long-term value across our client portfolios. STANLIB's significant AUM – which exceeds R650 billion – can be used to exert influence on investees to make a positive impact on society and the environment.

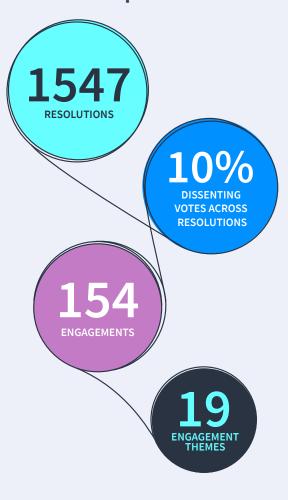
#### 2. Investment team process

**ESG integration by our independent investment teams.** The teams are responsible for ensuring ESG risks and opportunities are sufficiently integrated into their investment processes and are expected to address concerns identified mainly through active engagement and proxy voting on behalf of our clients.

We leverage our shareholding to engage proactively, exercise voting rights and collaborate – all key elements to influence positive change.

We monitor the outcomes of our active ownership activities (page 11) while ensuring ESG risks are continuously tracked.

#### Active ownership in 2021<sup>3</sup>



<sup>3</sup>Active ownership is reported for STANLIB's local assets only. International assets are managed mainly through external manager partnerships. ESG factors are considered as part of the manager selection initial due diligence in terms of having an appropriate ESG policy and being a PRI signatory. There is also ongoing monitoring through report-backs, including ESG-related reporting.

## Voting in 2021

Grouping resolutions by subject shows a consistent composition across the last three years, where boards of directors (30%), remuneration (26%), and committees and reporting (23%) resolutions were dominant. Additional resolutions included corporate structure (16%), general governance (4%) and other (1%).

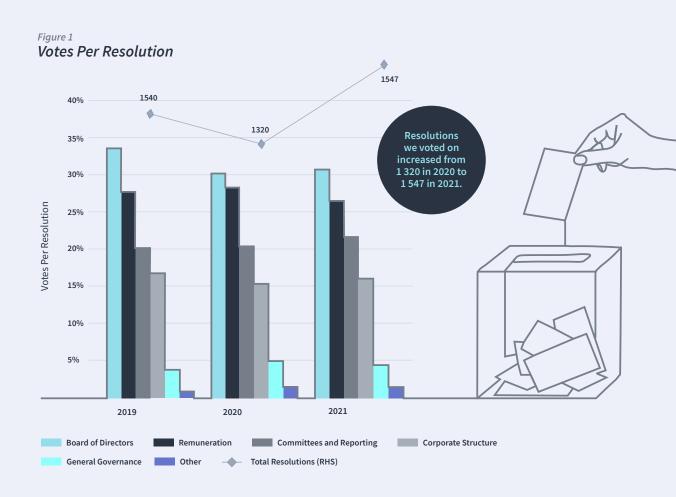
We voted against 10% of all resolutions across 57 of 76 companies, meaning we voted against at least one resolution in 75% of the AGMs of the equity holdings in our client portfolios.

There is a consistent profile of dissenting votes by resolution across the last three years. Remuneration resolutions remain the most dominant subject we voted against, accounting for about 36% of dissenting resolutions in 2021. Leadership issues, including boards of directors

and committees and reporting resolutions, also contributed significantly, at about **43%** of the dissenting votes, with emphasis on board independence. Corporate structure, general governance and other resolutions contributed 21%.

Our 2021 voting record for the Naspers-Prosus stable was included as a **brief case study (page 18)** considering the proposed share swap transaction which dominated headlines in 2021, given the large weighting on the JSE equity indexes.

More information on the guidelines of how we apply ownership rights relating to our various equity investments is available in the <u>STANLIB proxy voting policy</u>.



Stewardship Report 2021

Yearly Dissenting Votes on a Resolution Basis We voted against 60% Yearly Dissenting Votes on a Resolution Basis 12% of all 10% resolutions 50% 8% 40% 30% 20% 10% 2019 2020

Committees and Reporting

% of Total Resolutions (RHS)

# **Engagements in 2021**

**Board of Directors** 

General Governance

To ensure our engagements are objective-driven, our analysts are required to record the outcomes of all engagements. We believe a data-driven approach to active ownership allows us to meaningfully track progress and engagement outcomes across our client portfolios. It should

Remuneration

be noted that these outcomes are different from impact investment outcomes, which are measured against standard metrics such as the SDGs but are qualitatively assessed by responsible analysts. The outcomes can be positive, neutral, ongoing or negative.

Corporate Structure

154	Type of engagement	
engagements	Meeting	58%
85 entities	Written correspondence	36%
	Phone call	6%

In 2021, most engagements (55.6%) had a neutral outcome. In these, we seek to better understand ESG issues or communicate our ESG policies to investees. We rely on engagements of this nature as research to inform the integration of ESG into our investment processes and to help set a specific ESG agenda for companies. 37.6% of engagements had an ongoing outcome, where further engagement is required to drive the investee towards a specific objective. 6.8% of engagements had a positive outcome, and we continue to monitor these companies as part of our investment research.

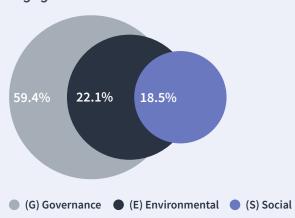
We are aware of the challenge of assigning a positive outcome to engagement activities. It is encouraging to note that we recorded no negative outcomes this year. An engagement would be classified as having a negative outcome where the objective is not met and further engagement would not change the outcome.

Our most engaged entity last year was the Land and Agricultural Development Bank. On **page 21**, we detail our SOE engagement framework for fixed income and credit investments.

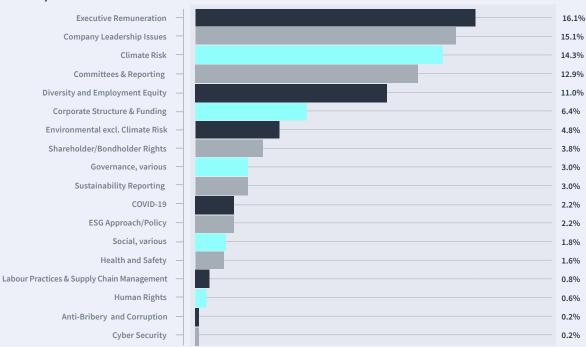
#### **Engagement Outcomes**

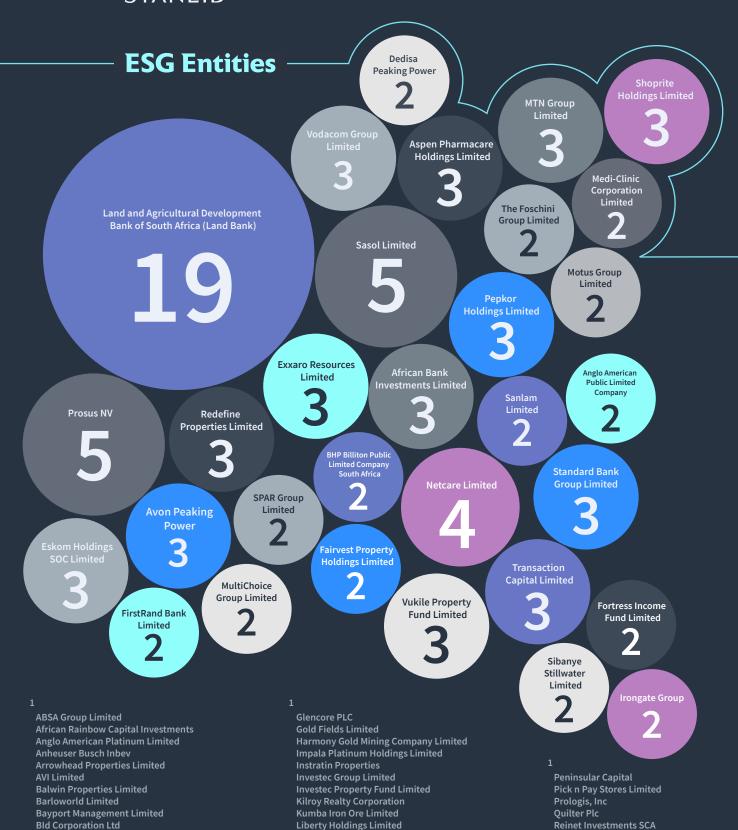


#### **Engagement Factors**



#### **ESG Topics**





Liberty Two Degrees

**Naspers Limited** 

Nedbank Limited

**Nedgroup Limited** 

Ninety One plc

Mr Price Group Limited

Northam Platinum Limited

**Old Mutual Public Limited Company** 

Life Healthcare Group Holdings Limited

**Old Mutual Life Assurance Company Limited South Africa** 

Richemont Securities Ag

Santam Limited

Draunberg)

Welltower, Inc.

Scatec Solar Kalkbult

Transnet SOC Limited

**Royal Bafokeng Platinum Limited** 

SIMACEL 160 (Pty) limited (Project

**SA Corporate Real Estate Trust** 

Woolworths Holdings Limited

**Discovery Life Collective Investments Proprietary Limited** 

British American Tobacco Public Limited Company

**Bidvest Group Limited** 

**DisChem Pharmacies** 

Clicks Group Ltd

**Capitec Bank Holdings Limited** 

Ethos Private Equity (Pty) Ltd

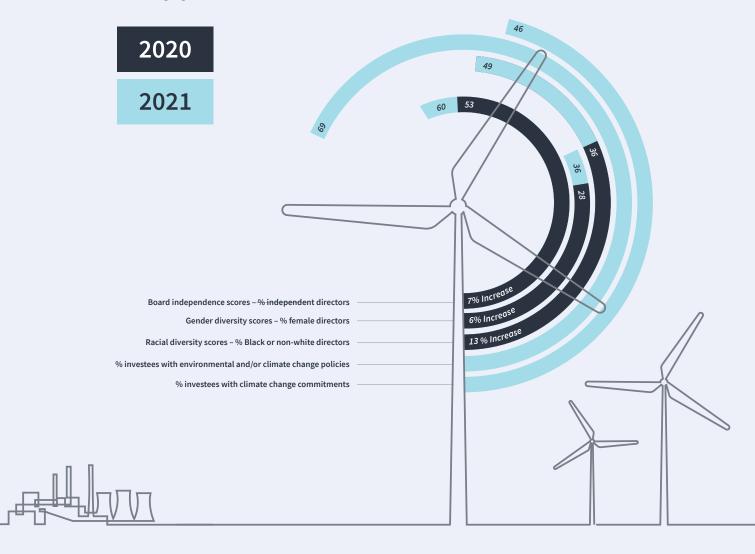
Compagnie Financiere Richemont SA

Deutsche Bank AG Johannesburg Branch

**Coronation Fund Managers Limited** 

#### **Driving improved outcomes from engagements**

We tracked data points related to the four focus areas highlighted in the engagement letter distributed by our Equity team, as outlined on **page 7** of this report. The outcomes are encouraging:



Although the diagram above shows year-onyear progress, there is room for improvement. We believe that sharing the outcomes of our findings with our investees will further incentivise improvement and communicate key ESG issues that should be addressed by management to improve a company's sustainability. This is a useful tool to ensure our processes and measurements are well understood and that, through investing, we can drive change. In 2022, we will share the governance ratings of companies in which we invest. We will continue strengthening our engagement on issues, including ESG reporting frameworks, biodiversity protection, water usage, gender diversity at management level, pay disparity and supply chain management.

## **Case Studies**

### Remuneration and board independence

Remuneration and board independence accounted for about 31% of our engagement topics and most dissenting votes in 2021. We identified these as focus areas for our active ownership agenda for the

year, and they were communicated in our inaugural stewardship letter to investee companies on behalf of our clients (page 7).

We believe board independence and remuneration policies that align with shareholder interests and have a long-term focus will drive sustainable management practices. The importance of these elements is reflected in their relatively high weightings in the ESG scorecard applied by our Equity team. The scorecard asserts that an effective board comprising an independent majority is more likely to consider the best interests of shareowners first, foster independent decision-making and mitigate conflicts of interest4. ESG-linked incentives for management align with the interests of broader stakeholders, including the community and operating environment, and address potential risks that can impact long-term value.

In assessing the materiality of ESG themes for the year, the ESG committee considers issues that have a high positive impact on the ESG risks across our client portfolios and our ability to successfully exert influence through active engagement and voting.

In the case studies that follow, we illustrate our engagement and voting activities on remuneration and board independence and the outcomes achieved.



\*CFA Institute, Board Independence & Independent Board of Directors. Available at: https://www.cfainstitute.org/en/advocacy/issues/board-independence#sort=%40pubbrowsedate%20descending

## Remuneration at Richemont

#### **Background**

In 2020, we wrote to the board's lead independent director expressing our disappointment that Richemont chose not to disclose AGM voting results FY2021 AGM. because it is not required under Swiss listing requirements. This letter served as an invitation to further discussion and, given the lead independent director's role as chair of the remuneration

committee and member of the nominations committee, a meeting was scheduled ahead of the

#### **Our focus**

We engaged with Richemont to convey and discuss the STANLIB 2021 ESG engagement letter, our policies relating to remuneration disclosure, board member independence and Richemont's sizeable board. We expressed concern regarding the limited disclosure around short-term incentive KPIs and asked the company to consider voluntary disclosure of AGM voting. We were assured that we would see progress regarding the board and remuneration in the next reporting period.

#### The outcome

Our concerns regarding the need for improved disclosure of voting records were noted and acknowledged by Richemont. Disclosure of voting records is not a requirement of the Swiss Stock Exchange.



We voted against a resolution for the approval of the maximum aggregate amount of variable compensation of the members of the senior executive committee. There were no clear linkages between executive KPIs and rewards, and financial and non-financial KPIs need to be disclosed.

We note the following enhancement to the remuneration policy contained in Richemont's 2022 annual report:

- 1. Variable compensation is clearly aligned with strategic priorities and ESG KPIs are included in short- and long-term incentives
- 2. Executive committee remit changed to focus on capital allocation and strategic decisionmaking
- 3. KPIs are clearly defined quantitatively and qualitatively, and include profitability and balance sheet metrics
- 4. There are still areas where the remuneration committee has discretion that we are **uncomfortable with,** such as the introduction of the Performance Cash Unit, which allows for additional cash incentives for significant outperformance of challenger targets which are not disclosed in advance

Despite founder and chairman Johann Rupert's desire not to fill committees with the same people, the board is shrinking. In Financial Year (FY) 2020 the board was at 20 members; in FY2021, it was 18 and will reduce to 16 at the FY2022 AGM in September, resulting in an improvement in STANLIB's governance score and ranking.

Our assessment is that overall governance has improved since our engagement. Long-tenured board members are retiring, and newer members are gaining in stature. The remuneration policy has improved but there is room for more refinement.



# **Board independence: Coronation Fund Managers** (Coronation)

#### **Background**

February 2021 indicated a lack of independence. In terms of STANLIB's definition, only five NEDs were

deemed independent, effectively rendering the board non-independent.

#### **Our focus**

We engaged senior management and the board on the lack of board independence, expressing our concern over the long tenures of half of the board members. Our preference is for tenure to not exceed 10 years. We also conveyed our preference for KPIs to be strongly linked to ESG targets, especially environmental KPIs.

We voted against resolutions to re-elect three audit and risk committee members we believed were no longer independent as their tenure exceeded 10 years. The audit and risk committees were subsequently reconstituted and the audit committee is now independent.

#### The outcome

Coronation agreed to reassess its policies around board tenure. Subsequently, the board appointed three



new directors. One longtenured director retired and, sadly, the long-tenured chairman passed away. These changes led to a marked improvement in independence and thought diversity.

# **Board independence: Pepkor Holdings Limited (Pepkor)**

#### **Background**

In our 2020 stewardship report, we detailed our engagements with Pepkor on a potential conflict of interest of the chairman, who should not seek

re-election. We achieved a positive outcome, and a new chairman was appointed. We remained concerned about the independence of the board.

#### **Our focus**

We met with the incoming chairman to raise governance-related concerns, which included whether the interests of minority shareholders were being represented in discussions with Steinhoff International Holdings (Steinhoff) in terms of future shareholding, and the potential implications for minority shareholders. We also wanted to ensure that the opportunity to reform the board was taken advantage of, given the recent departures, and that the independence and diversity of the board were strengthened. We also raised that diversity at board and management level is a key disappointment in the ESG assessment for Pepkor.

#### The outcome

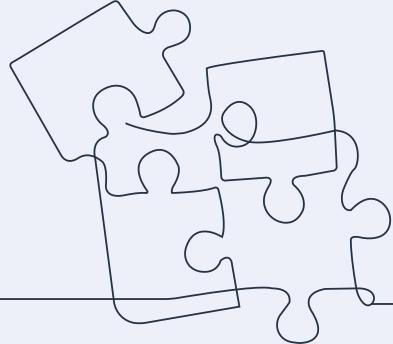
Pepkor asserted that while it engages with Steinhoff, it has no control or influence over Steinhoff's actions regarding its corporate activity and legal processes. We emphasised



the importance of the board considering the implications of various Steinhoff scenarios on minority shareholders and raising those concerns with Steinhoff's management and board. The chairman confirmed that Pepkor is recruiting new directors to enhance board diversity, independence and skills, and bringing the number of board members to an acceptable level.

At the 2021 AGM, STANLIB voted against resolutions to re-elect non-independent directors who retired by rotation. On 27 May 2021, Pepkor appointed five new board members. The board is now independent by our definition, which ensures improved minority shareholder protection.

We will work towards further improvements in gender and race diversity on the Pepkor board.



## **Governance: Naspers-Prosus**

#### **Background**

The Naspers-Prosus stable was trading at a large discount relative to its underlying assets. Management believed Naspers – the single largest constituent of the Shareholder Weighted All Share Index (SWIX), which peaked at around 25% in weight last year – contributed to the increased discount relative to net asset value. Consequently,

in May 2021, management proposed a transaction to reduce its weighting in SWIX through a share swap, where Prosus would acquire 45% of Naspers shares by issuing new Prosus shares. The proposal was put to vote at the AGM in August 2021.

#### **Our focus**

Over 30 asset managers drafted a letter to Naspers' independent NEDs highlighting concerns around the proposed transaction. STANLIB was involved in initial discussions, but more time was necessary to explore the consequences of the transaction. We engaged directly with Naspers to better understand the transaction and drafted a letter to the NEDs detailing our concerns with the proposed transaction. We had two reservations:

- 1. The resulting complexity of the corporate structure, which would introduce a crossshareholding structure, would reduce the discount; it was also not clear which additional steps would be taken to address the trading discounts in the longer term
- 2. The management incentives put in place were not aligned with unlocking Naspers' value, and instead favoured Prosus-based targets

#### The outcome

STANLIB voted in favour of the proposed transaction, believing it signalled the first step in unlocking the discount between Naspers and Prosus. Furthermore,



the exchange ratio allowed Naspers shareholders to swap their shareholding for Prosus, unlocking value for Naspers shareholders when the transaction was implemented. We voted against the remuneration resolutions. Although the detailed disclosure had improved, with clear financial and non-financial metrics being disclosed, we felt the quantum did not align with the creation of value at shareholder level.

To date, management's value unlock strategy has not been successful; there are multiple reasons for the continued discounts within the structure. Management is alive to shareholders' concerns and more will be done to unlock value soon. We continue to engage on this issue.



## Update on prior engagements reported

As part of our approach to active ownership (page 8), we continue to monitor companies on ESG-related matters after an engagement objective has been achieved. We also continue to exert influence where we can positively influence management, despite not meeting our objective

in prior engagements. As such, ESG-related engagements are likely to extend over multiple years. This section provides updates on two longstanding holdings in our equity portfolios previously reported on.

# Shoprite Holdings Limited (Shoprite): a steady journey to better governance

#### **Background**

With 2 432 stores, Shoprite is Africa's largest fast-moving consumer goods retailer. Through its wide range of customer-facing brands, value-added services and logistics services, the group employs over 149 000 people and operates across numerous industries to deliver robust products and services.

STANLIB has been a Shoprite shareholder for decades. As our preferred food retailer, Shoprite's established strategy of growing its share among

higher-income consumers while consolidating its leading position as a value retailer continues to gain traction at the expense of its competition.

Over the years, our ESG engagement journey with Shoprite's board and management could be adversarial. However, more recently, our engagements have been more constructive, given Shoprite's transition from its roots as a founder-led business to a best-in-class corporate citizen.

#### **Our focus**

As an active investor in Shoprite, we noted several ESG items to be addressed with management during 2021. These issues mostly centred around governance.

We had six ESG engagements over the last two years, which covered:

- 1. Succession planning for the chairman and founder: Shoprite's founder, Dr Christo Wiese, has since stepped down as chairman and is now classified as a non-independent NED. Significantly, Wendy Lucas-Bull became Shoprite's first female chairman on 1 April 2022.
- 2. Executive remuneration policy: remuneration remains an area for improvement and while significant strides have been made over the last three years, the balance of executive committee pay can improve; the pay gap between highest- and lowest-paid employees should be addressed; and KPIs that include ESG targets should be more transparent.

**3. Sustainability reporting:** Shoprite embraced sustainability, with its inaugural report in 2020 providing a solid foundation. After its publication, management engaged extensively, using feedback to improve its reporting practices.

#### The outcome

This engagement process proves the value of continued robust engagement at executive and board level, and with the chairman. Overall, the ESG outcomes over time have been



positive for minority shareholders. By our definition the board is independent, and we continue to engage to improve the gender and racial diversity thereof.

To date, management's value unlock strategy has not been successful; there are multiple reasons for the continued discounts within the structure. Management is alive to shareholders' concerns and more will be done to unlock value soon. We continue to engage on this issue.

# Sasol: at the heart of climate change

#### Background

Sasol, a global integrated chemicals and energy company, supplies energy to South Africa and its neighbours. Sasol was established over 50 years ago and employs over 31 000 people. In FY2020, it paid R2 billion in taxes and substituted approximately R21 billion worth of imports. These figures highlight Sasol's significant contribution to South Africa's economy, which is critical considering fiscal

challenges and social vulnerability. We documented Sasol's complex role in South Africa's climate change debate in our 2020 stewardship report. Sasol's role in limiting global temperature rise to 1.5°C by 2050 is crucial. Sasol is the largest private emitter of greenhouse gas (GHG) emissions in Africa, second to Eskom in absolute terms.

#### **Our focus**

As shareholders, we must balance the need for energy and jobs provided by the industry with the equally-important duty to urgently reduce GHG emissions. It is critical that companies like Sasol manage an effective transition of jobs and communities as they move to renewable energy and improve processes to reduce their environmental impact. Sasol's shareholders and other interested stakeholders play an important role in encouraging the business to quantify the scope of the problem and define how to address it.

Sasol's inaugural 2020 climate change report outlined its plan to reduce emissions and transition away from coal as the major source of power through renewables and then gas as the feedstock to produce liquid energy for the South African market.

To that end, we engaged with Sasol's board and management on its climate change strategy and implementation roadmap. We held seven ESG engagements with Sasol over the past two years on the following topics:

#### 1. Remuneration and KPIs: links to ESG strategy

STANLIB engaged on remuneration policy changes, focusing on changes to KPIs to accommodate more relevant profitability and return metrics after the sale of Lake Charles Chemicals Project, and on the introduction of KPIs that measure the transition from a high-carbon intensity business to a lower-and then low-carbon intensity business.

# 2. Climate risk and GHG reduction strategy and implementation

At first, management did not commit to net-zero emissions by 2050. However, management has now developed net-zero emissions targets with a clearly-defined glide path to reduce emissions. The 2030 goal was enhanced from 10% to 30% GHG reduction. The roadmap is articulated for 2030, but clarity is still forthcoming for the extended period of 2030 to 2050. This will require a clearer strategy for the use of hydrogen and can be defined in the medium term. Sasol has indicated that there are multiple paths to achieve its 2030 to 2050 goals.

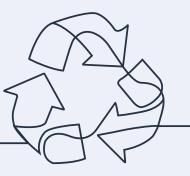
#### The outcome

Sasol's management team endeavours to ensure it continues to play a role in South Africa's economy. The company is aggressively working to enable green

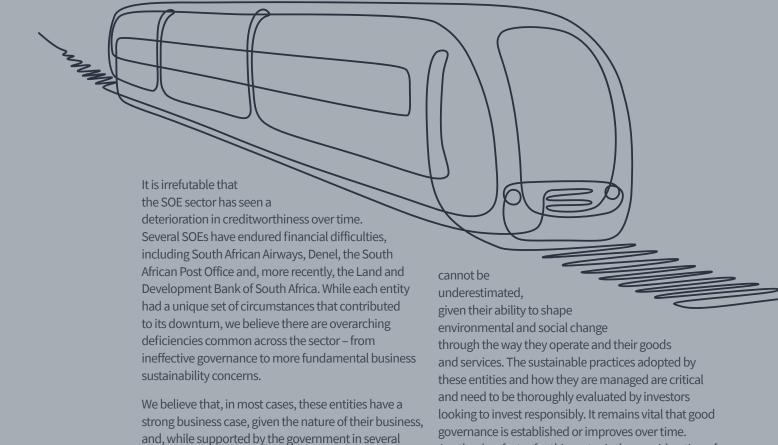


hydrogen as an energy source in industrial applications and to reduce its Scope 1  $\rm CO_2$  emissions by commissioning renewal power plants. We will be able to measure progress post the commissioning of these facilities in 2023.

As shareholders, we will continue to hold management accountable through their corporate journey.







#### **Our framework**

#### The following principles inform our philosophy on lending to the public sector:

We first assess **the business model of an SOE** to establish its sustainability. This is partly informed by the strategic or critical role the entity plays in the economy, and its ability to sustain itself financially without external support from the government.

ways, must be able to stand on their own merits. The

role SOEs play in developing South Africa's economy

Transnet's business model is an example of an SOE that owns and operates critical infrastructure in South Africa including, among others, the national rail network and strategic ports. In South Africa's largely commodity-driven economy, Transnet plays a vital role in ensuring the movement of commodities and goods from source to port, and from coastal to inland areas.

Rail infrastructure in South Africa, albeit in need of upgrades, remains an efficient and sustainable way of transporting goods – especially if one considers road transport's higher carbon footprint. Transnet is a significant employer, indirectly facilitating employment by virtue of the industries it supports, in particular the mining sector.

Another key factor for this sector is the consideration of

qualified audits and what this means for the entity.

To date, Transnet has raised funding based on the strength of its balance sheet without the need for government guarantees or other forms of support. In this regard, we evolved our approach to rating such SOEs by de-emphasising the implicit support assumption from the government. We believe this to be a prudent approach.

From a **governance perspective**, we comprehensively assess the governance structures in place. In our view, the role of the board of directors in ensuring effective oversight is paramount.

in ensuring effective oversight is paramount. Accordingly, we assess the board's composition in terms of capability, tenure and independence.

In the past, we engaged with certain SOEs to understand the appointment of board members where we believed a conflict to be apparent, as well as the plans in place to fill critical executive positions or vacant board seats. In exceptional cases, the counterparty would be referred to an internal customer review committee for a high-risk assessment. Regarding the executive management team, we consider the ability and credibility of key management, including whether those individuals have been associated with past transgressions, to evaluate the appropriateness of appointments.

We rely on management to run vital and vast organisations responsibly, so we assess these teams in the same way as we would those in the private sector. For STANLIB, the prevalence of acting positions for prolonged periods in the public sector is a warning sign of instability, and we view such occurrences with caution.

Another prevailing feature within the public sector is the **publication of qualified audit opinions.**These sometimes relate to Public Finance
Management Act (PFMA) audit qualifications,
where corruption and/or irregular and fruitless
expenditure is uncovered and not disclosed
in accordance with regulations. We take these
occurrences seriously and, where possible,
endeavour to include them as "events of default"
in our loan documentation. Perpetual audit
qualifications cast a negative light on an SOE's
internal controls, leading investors to doubt the
accuracy and reliability of financial information

Notwithstanding this, we have found instances where PFMA audit qualifications relate to irregular expenditure which predates the existing management teams. In these cases, we opt for extensive, direct engagement with the teams to assess remedial plans implemented in response. Where clear and tangible progress is noted, we adopt a constructive approach to such counters while holding entities accountable on their planned path to remediation.

and reporting.

#### **Conclusion**

SOEs and public sector entities in South Africa play an important role in maintaining and growing the economy and delivering much-needed services to South Africans. They employ many people, contributing to South Africa's social well-being. Investing in these entities is essential for their continuity and provides good investment opportunities for capital allocators.

We believe that through comprehensive evaluations of public sector entities, particularly SOEs, when investing in listed or private debt, we can identify sector-specific risks and opportunities. Our research and investment decisions benefit from the collaboration of two teams with diverse skill sets. It is fundamental that investors across all types of investment shift the focus to ensure capital is allocated to such entities responsibly.

STANLIB believes identifying ESG factors specific to these entities upfront enables transparent engagement among all stakeholders, leading to better investment outcomes for our clients and the country. With existing investments, we continue to advocate for positive change and engage across the teams with SOEs and public sector entities to ensure we drive accountability. We believe this will lead to positive outcomes in the long term.



Investing for Impact through

# Low-Income Housing

# Low-income housing in South Africa

Access to affordable, decent housing is a fundamental socioeconomic right. Our Credit Alternatives team is a key participant in the developmental and impact finance spaces. This is driven by our credit investment activities and management of the Khanyisa Impact Fund (Khanyisa). Khanyisa was designed to invest in private credit assets that have a tangible social benefit. We strategically focus on financing social infrastructure, which includes healthcare, education and housing. Aligned with this focus, the team assesses and invests in opportunities within the low- to middle-income housing market, often referred to as affordable housing. This is a large market space that covers both rental and buy-to-own opportunities.

Housing, particularly low-income housing, is key to delivering on the UN SDGs. Khanyisa aligns our impact outcomes to these SDGs.

While housing is covered by SDG 11, it can also be seen as the undercurrent of all SDG-related goals. Decent housing drives access to basic services,

contributes to inclusive growth and supports the development of a sustainable future, with a direct impact on the factors that contribute to or mediate the effects of climate change. Investment in affordable housing is likely to impact at least 14 SDGs.

#### **UN Sustainable Development Goals**



































#### The South African low-income housing market

The non-traditional housing landscape is vast and varied in South Africa. It spans regulated definitions, such as social housing, to the more loosely coined "affordable housing". For the purposes of this article, we will use "low-income housing" as a catch-all phrase to describe the various aspects of the value chain in this market, including social housing.

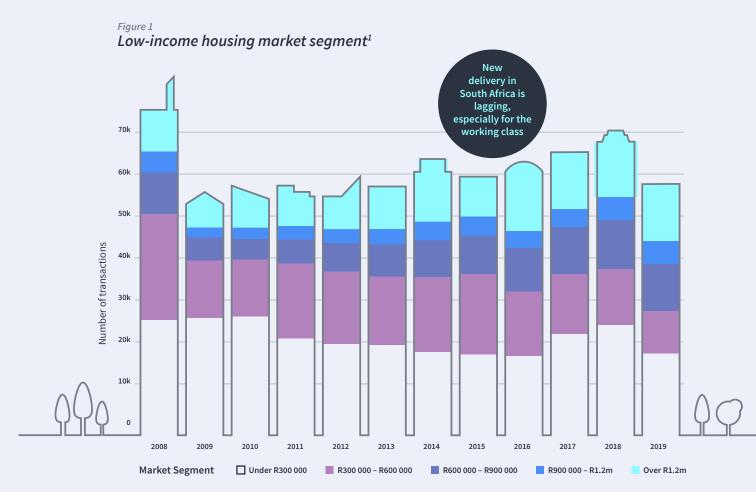
In 1994, 61% of the population occupied urban dwellings. In December 2019, this increased to 85%, indicating that demand for formal housing increased exponentially over the years. In fact, South Africa had one of the highest urbanisation rates in the world, a trend expected to increase as rates of urbanisation outpace population growth.

The delivery of affordable housing stock over the past 27 years profoundly affected South Africa's residential property market: today, most properties in South Africa's residential property market fall

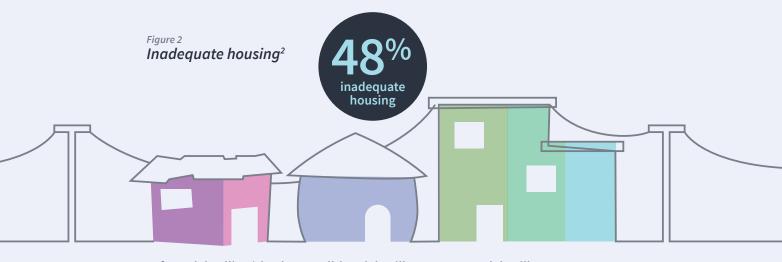
into the low-income housing category. At the end of 2019, there were approximately 6.6 million residential properties on the deeds' registry, and over half (55%) were valued at less than R600 000 (Figure 1 below).

According to Stats South Africa's (SA) South African census, 58 million people live in 16 million households. Of this, over 75% of the population falls into the affordable housing target market and 48% live in what Stats SA describes as "inadequate housing" (see Figure 2 below).

The backlog for affordable housing sits at 2.3 million units, and about R800 billion is needed to reduce this backlog in the short term (three years). The demand for rental properties significantly contributed to increased demand over the past 27 years. As of 2020, about 13% of households were renting their properties; the rental market is large in scope and drives activity.



Stewardship Report 2021



Informal dwelling/shack

**Traditional dwelling** 

Formal dwelling

1 249 713 not in backyard

13 1 139 300

3 445 203

no flush toilet

712 481

403 248

overcrowded

in backyard

275 773 no flush toilet & overcrowded

Figure 3
Residential property by market segment: number of properties,
South Africa, 31 December 2021<sup>3</sup>



Properties worth R300 000 or less 2 202 406 – R323.6B

#### The affordable market

Properties worth R300 000 – R600 000 1 466 220 – R654.5B

#### The conventional market

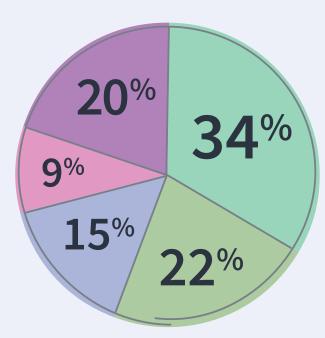
Properties worth R600 000 – R900 000 1 022 642 – R757.0B

#### The high-end market

Properties worth R900 000 – R1.2 million 606 487 – R628.7B

#### The luxury market

Properties worth over R1.2 million 1 310 048 – R3 192.8B



<sup>2</sup>48% of the affordable housing market live in inadequate housing

#### **Funding low-income housing**

Government plays a key role in providing funding for the low-income housing segment, and the success of initiatives aimed at scaling activity often involves collaboration between the private and public sectors. Key examples include mechanisms for buy-to-own activities, such as the financelinked individual subsidy programme (FLISP), and rental activity through the Social Housing Regulatory Authority.

The FLISP provides a blended financing facility mechanism, allowing market participants in the

low-income housing segment to afford subsidised home loan products. All major funding institutions including major banks - participate in FLISP, allowing customers to, for instance, apply directly to a bank for a home loan, augmenting their application with a FLISP application. Our investments in this sector include transactions into FLISP arrangements in place, allowing our funds to scale lending activity aimed at the low-income segment.

#### **Investor perspectives**

affordability and access to housing stock for low-

Despite some of the interventions described above, income housing participants remain challenging (see Figure 4 below).

Figure 4 South Africa: annual income profile for rural and urban households based on consumption (PPP\$), 2019<sup>4</sup>



Average annual household income needed for the cheapest newly-built house by a formal developer, 2019 Average annual household income using expenditure, 2019 (PPP\$)

Population	58 558 270	House price PPP\$	PPP\$79 004
Urbanisation rate	2.09%	Urban households that could	
Cost of cheapest		afford this house with finance	21.15%
newly-built house	ZAR539 830	1 PPP\$	ZAR6.83

The low-income housing market has remained buoyant over the past 10 years, driven by pent-up demand for affordable housing stock – especially when compared with the traditional housing market. Independent research indicates structural supply issues within this segment, impacting overall affordability and necessitating further interventions from the private sector and government. There is an opportunity for investors to support significant development in this space, not only for the return potential but also to address the need for social well-being in our country.

In 2021, STANLIB's Credit Alternatives team participated in its first social housing transaction with The Housing Hub. The development situated in Randfontein in Johannesburg's West Rand - comprises 1 080 social housing units constructed in three phases. Phase three is under construction, phase two is in the final stages of construction, and tenants moved into phase one housing in March 2022. Most tenants are single mothers, working individuals between the ages of 20 and 35, and young families. The tenants – many of whom have not had previous access to basic necessities – enjoy semi-furnished, secure, childfriendly neighbourhoods with modern amenities, such as an outdoor gym, aftercare, large gardens and play areas, solar geysers, electric stoves and running water.

Investments of this nature represent high-impact outcomes for our funds and, on all relevant metrics, provide solid returns to investors.

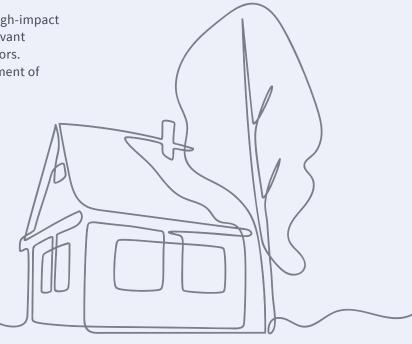
Based on our experience, this sub-segment of

the market is associated with low default rates, high occupancy rates and long-duration lease profiles, all of which contribute to sustainable financial returns.

STANLIB is looking at a pipeline of about R1 billion across social housing, affordable housing and student accommodation.

#### Conclusion

We aim to deliver financial returns on investments while fulfilling client mandates and driving responsible investment practices by investing for impact. We focus on unlocking the potential of the low-income housing market and believe the economic and financial features of this segment are countercyclical and imbued with portfolio benefits. We see no trade-off between the impact benefits of investing in this segment and realising long-term sustainable financial returns. Our approach is underpinned by our investment aims: to secure sustainable financial returns for investors and unlock capital, leading to positive impact outcomes.





# Achieving net zero: the path to a carbonneutral world

Authors

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J.P.Morgan

The focus on achieving net-zero emissions by 2050 has intensified over the past year. European governments in particular are even more determined to accelerate the roll-out of renewable energy in the wake of the conflict in Ukraine, which has led to soaring commodity prices and an increased urgency to end dependency on Russian fossil fuels.

Yet reaching net zero over the coming decades remains fiendishly difficult. Success will require huge changes to the global economy, in terms of energy generation, consumption, housing and even human diets – all of which carry significant risks, as well as opportunities, for investors.

To help ensure investors are well prepared, we look at the scale of the challenge, the best strategies to achieve net zero and the options for policymakers. A review of the key investment considerations for the transition ahead and implications for investors can be found in a separate article.

#### The scale of the challenge

The task of cutting greenhouse gas (GHG) emissions to the degree that is needed to reach net zero by 2050 should not be underestimated. Even before targets for emissions reduction can be set, policymakers and investors need to be able to precisely map, quantify and analyse global greenhouse gas emissions, which itself is fraught with uncertainties.

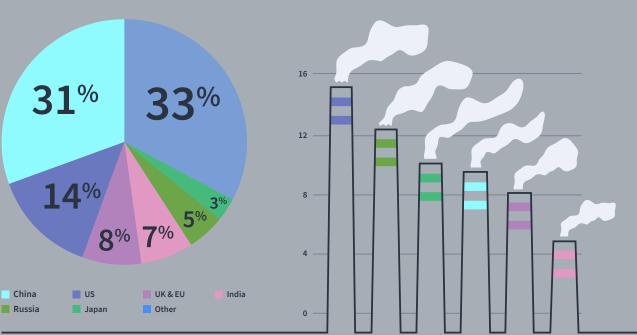
The problem is that not all emissions are created equal, with different greenhouse gases having different lifetimes and varying abilities to absorb infrared radiation (heat). Carbon dioxide ( $CO_2$ ), for example, has the lowest global warming potential of the major greenhouse gases, but one of the longest lifetimes in our atmosphere – which helps to explain why the immediate focus of policymakers is on bold  $CO_2$  reduction targets. However, reducing emissions of shorter-lived but more damaging greenhouse gases, such as methane and nitrous oxide, will also need to be addressed if emission reduction plans are to remain credible.

Governments face significant challenges putting their emission reduction goals into action. One issue is that the effort required to reach net zero falls disproportionately on the emerging markets, which tend to be among the biggest polluters (greenhouse gas emissions from China and India have grown by over 300% in the last three decades alone) but also face some of the biggest challenges reaching net zero. The level of employment created by fossil fuel industries in many developing economies is one example.

Leaders in the emerging world continue to stress that emissions reduction targets must be balanced against economic goals, and that emissions per capita, stages of economic development and the effect of "offshoring" manufacturing need to be accounted for when setting climate goals. Agreements and trade-offs will therefore need to be made between the developed and emerging worlds to ensure emissions targets remain on track.

# Global CO<sub>2</sub> emissions by country %, 2020

#### Global CO₂ emissions per capita tonnes, 2020



Source: (all charts): Gapminder, Global Carbon Project, Our World in Data, United Nations, J.P. Morgan Asset Management. Emission impact from land use change (such as deforestation) is not included. Data as of 31 March 2022.

#### What is the right metric to measure emissions?

"At the country level, absolute GHG emissions don't tell the whole story about the relative environmental impact of each country. At a minimum, we need to account for differences in population size by looking at emissions per capita, and we should acknowledge that countries are at different stages of economic development by assessing emissions per unit of GDP. We may also consider that, historically, emerging markets have contributed less to global GHG emissions because their economic output has been lower. In addition, some emerging market countries have higher CO<sub>2</sub> emissions because the production of CO<sub>2</sub>-intensive goods has been offshored.

For companies, beyond looking at total carbon emissions, one can take into account their relative size by assessing efficiency relative to revenues or physical units of production. Those emissions can also be broken down into various categories, or scopes (as defined by the Greenhouse Gas Protocol), reflecting at which point in the value

chain of a company emissions are generated. Although most efforts are currently focused on Scope 1 (direct emissions from controlled assets) and Scope 2 (indirect emissions from purchased electricity or heating/cooling) emissions, there is a growing interest in Scope 3 emissions, where indirect emissions from the rest of a company's value chain are also considered.

Combining all these insights to determine the emissions characteristics of investments is an area of active research, with rapidly-developing standards. In this context, our team recently published a document reviewing the current state of greenhouse gas accounting and clarifying how the range of carbon metrics can be applied to the investment process."

Keven Roy, Ph.D., Climate Change Research Analyst, J.P. Morgan Asset Management Sustainable Investing team

#### The best strategies to achieve net zero

The challenges posed by decarbonisation are considerable, but they are not insurmountable. We have identified four key strategies that are

needed for achieving net-zero emissions: increase clean energy generation, accelerate electrification, improve efficiency and offset remaining emissions.

#### **Strategy** Description Overhaul global energy mix to boost Accelerated renewables rollout Increase clean energy renewables and reduce/eliminate fossil • Infrastructure upgrades to enable generation fuels, especially coal transmission of renewable power • Maximise use of electricity across Electric vehicles **Accelerate** industry and household energy Electrified industrial production electrification consumption Energy-efficient lightbulbs Improve efficiency Reduce energy demand by upgrading equipment Reduced meat consumption, rise of • Shift in consumer preferences, such as meat alternatives · Reduced food waste • Greater precision within agriculture Offset emissions • Remove remaining unavoidable · Reforestation and bolstered emissions from the atmosphere, and conservation efforts Increased focus on biodiversity store in ways that avoid harm Man-made technology solutions, such as carbon capture

#### Increase clean energy generation

Clean energy technologies have the largest role to play in achieving net-zero targets, given that 73% of global emissions stem from the energy sector itself. Many estimates suggest that the share of oil, coal and gas in the global energy mix will need to decline from the current level of around 90% to close to 20% by 2050.

However, significant investment is required to ramp up production and to upgrade infrastructure to enable the transfer of clean energy around the world.

Designing a power grid with the flexibility to deal with the variability of wind and solar power production is another complex challenge. Governments will therefore need to drive progress by investing in infrastructure, such as robust transmission systems, while incentivising the private sector to hunt for technology breakthroughs. The recent collaboration between Norway and Denmark is one example of progress.

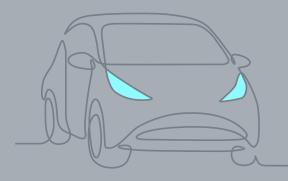
While Norway generates most of its electricity from hydropower, Denmark relies much more on wind power. Thanks to new high-voltage power cables, the two nations are now well positioned to leverage each other's energy sources depending on weather conditions.

Much cheaper storage options will also be needed to smooth out fluctuations in renewable power sources. While manufacturing costs of storage technology, such as batteries, will come down with scale, the rising cost of the raw materials used to make them could prove more challenging. We believe the clean energy transition will have implications for global commodities, potentially launching a new supercycle.

#### **Accelerate electrification**

The large-scale electrification of existing industries is the next step to achieving net zero, with the rise of electric vehicles being one example. A wave of auto manufacturers has announced plans to shift to all-electric production over the coming years, but uptake is slow: while EVs have tripled their market share versus two years earlier, electric vehicle sales still made up only 8.6% of total auto sales in 2021.

Part of the challenge is that, until recently, there had been little first-mover advantage. Motorists



were reluctant to go electric until a robust charging infrastructure had been created, while energy companies were wary of building the charging network without being able to see the demand. We expect the long-term winners in this area to be those who focus on dedicated electric vehicle platforms, rather than bridge technologies such as hybrids.

For some industries, however, full electrification is not feasible. For example, prototype electric engines are being developed for aeroplanes, but batteries are still far too heavy to be a viable energy source for long-haul flights. Industrial production that uses high-heat processes is another area where full electrification may not be achievable. Here, low-carbon biofuels and hydrogen power will likely form part of the solution.

#### Improve efficiency

Improvements in energy efficiency to reduce the overall level of energy demand will need to play an important part in reducing emissions. The expansion of LED lightbulb usage in India is a good example of a high-impact change. Changes

> may be straightforward for assets with relatively short lifetimes

> > such as lightbulbs, but greater policy incentives will be needed for equipment that is replaced much less frequently.

Food production and food waste is another area where energy demand could be reduced significantly. Cutting meat production (meat and dairy production account for 77% of agricultural land use but just 18% of the world's calories<sup>2</sup>), reducing the use of chemicals in food production, reducing food packaging and cutting food miles will all help, while tackling food waste - which contributes 6% of global greenhouse gas emissions – is another priority.

Changes will be required in the agriculture industry too, particularly around the efficiency and precision of fertiliser and water usage. European Commission research has shown that, when used efficiently, fertilisers can improve crop yields while simultaneously helping to capture more carbon dioxide thanks to the increased production of biomass. However, excessive fertiliser use can create significant disruption to the surrounding environment. High investment costs to employ more precise techniques have historically hampered uptake, again highlighting the need for policy incentives to drive change.

#### Offset emissions

Given that emissions will not be fully eliminated by 2050, carbon offsets will be needed to help companies reach their net-zero targets. Natural offsets, such as forests and peatlands, are the most effective, yet they are disappearing at a frightening pace. The world lost over 47 million hectares of forest over the past decade, an area equivalent to the size of Sweden. At the same time, about 20% of greenhouse gas emissions are created by activities that are destroying these natural habitats.

To counter this damage, we expect the focus on biodiversity – the way that companies coexist with and protect the environment around them - to accelerate accordingly. The good news is that countries that are especially vulnerable to biodiversity loss are starting to innovate. "Blue bonds" – debt instruments that are issued to support investment in healthy oceans - are one way that countries are gaining access to new capital in exchange for conserving biodiversity.

Technology-based offsets, such as carbon capture, utilisation and storage (CCUS), will be another tool to help reach net zero. CCUS involves separating CO<sub>2</sub> emissions from other gases created by industrial processes or power generation, and then compressing and transporting them to sites where they can be used or stored. However, huge investment will be required to scale up projects to lower the cost of carbon capture.

Investors should also be wary about overestimating the impact of CO<sub>2</sub> sequestration and removal, which the Intergovernmental Panel on Climate Change

contribute less than 10% of the net emissions reduction required over the next decade to stay on track to hit net zero by 2050. For most industries, emissions reduction - rather than offset - will need to be the priority.

estimates will be able to



<sup>1</sup> https://www.carbonbrief.org/guest-post-how-energy-efficient-led-bulbs-lit-up-india-in-just-five-years. A policy initiative procured LED bulbs for the national market at scale and sold them through vendors at lower prices, although still at a profit. LED bulb sales rocketed, taking annual sales from 5 million in 2014 to about 670 million in 2018. The annual energy savings from the project are estimated to be sufficient to power the whole of Denmark for a year. <sup>2</sup> Our World in Data - https://ourworldindata.org/global-land-for-agriculture.

#### The options for policymakers

Policy implementation may prove the hardest part of the journey to net zero. Governments can meet the challenge with a "sticks"-based approach that mandates climate change mitigation, or a "carrots"- based approach that incentivises

it. Infrastructure investment, research and development (R&D) spending, subsidies and tax incentives (carrots), along with regulation and carbon pricing (sticks), will all have roles to play.

#### Infrastructure investment

Public infrastructure investment can help by committing vast sums of money and taking on more risk than individual companies can, while quickly building scale and consistency. Government investment serves as the foundation on which the private sector can then innovate, compete and ultimately reduce costs. Formal public-private partnerships can advance the energy transition while also generating opportunities for private investors. Real assets stand to be notable beneficiaries.

Infrastructure that supports the supply of renewable energy is a high priority. Both solar and wind investment and capacity continue to grow, and further investment could help meet some of the technological challenges around storage and efficiency. In the meantime, investment in national grids could connect the many isolated suppliers and expand the reach of renewables. Increasing investment to improve nuclear power, a reasonably reliable and efficient form of sustainable energy, will also help diversify from solar and wind, which are currently less reliable and efficient.

Policymakers also need to invest in greener transportation. There is a number of options, such as accelerating individual electric vehicle adoption by building more charging stations, or improving rail links to provide a more credible alternative to air travel. Local governments can electrify their fleets of vehicles, from police cars to school buses and everything in between.

#### Research and development spending

R&D spending on innovation and technology will be key to developing solutions that are not available yet. For example, we do not yet have carbon-neutral materials to use in steel, cement or fertiliser. We are unlikely to be able to electrify

aeroplanes or long-haul trucks, but they could use more advanced biofuels that we have not yet developed.

We need more research on direct air capture (DAC) technology that seeks to remove CO<sub>2</sub> that is already in the air. These initiatives require much longer timelines and have a high probability of failure. Yet the scientific community achieved an extraordinary feat with COVID-19 vaccines in less than a year, with the help of ample funding, global co-ordination and a partnership between the public sector, private industry and the academic community. This can be replicated over time to meet some of the toughest challenges to achieving net zero.

#### **Subsidies and tax incentives**

Subsidies, tax credits and other incentives, such as loans and guarantees, can help accelerate change and bring down costs. Investment in solar and wind, for example, has been greatly aided by subsidies.

Incentive programmes that engage consumers, such as swapping internal combustion vehicles for electric vehicles or upgrading appliances, can speed up transitions already under way. They can also help smooth out more challenging transitions over time. For example, subsidies or tax breaks to create electric vehicle manufacturing plants in areas where a local economy has depended on coal mining could provide new jobs and growth that eventually surpass the economic importance of coal.

#### Regulation

Thoughtful regulation can help reduce economic barriers and catalyse change. For example, tougher fuel, energy and appliance standards can push companies and consumers to reduce their carbon footprints, while more stringent codes for buildings

and future construction, with respect to insulation, material usage, heating, and cooling systems and lighting, can have a similar effect.

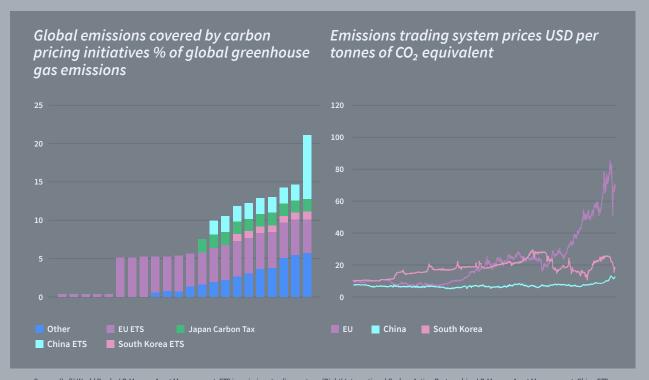
If these regulatory items are phased in over the course of a decade, companies and consumers will have ample time to comply with new standards. In some cases, regulation can actually be helpful in creating demand, such as with nuclear energy, where regulatory oversight may help overcome safety and environmental concerns.

#### **Carbon pricing**

The price of carbon can be set through taxes or emissions trading schemes (ETS), both of which incentivise carbon producers to reduce their carbon intensity. The European Union (EU) has been a pioneer in this field, launching the world's first carbon market in 2005. The EU's example is being increasingly copied, with several individual countries, notably China, launching their own emissions trading systems over the last couple of years. As a result, close to 25% of global GHG emissions are now covered by carbon pricing initiatives compared with just 5% in 2005.

However, there is not one common carbon price, with international carbon prices remaining generally well below those in Europe. More importantly, most carbon prices are also below the level required to reach net-zero emissions by 2050, according to many climate scientists and policymakers.<sup>3</sup>

The goal of a common global carbon price set at a level that could help meaningfully reduce emissions is currently out of reach. However, there are positive developments. The EU - mindful of the delicate balancing act it faces between meeting domestic climate ambitions while at the same time not damaging European corporate competitiveness has suggested it could introduce a carbon border adjustment mechanism (CBAM) to ensure that the environmental footprint of a product is priced the same, whether it is manufactured locally or imported. So far, the CBAM has only acted as a threat to international peers, but the credibility of that threat has been strengthened following the recent agreement by EU member states on the required regulation for implementation.



Source: (Left) World Bank, J.P. Morgan Asset Management. ETS is emissions trading system. (Right) International Carbon Action Partnership, J.P. Morgan Asset Management. China ETS price is based on the average of Beijing, Chongqing, Guangdong, Hubei, Shanghai, Shenzhen and Tianjin ETS prices. Data as of 31 March 2022.

#### The key implications for investors

The transition to a net-zero emissions world will have an enormous, but uneven, impact across economic sectors. Our research analysts have analysed how the transition to net zero will impact some of the industries that will undergo the greatest changes: auto, energy, infrastructure, real estate, retail and utilities. Businesses within these

sectors have opportunities to shift their business models to adapt to regulatory and customer-led change.

To read the views from the JPMAM research analysts, refer to the <u>full article here</u>.

#### **Conclusion**

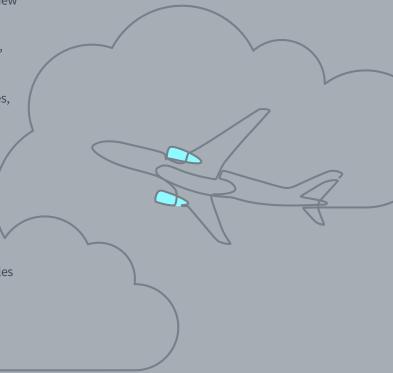
Dramatic changes to the global economy will be required if net-zero emission targets are to be achieved by 2050. Quantifying the scale of the problem is a challenge in itself. Calculations should account for a company or country's size and stage of economic development, rather than looking at the volume of emissions alone. To reduce emissions, a combination of increased clean energy generation and electrification alongside improved efficiency will be required.

Offset strategies will be needed to tackle the remaining unavoidable emissions, although these strategies are capacity constrained. For most industries, reducing emissions rather than offsetting emissions is required, and investors should view corporate commitments with this in mind.

Policymakers will be the key driver of change, providing both carrots-based incentives to encourage investment, research and development, and also sticks-based measures, such as carbon pricing schemes. The war in Ukraine has only accelerated the desire of policymakers to shift away from fossil fuels. Our research analysts see both opportunities and risks in their sectors: for industries such as utilities, we are finding attractive valuations in several companies that stand to benefit from the huge increase in electricity demand, while in other areas, such as energy, we see examples

where the market may be overly focused on potentially transient sources of cash flow.

Following a decade of dominance for consumerfacing technology companies, companies that can enable climate-based technology solutions look set to be the biggest beneficiaries of new environmental initiatives going forward. Regardless of the industry under consideration, a thorough understanding of how the wave of policy changes ahead will impact cash flows and valuations should be an essential part of any investment decision today.





STANLIB Infrastructure Investments:

making an impact

Infrastructure is the backbone of the economy. It connects people, facilitates commerce and enhances quality of life. Investments in infrastructure have the power to enable economic growth and prosperity.

We believe that investment in infrastructure in South Africa offers investors diversified, risk-appropriate, stable and long-term returns and a powerful means of making a tangible and sustainable difference to South African communities.

STANLIB Infrastructure Investments offers a compelling opportunity to invest in various infrastructure projects through private equity funds. Investments focus on broad-based infrastructure, which includes sectors such as power, renewable energy, rail, airports, roads, water, storage and logistics, and digital infrastructure.

## **Our Funds**

#### An overview of our funds

The STANLIB Infrastructure Fund of Funds was established to provide institutional investors with a platform to invest in a diversified range of South African infrastructure projects. This platform

has created a significant competitive advantage through an investment portfolio that has both scale and diversification.

#### STANLIB Infrastructure Fund of Funds

#### **Fund I: 37.7%**

#### Portfolio of assets: R2.3 billion

- > Portfolio comprises minority equity shareholdings in 4 solar PV plants and 1 wind plant with a total installed capacity of 345 MW
- > Projects have an average operating history of c. 7 years
- > Exposure by value is 70% to solar PV and 30% to wind

#### Fund II: 83.1%

#### Portfolio of assets: R6.6 billion

- Portfolio is well diversified across underlying assets and across sectors with a bias towards renewable energy (52%) and digital infrastructure (33%)
- Exposure to 22 underlying assets, providing investors with a diversified pool of infrastructure investments

#### **Projects Geographic Location**

Digital infrastructure assets are located in all major metros across the country



# Sustainable development goals

Managing two funds of close to R10 billion, our investments impact South Africa's economic development and growth. It is important that we invest responsibly for optimal economic growth while protecting our planet and the well-being of communities. We use our support for the UN SDGs to assess our response to ESG challenges. While all 17 SDGs are critical to achieving global goals, we have identified four SDGs we believe we can positively influence through our investments.

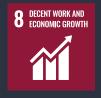




There is a strong correlation between investing in education and economic growth. With fund mandates with a South African focus, we are committed to addressing

the country's economic challenges by investing in education initiatives (through investee companies' CSI and SED projects) which:

- improve the quality of early childhood development, care and pre-primary education;
- provide equal access for all women and men to affordable and quality technical, vocational and tertiary education; and
- increase the number of people who have relevant skills, including technical and vocational skills, for employment, decent jobs and entrepreneurship.



Through our investments, we promote the reduction of the proportion of young adult unemployment, and enhancing opportunities for further education or training

through investee companies' CSI projects or SED spend.



7 AFFORDABLE AND CLEAN ENERGY

Energy is the main contributor to climate change as it produces c.60% of greenhouse gases.

To address this challenge, and in line with our mandate, we invest in renewable energy projects. In addition, we promote investments into surrounding communities (through investee companies' CSI or SED spend) which enhances the use of affordable and clean energy.



Investing in infrastructure assets is a catalyst for economic growth. In line with our mandate, we aim to:

- invest in quality, reliable, sustainable and resilient infrastructure to support economic development and human wellbeing;
- upgrade infrastructure with increased resource-use efficiency and greater adoption of clean and environmentallysound technologies; and
- increase access to information and communications technology.

# **Impact in 2021**

Delivering a positive impact beyond a financial return is critical. Below, we share impact outcomes of our two funds.

**STANLIB Infrastructure Fund I** was established in May 2013 with a mandate to invest in longterm equity and equity-related greenfield and brownfield infrastructure projects in sub-Saharan Africa, principally South Africa. Fund I has invested in five renewable energy assets since

inception. These assets were selected as part of rounds one and two of the renewable energy programme in South Africa and are situated in the Eastern and Northern Cape. The total installed capacity is 345 MW.

#### STANLIB Infrastructure - Fund I Impact<sup>1</sup>



#### **Energy**

- > Renewable energy portfolio accounted for c. 7% of all renewable energy projects in South Africa?
- > c. 790 000 MWh of renewable energy produced in 2021
- > c. 760 000 tonnes of greenhouse gas mitigated over the 12 month period

#### **Communities**

- > c. R4.8 million invested in
- towards socioeconomic development (SED) within local communities, 48% of which was allocated to education and skills development
- > R132 million<sup>3</sup> spent on local procurement, B-BBEE procurement spend accounted for 71%

#### **Job creation**

- > 150 full-time-equivalent employees across projects, including permanent and contract employees<sup>4</sup>
- 42% Black employee
- 24% womer
- 64% youth

#### Governance

- > Balanced boards, with c. 59% of directors being female
- Quarterly reporting to the Department of Energy
- > Annual financial statements prepared, approved by the boards and audited by reputable third parties
- > Transparent quarterly board reporting in place
- > STANLIB board representation to ensure strong governance oversight
- > STANLIB participates at subcommittee level e.g. Audit and Risk, Social and Ethics, and Remuneration committees

<sup>1</sup>12-month period starting July 2020 – June 2021. <sup>2</sup>Based on operational projects in South Africa. <sup>2</sup>Illustrates spend from renewable energy projects only. <sup>4</sup>Measured in person months Source: IPP Projects database; CO2 emissions per capita: knoema.com

STANLIB Infrastructure Fund II has invested in a portfolio of operationally-mature and diversified renewable energy projects in key renewable energy resource locations. The total installed capacity is 1 102 MW. The portfolio includes investments in three toll road assets, which represent the only privately-tolled roads under concession in Southern Africa. These routes connect key transportation corridors through Gauteng, the ports of Durban and Maputo as well as the Botswana border. The fund invested in a grain storage and logistics asset across several strategic locations in South Africa, which

contributes to the diversification of the fund's asset portfolio. Another key investment into the digital infrastructure sector comprises a stake in a leading fibre-optic company through its two wholly-owned operating subsidiaries, which services the enterprise connectivity market and fibre-to-the-home connectivity.

You can read more on STANLIB and its investee companies' commitments to creating real and sustainable value in South Africa in the <u>STANLIB</u> <u>Infrastructure Investment Impact Report 2021.</u>

#### STANLIB Infrastructure - Fund II Impact<sup>1</sup>



#### **Sector impact**

#### Renewable energy:

- > 2.8m MWh of renewable energy generated in the last 12 months
- > 2.7m tonnes of greenhouse gas mitigated
- > Projects account for c. 21% of all renewable energy projects in South Africa<sup>2</sup>
- > Toll Roads: three road projects with a total road network of >1 300 km
- > Grain storage: c. 25% of the total grain storage capacity in South Africa

# Digital Infrastructure market share:

- > Fibre to the home: c. 40% of homes passed
- > Mobile backhaul: 34%
- > Metro and National Long Distance: 47%
- > Fibre to business: 23%

#### **Communities**

- > R28 million invested in Enterprise Developmen
- > R84 million contributed towards socioeconomic development (SED) within local communities, 50% of this was allocated to education and skills development
- > R870 million<sup>3</sup> spent on local procurement, of which B-BBEE procurement spend

#### **Job creation**

- > 5 400 full-time-equivalent employees across projects, including permanent and contract employees<sup>4</sup>
- 86% Black employees
- 30% womer
- 52% youth

#### Governance

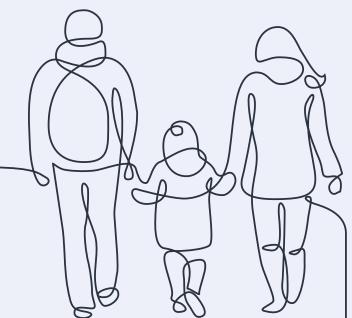
- > Balanced boards, with c. 26%
- > Quarterly reporting to the relevant government
- > Annual financial statements prepared, approved by the boards and audited by reputable third parties
- > Transparent quarterly board reporting in place
- > STANLIB board representation to ensure strong governance oversight
- committee participates at suocommittee level e.g. Audit and Risk, Social and Ethics, and Remuneration committees

12-month period starting from July 2020 – June 2021. <sup>2</sup>Based on operational projects in South Africa. <sup>3</sup>Illustrates spend from renewable energy projects only. <sup>4</sup>Measured in person months. Source: IPP Projects database. CO2 emissions per capita: knoema.com. All data based on project-level information, not on a see-through holdings basis.

# Outlook

The market and economic backdrop of the past two years continue to profoundly impact societies and the sustainability of our environment. The COVID-19 pandemic has driven long-term, permanent changes, while the recent Russia-Ukraine war is impacting societies worldwide, including through rising energy prices which directly affect low-income consumers. As a responsible corporate citizen, evolving and improving the way we invest and grow as an asset manager is critical to our ability to deliver optimal financial outcomes to our clients while also doing good.

ESG and responsible investing have become an essential part of investing, and the focus on environment-related issues, especially climate change, is eclipsing social and governance issues – particularly in developed nations. Biodiversity and maintaining a liveable planet are also top-of-mind as consumers become more enlightened about the adverse impacts of current food production methods and consumption behaviours. Shifts of this nature not only bring positive outcomes for the longevity of the planet, but also opportunities for businesses to adapt and grow for changing needs. Regulation is also a strong trend in the ESG arena, and as more data, information and reporting are made available, organisations will move to align standards.



As we navigate the ESG landscape for long-term change, our 2022 focus areas will encompass:

- Regulation and good practice: ensuring that our activities remain aligned to industry best practice as outlined by bodies such as the UNPRI and local regulators
- **2. Investment process:** continuing to deepen and entrench responsible investing activities across the investment value chain
- **3. Collaboration:** prioritising collaboration across investment teams, our strategic partners and industry participants, ensuring that, as a collective, we can have a more profound impact in driving positive change

#### 4. Disclosure:

- We are committed to transparency and actively encourage companies to disclose ESG information in line with best practice to facilitate better understanding of risks and opportunities
- > We focus on improving disclosures to investors, including aligning our reporting and disclosure on climate-related issues to best practices outlined by the TCFD

#### DISCI AIMER

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