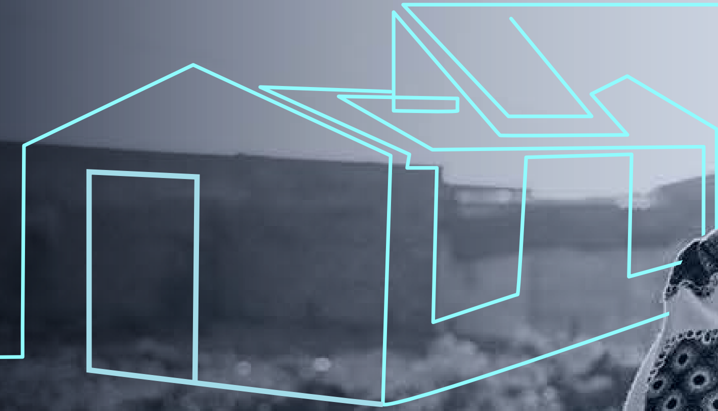
STANLIB



# STEWARDSHIP REPORT 2022

STANLIB

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# Chief Executive Officer's foreword

**Derrick Msibi**
*Chief Executive Officer*

Over the last two years, responsible investing and environmental, social and governance (ESG) principles have become high-profile issues for institutional investors. As ever, there is resistance to new ideas and suspicion that compliance is a matter of box-ticking rather than a sincere commitment to change. Pressure to comply with these emerging standards has caused some asset managers and other financial services companies to come unstuck, accused of "greenwashing" and misleading clients about their ESG activities.

As a framework for change that imposes real costs on companies, ESG has been politicised, particularly in the US. Opponents claim that it is an ideological exercise which creates a headwind for growth and investment in the real economy.

While developed markets grapple with the social dimensions of ESG, many emerging economies confront an environmental dilemma. The economy of the developed world was built on cheap fossil-fuel energy but the global response to the climate change crisis is pressuring emerging economies to switch to, at times, more expensive, renewable sources of energy. Countries like SA that do commit to move away from fossil fuels must not only support the growth of their economies through the transition, but also mitigate the impact on communities dependent on the coal economy.

At STANLIB, we have integrated ESG into our investment process, believing it to be a material driver of good risk-adjusted returns for clients. We continued our responsible investing journey in 2022/3, endorsing the Code for Responsible Investing 2 (CRISA 2) which follows CRISA 1 as a framework for ESG investment activities and disclosures in SA. We have also joined the Association for Savings and Investment South Africa Responsible Investing (ASISA RI) Forum which co-ordinates RI activities across the investment industry. Lastly, we are proud to be recognised as one of the top three ranked South African Fixed Income asset managers in the 27four Investment Manager's Annual ESG survey for 2022. The survey follows trends in ESG investment and sustainable finance in SA and recognises excellence in asset managers' ESG commitments and capabilities.

As a responsible investor, STANLIB encourages our investee companies to be better corporate citizens through active engagement rather than exclusion. The case studies in this Stewardship Report show this philosophy in action. Influencing the behaviour of our portfolio companies can require patience – sometimes change is only achieved after years of consistent engagement – but in every

case STANLIB takes care to set out a clear agenda and steadily pursue it. Our size and status as one of SA's largest asset managers helps us to attract management's attention and advocate for change, where required.

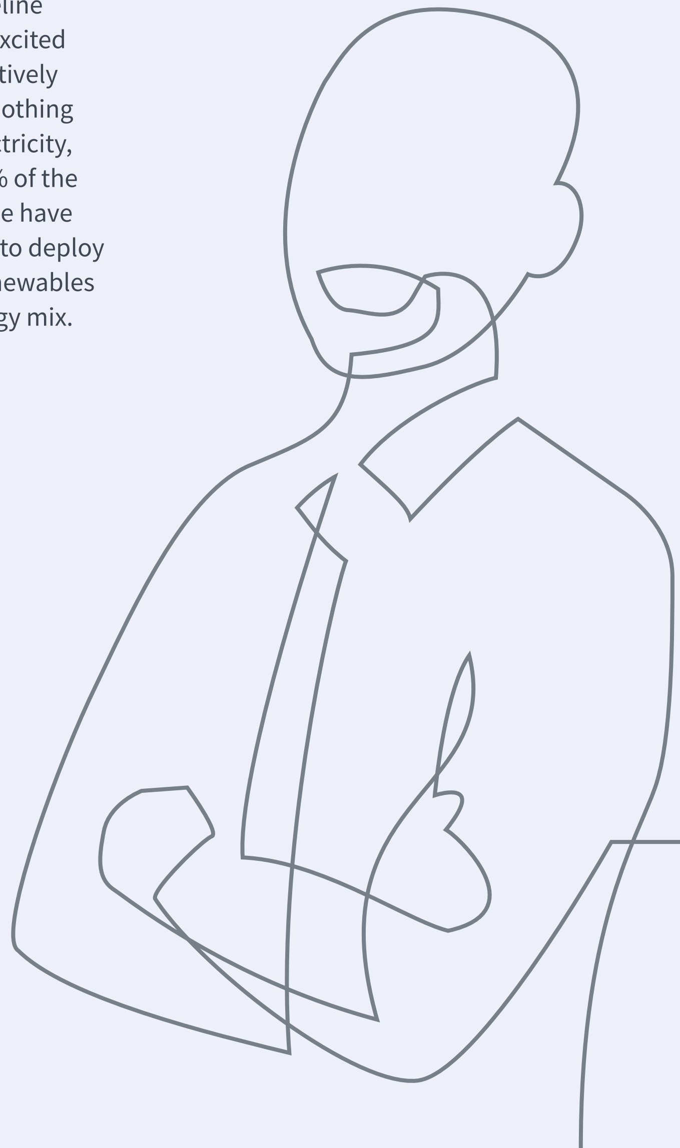
The world has been awakened to the opportunity for investors to generate financial returns while explicitly creating positive impact. Today impact investing is an asset class in its own right. We are proud to announce the first close of our Khanyisa Impact Investment Fund. Raising funds for the Khanyisa Fund has required a process of investor education during which we also learned much about positioning the fund. Our portfolio managers have identified a pipeline of investment opportunities and we are excited at the prospect of watching the fund positively impact SA's present and future. There is nothing more topical in SA than the supply of electricity, and STANLIB is proud to have funded 25% of the country's installed renewable capacity. We have established a strong position from which to deploy further capital and influence policy as renewables increase their share of the country's energy mix.

Over the coming year, we will continue to invest our clients' money responsibly, with an increased emphasis on climate-related commitments, while ensuring that STANLIB's own CSI initiatives are consistent with the standards we set for our portfolio companies.

STANLIB takes its responsibilities as a steward of its client's funds seriously, as it does the obligations of corporate citizenship, which come with being one of SA's largest asset managers.

We hope you enjoy reading our report.

**Derrick Msibi**
*STANLIB CEO*



# A note from our heads of investments

**Mark Lovett**
*Head of Investments*

**Henry Munzara**
*Deputy Head of Investments*

Responsible Investing means creating positive impact where we can, while encouraging our portfolio companies to become better corporate citizens. This report demonstrates how we have delivered on these ambitions over the past year.

In order to present a consistent ESG agenda, every year STANLIB writes an 'engagement letter' to our portfolio companies. In this report we share details of the letter that we sent to all our investees in 2022.

Experience supports STANLIB's belief that consistent shareholder pressure can produce real transformation in our portfolio companies. In this report, we explore the example of Richemont, where a multi-year journey of engagement achieved the desired outcome.

Shareholder activism is often most powerfully expressed when things go wrong. Readers will recall the Steinhoff debacle, where a multi-year fraud devastated shareholder value. STANLIB was an active participant in the shareholder class action that is now in its final stages, and which has helped to mitigate our clients' financial losses.

Shareholder engagement is not only about helping companies to evolve as corporate citizens. For example, our property fund managers have consistently petitioned the Investec Property Fund to change its operating structure. The fund has historically outsourced its management function to another entity owned by Investec, whose interests were not perfectly aligned with those of the fund's investors. The Investec Property Fund is one of the last remaining companies in its sector to have such a structure. As a result of consistent engagement by STANLIB and other shareholders, the fund will now internalise the management function, to the benefit of all shareholders.

Another instance of STANLIB's active engagement is the influential role played by our Fixed Income and Credit Alternatives teams in the Land Bank default. We engaged at every level of the restructuring process, and we have now been substantially repaid. We have also learned important lessons from the process and have improved our understanding of the risks involved in lending money to SOEs.

In the impact investing space, we are proud to announce that our Khanyisa Impact Investment Fund has reached its first close. The fund will now begin deploying capital into a pipeline of projects which will give our investors competitive financial returns while addressing many of the challenges that face SA. On a separate note, our Infrastructure team continues to play a meaningful role in the energy space by investing in environmentally-friendly renewable energy projects.

These are just a few examples of STANLIB's commitment to responsible investing. With our size comes the responsibility to use our influence for the good of our investors, fellow shareholders and the country at large.

We hope you enjoy reading this report and look forward to updating you on STANLIB's further progress on its responsible investing journey.

**Henry Munzara & Mark Lovett**

*STANLIB Heads of Investments*

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# STANLIB's principles for **responsible investing**

## Integration of ESG factors

STANLIB considers ESG factors in its investment processes to achieve a holistic understanding of the risks associated with investment opportunities.

## Active engagement

STANLIB's ESG approach is to actively engage business stakeholders to effect change. 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

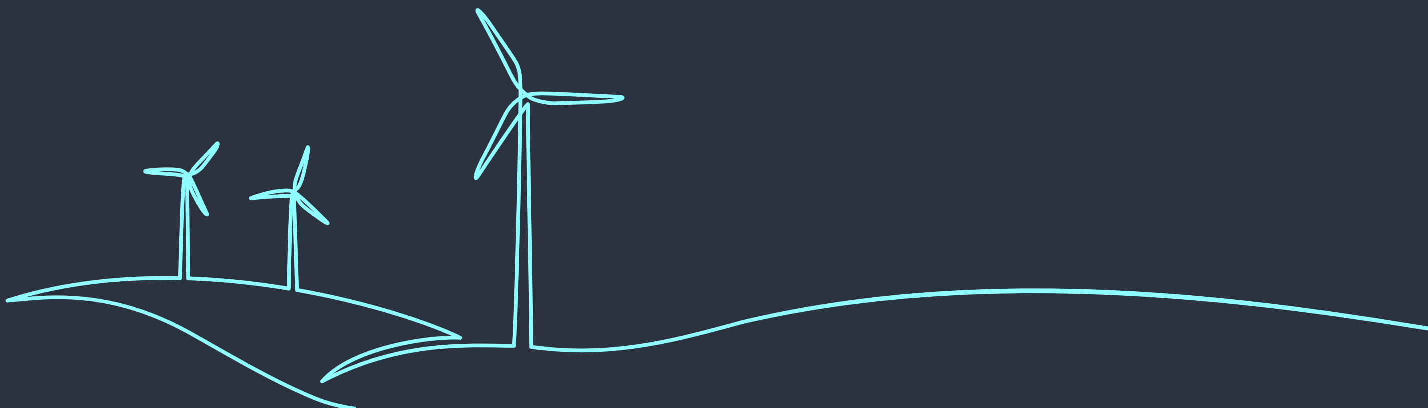
Our portfolio companies' approach to ESG is an essential factor in their ability to create sustainable shareholder value and deliver risk-adjusted returns for our investors.

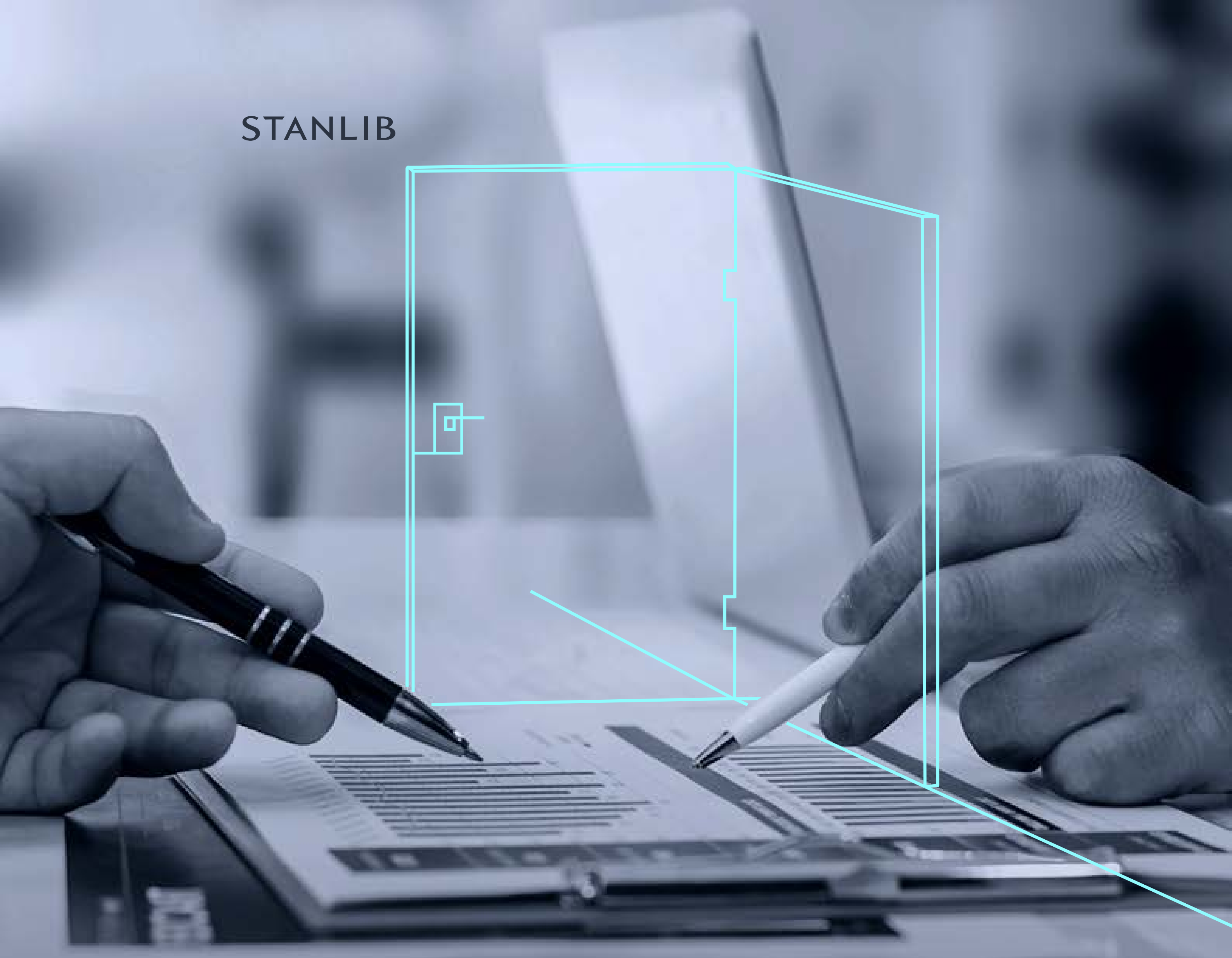
## Ownership rights

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.



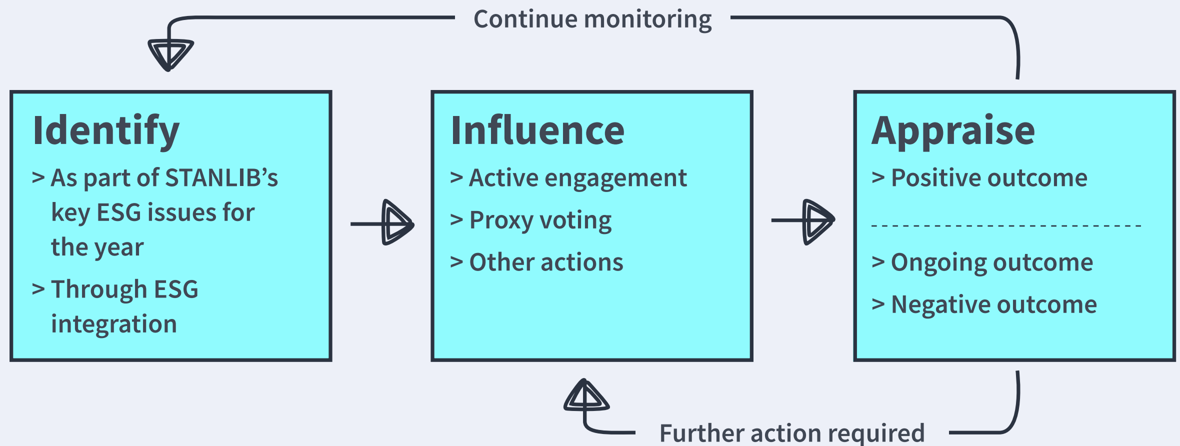



# Active ownership and engagement

STANLIB believes a thoughtful approach to ESG issues is necessary for any business to succeed over the long term. As such, we include ESG considerations in our investment process. This internal ESG assessment informs how we construct client portfolios and identify ESG issues that could impact their long-term sustainability.

Our universe of investible assets is relatively concentrated, and we operate in a continent facing tremendous economic and social challenges. When identifying ESG concerns in investee companies, we believe that exiting (i.e., selling our position) is not the answer. As active owners, we prefer to use engagement and voting to drive the positive changes that we believe will ultimately reward all stakeholders.

## Our approach to active ownership




### Our active ownership activities are derived from two sources:

1. **ESG committee**

   **STANLIB prioritises 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 assets under management (AUM) – which exceed R620 billion – allow us to exert influence on investees to make a positive impact on society and the environment.

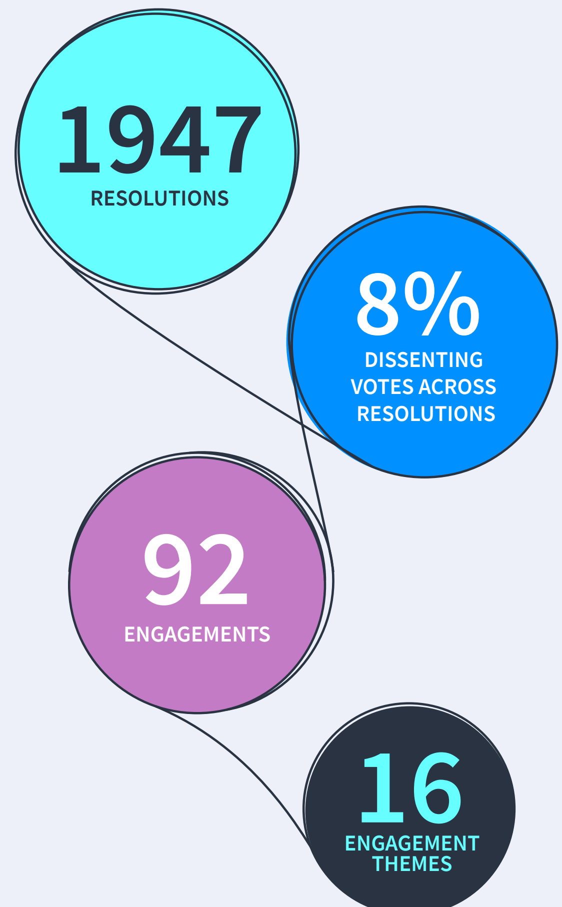
2. **Investment team process**

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

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

### Active ownership in 2022

Domestic-only listed AUM[1]




[1]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.

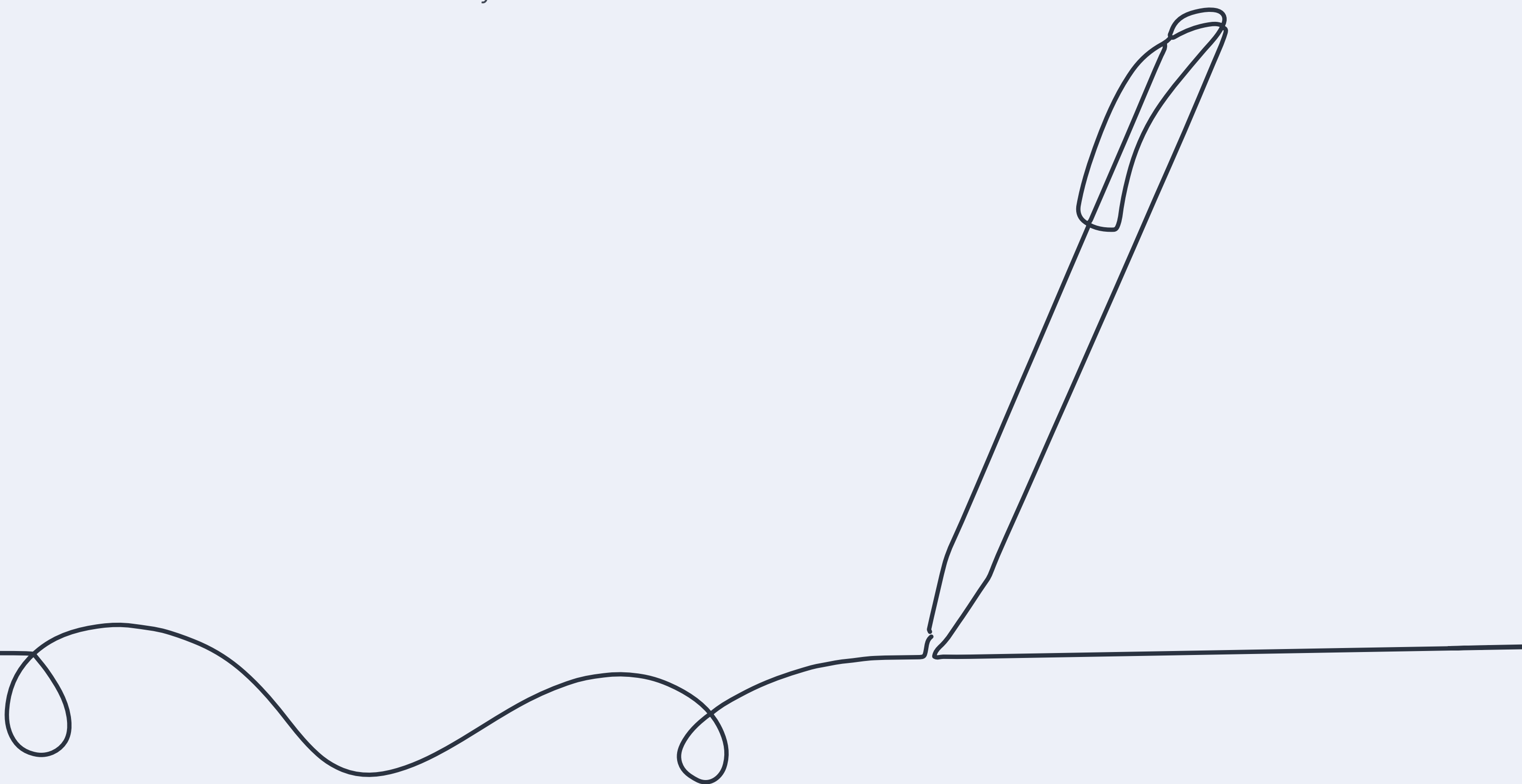
## Voting in 2022

We voted on 100% of resolutions passed by companies held in our active equity client portfolios. Overall we exercised voting rights on behalf of clients across 86 companies with a combined 1 947 tabled resolutions.

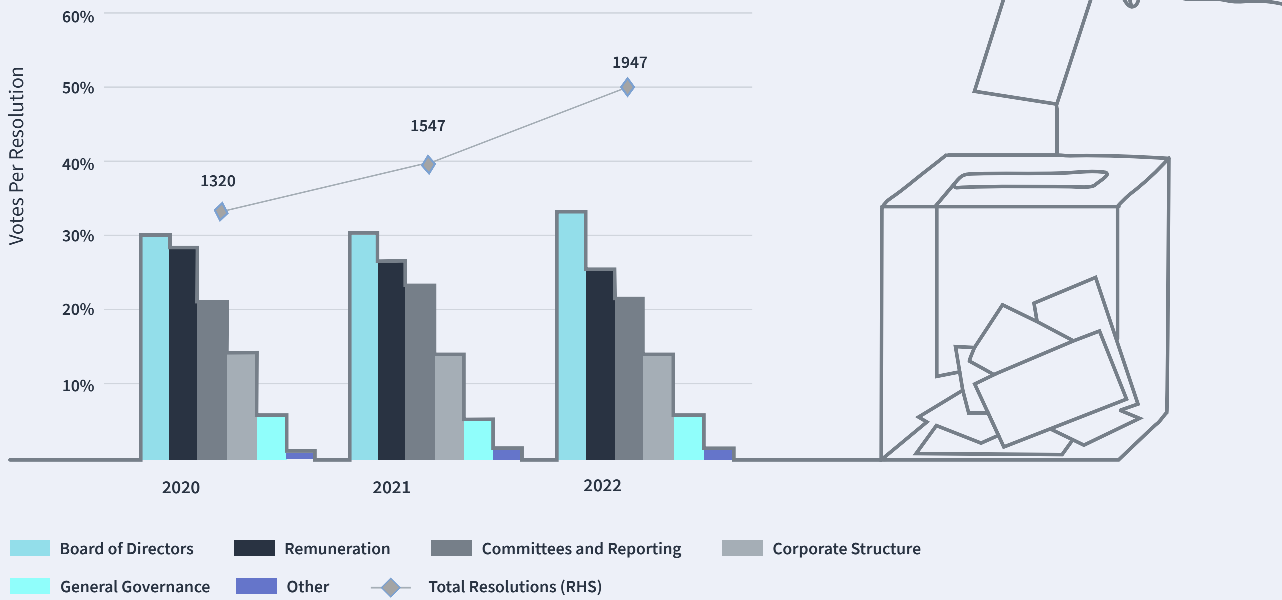
Eight percent of the total resolutions were dissenting votes, and 63% of the resolutions we voted against were related to remuneration and board independence, as these continue to be an effective means of driving good corporate governance practices in our client portfolios.

We report the outcomes of our proxy voting activities to demonstrate how we exercise ownership rights on behalf of clients. Each resolution is carefully considered on its own merits and we vote in line with our voting policy. We do not have targets or key performance indicators related to proxy voting statistics that determine how we vote.

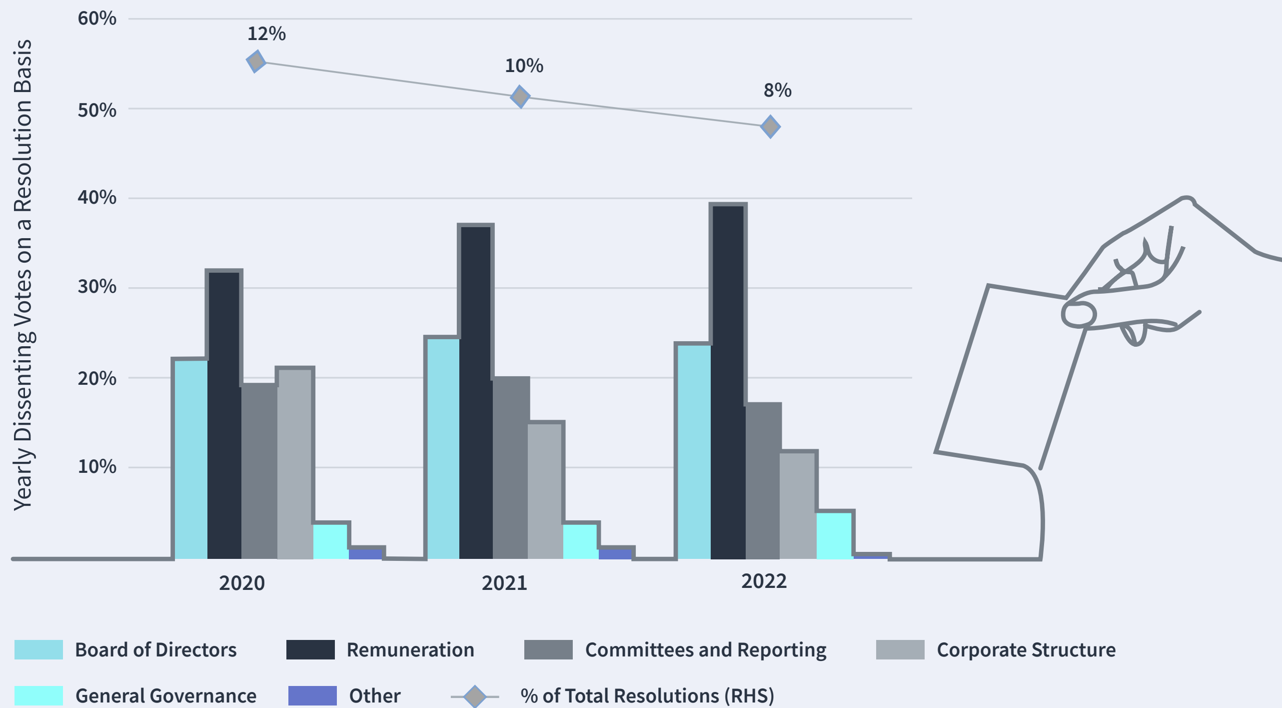
More information on the guidelines of how we apply ownership rights relating to our various equity investments is available in the STANLIB proxy voting policy.



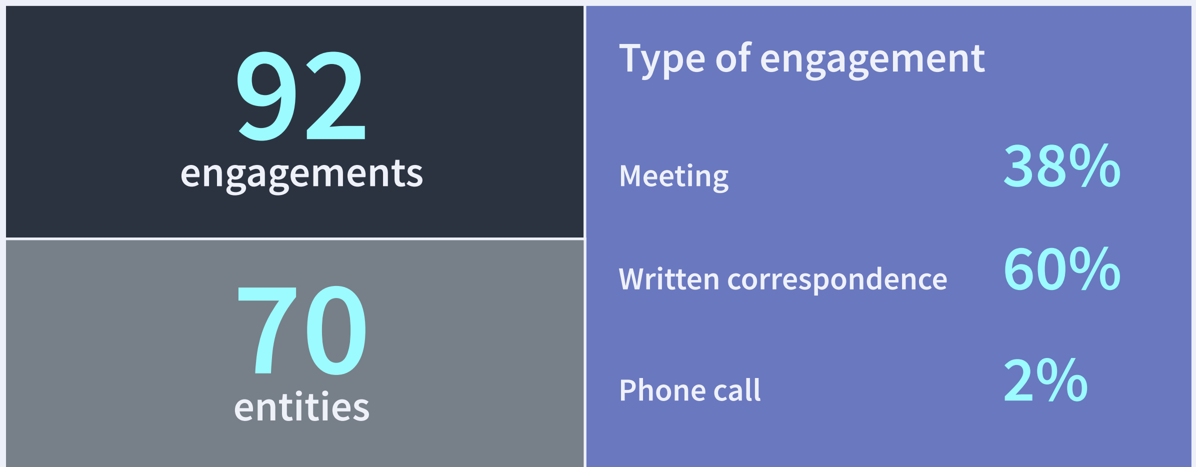
## Breakdown of Resolutions



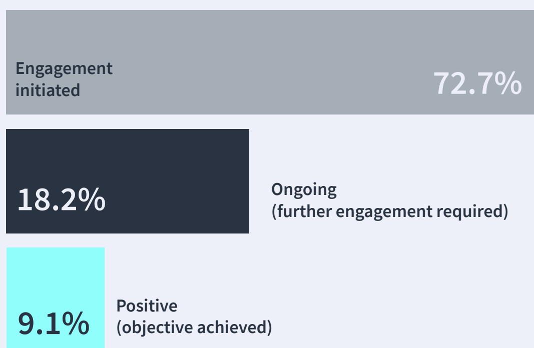

## Breakdown of Dissenting Resolutions



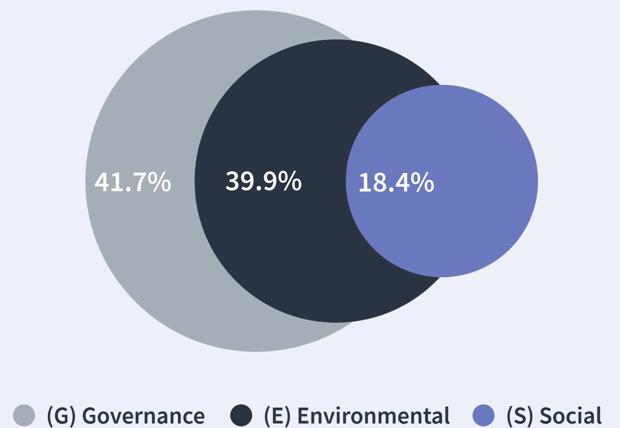
## Engagements in 2022



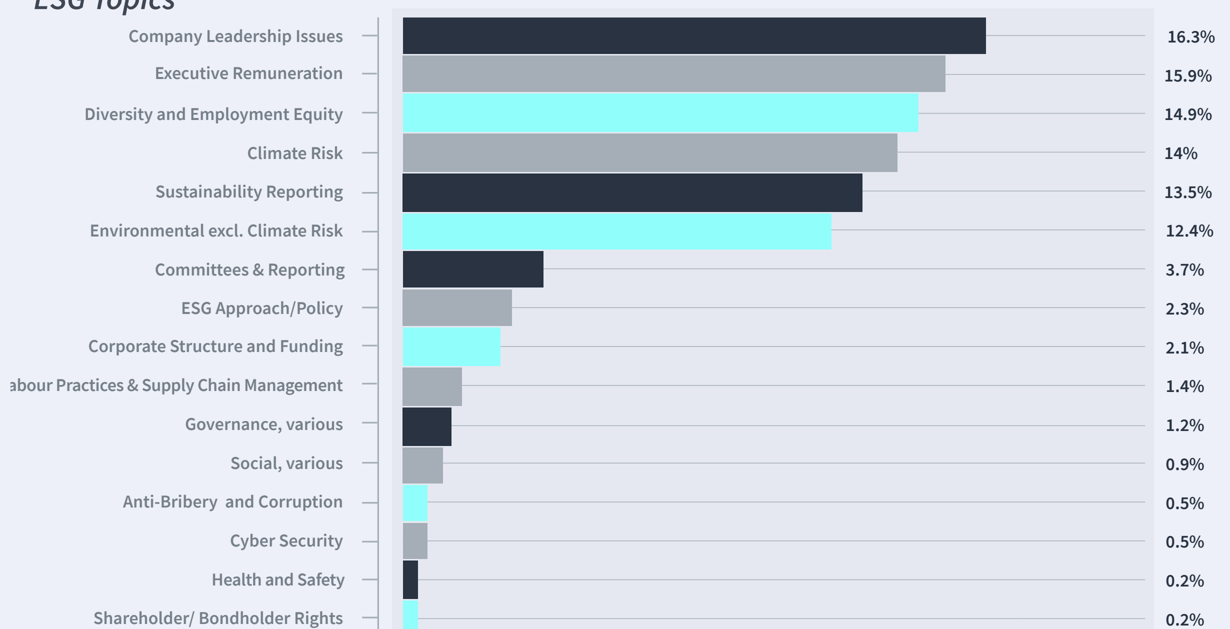

### *Engagement Outcomes*




### *Engagement Factors*




### *ESG Topics*



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# Companies Engaged in 2022

1

- Africa Cellular Towers Limited
- Anglo American Platinum Limited
- Anglo American Public Limited Company
- ANHEUSER BUSCH INBEV
- Aspen Pharmacare Holdings Limited
- AVI Limited
- BHP Billiton Public Limited Company South Africa
- Bld Corporation Ltd
- BIDVEST BANK LIMITED
- Bidvest Group Limited
- British American Tobacco Public Limited Company
- Capital Appreciation Limited
- Capitec Bank Holdings Limited
- City of Johannesburg Metropolitan Municipality
- DisChem Pharmacies
- Discount House
- Equites Property Fund Limited
- Ethos Private Equity (Pty) Ltd
- First capital Real Estate IN
- Glencore PLC

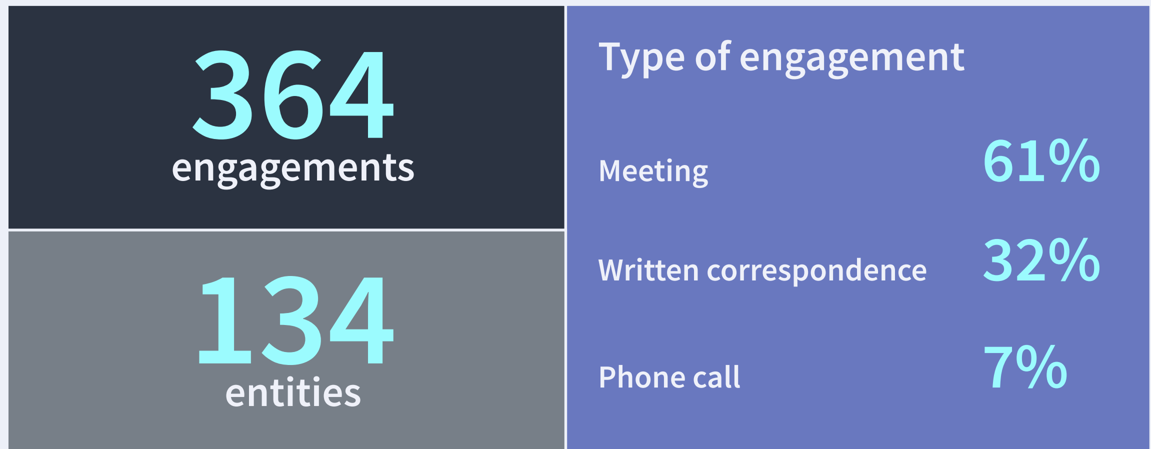
1

- Gold Fields Limited
- Greenpoint Capital
- Impala Platinum Holdings Limited
- Investec Group Limited
- Italtile Limited
- Land and Agricultural Development Bank of South Africa (Land Bank)
- Massmart Holdings Limited
- Medi-Clinic Corporation Limited
- Mondi Group Limited
- Mr Price Group Limited
- Nedbank AGL Stub
- Netcare Limited
- NINETY ONE Limited
- Northam Platinum Limited
- PEPKOR HOLDINGS Limited
- Pick n Pay Holdings Limited
- PROSUS NV
- Quilter Plc
- Redefine Properties Limited

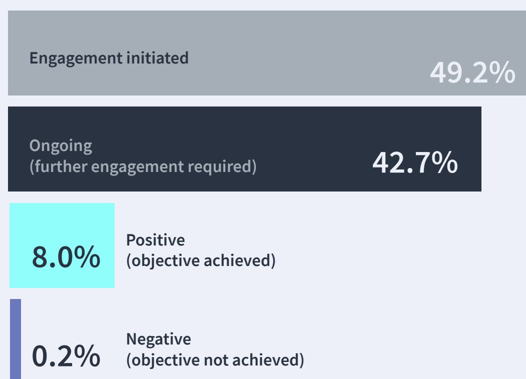
1

- Sanlam Capital Markets Proprietary Limited
- Sappi Limited
- Sasfin Bank Limited
- Sasol Limited
- Sibanye Gold Limited
- SIRIUS REAL ESTATE Limited
- South32
- SPAR Group Limited
- Spear REIT Limited
- The Foschini Group Limited
- Trans African Concessions (Pty)
- Limited Transnet SOC Limited
- Woolworths Holdings Limited

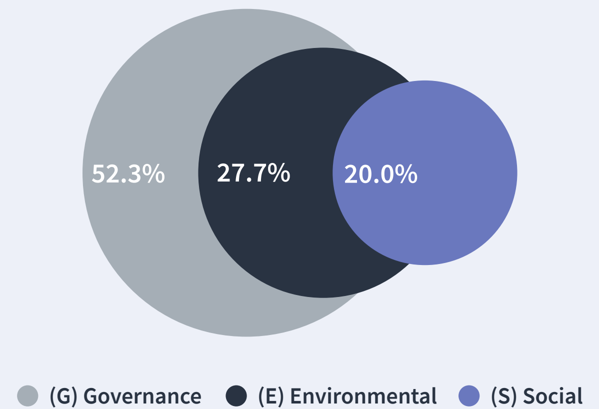
## Engagements in the past three years



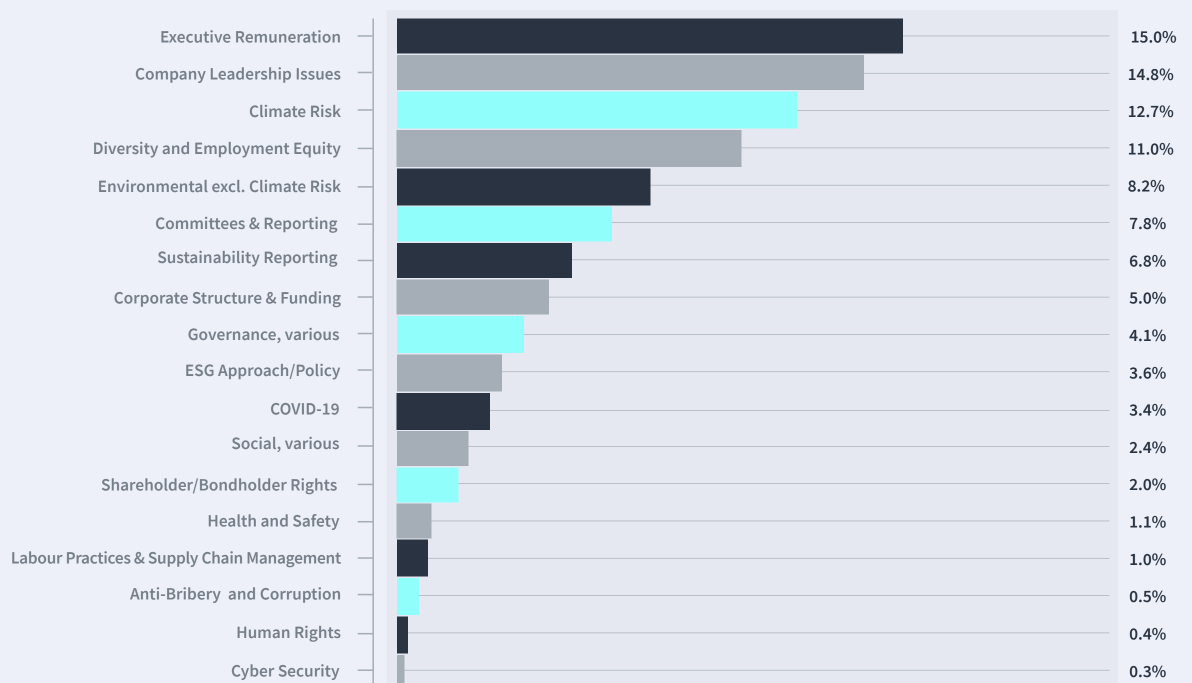

### *Engagement Outcomes*




### *Engagement Factors*




### *ESG Topics*



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# Companies Engaged Over Three Years

Kumba Iron Ore Limited 2
AVI Limited 3
Netcare Limited 7
City of Tshwane Metropolitan Municipality 4
Capitec Bank Holdings Limited 3
MAS Real Estate Company 3
Transaction Capital Limited 5
ANHEUSER BUSCH INBEV 2
Eskom Holdings SOC Limited 7
Balwin Properties Limited 2
African Bank Investments Limited 3
Woolworths Holdings Limited 2
Standard Bank Group Limited 6
Fortress Income Fund Limited 9
Redefine Properties Limited 8
Anglo American Platinum Limited 4
Fairvest Property Holdings Limited 2
KAP Industrial Holdings Limited 2
Bidvest Group Limited 2
Avon Peaking Power 3
Industrial Development Corporation (IDC) 4
Land and Agricultural Development Bank of South Africa (Land Bank) 21
Vukile Property Fund Limited 11
MTN Group Limited 7
Dedisa Peaking Power 2
Growthpoint Properties Limited 5
Anglo American Public Limited Company 4
DisChem Pharmacies 4
Resilient Properties Proprietary Limited 2
City of Johannesburg Metropolitan Municipality 2
Medi-Clinic Corporation Limited 3
Sasol Limited 9
Shoprite Holdings Limited 8
Life Healthcare Group Holdings Limited 4
CIVH LOANCO RF PTY Limited 2
Mondi Group Limited 2
Aspen Pharmacare Holdings Limited 4
SPAR Group Limited 3
Investec Property Fund Limited 2
Sibanye Stillwater Limited 2
Investec Group Limited 3
Exxaro Resources Limited 6
Ethos Private Equity (Pty) Ltd 2
Glencore PLC 2
Mr Price Group Limited 3
PEPKOR HOLDINGS Limited 7
PROSUS NV 6
Clicks Group Ltd 3
Irongate Group 3
Motus Group Limited 2
Resilient Property Income Fund Limited 3
Barloworld Limited 5
Equites Property Fund Limited 3
Vodacom Group Limited 6
FirstRand Bank Limited 5
SA National Roads Agency Limited (SANRAL) 3
Development Bank of Southern Africa (DBSA) 3
ABSA Group Limited 4
BId Corporation Ltd 2
BHP Billiton Public Limited Company South Africa 4
Transnet SOC Limited 5
Netcare Limited 4
Compagnie Financiere Richemont SA 2
Santam Limited 3
Hyprop Investments Limited 3

[1]

Africa Cellular Towers Limited
African Rainbow Capital Investments
African Rainbow Minerals Limited
Airports Company South Africa SOC Limited
Arrowhead Properties Limited
Bank of China Limited South Africa
Bayport Management Limited
BIDVEST BANK LIMITED
Blue Label Telecoms Limited
Capital Appreciation Limited
City of Cape Town Metropolitan Municipality
Coronation Fund Managers Limited
Deutsche Bank AG Johannesburg Branch
Discount House
Discovery Life Collective Investments Proprietary Limited
Discovery Limited
EPP N.V
First capital Real Estate IN
Green Building Council South Africa
Greenpoint Capital

[1]

Harmony Gold Mining Company Limited
Imperial Logistics
Instratin Properties
Kilroy Realty Corporation
Liberty Holdings Limited
Liberty Two Degrees
Massmart Holdings Limited
Namibia Power Corporation (Pty) limited - Nampower
Nampost
Nedbank AGL Stub
Nedbank Limited
NINETY ONE PLC
Old Mutual Life Assurance Company Limited South Africa
Peninsular Capital
Pick n Pay Holdings Limited
Pick n Pay Stores Limited
Prologis, Inc
Reinet Investments SCA
Royal Bafokeng Platinum Limited
SA Corporate Real Estate Trust

[1]

SAHL Investment Holdings Proprietary Limited (SA Homeloans)
Sanlam Capital Markets Proprietary Limited
Sappi Limited
Sasfin Bank Limited
Scatec Solar Kalkbult
Sibanye Gold Limited
SIMACEL 160 (PTY) Limited (PROJECT DRAUNBERG)
SIRIUS REAL ESTATE Limited
South32
Spear REIT Limited
Stor-Age Property REIT Limited Toyota
Financial Services South Africa Limited
Trans African Concessions (Pty) Limited
Welltower Inc.

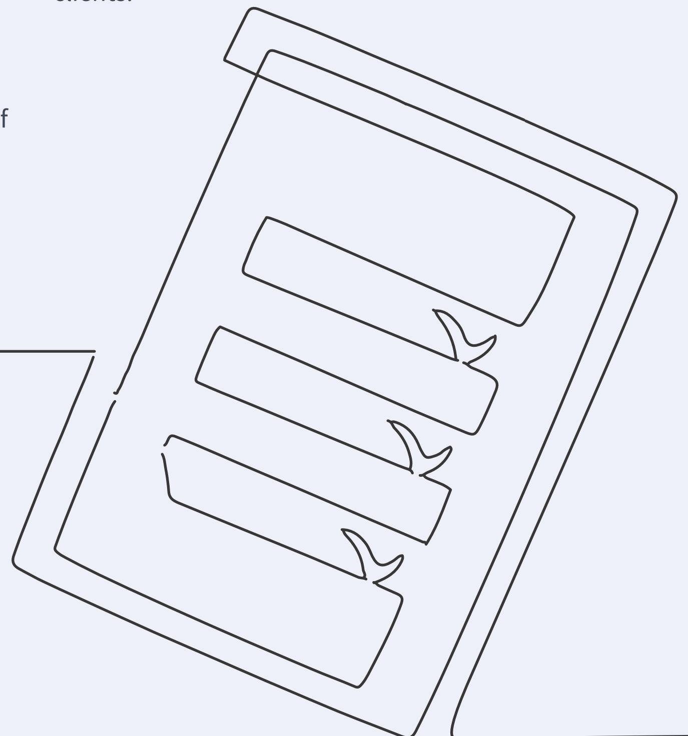
Our analysts record the outcomes of all engagements to track progress across our client portfolios. These outcomes are not measured against standard metrics, such as the UN Sustainable Development Goals (SDGs), but are qualitatively assessed by responsible analysts in line with the objective set out for the engagement beforehand. Outcomes can be positive when a specific engagement objective is met, ongoing when further engagement is required to drive the investee towards a specific objective, and negative when the engagement objective was not met and further engagement would not change the outcome. We have also added an outcome specifically for engagements initiated through our annual engagement letter to investee entities.

As with proxy voting disclosures, we have included engagement records for the past three years. This is an acknowledgement of the multi-year nature of client engagements. Even where the engagement yields a positive result, we continue to monitor ESG risks as part of the investment process.

Land Bank is the single entity we have most engaged with over the past three years, on behalf our fixed income clients. A case study on this multi-year engagement is discussed later in this report.

As part of our data-driven approach to engagement reporting, we maintain records on engagement topics. This is to ensure that we are acting on ESG issues that we seek to drive collectively as an investment platform, and identify ESG risks emerging from the research processes of our independent investment teams. In the past three years, remuneration and board independence have dominated our active ownership activities. Thirty percent of our engagements were focused on these two governance topics, which also accounted for over half of the resolutions we voted against in the same period. The importance of these elements is reflected in their relatively high weightings in the ESG scorecard applied by our Equity team.

In the following section we disclose case studies that we hope will bring our active ownership to life and demonstrate how we apply our ESG guiding principles as part of our fiduciary duty to clients.



STANLIB

# STANLIB's 2022 Stewardship Engagement Letter: talking ESG with our portfolio companies

In 2022, STANLIB sent its second letter to the boards of its portfolio companies identifying certain ESG matters for the year ahead. Here are the issues that we highlighted in the letter.

Climate change is a hot topic all over the world. Well-managed companies should be grappling with the risks that a warming planet presents to their businesses, customers, staff, communities and suppliers. Many companies have adopted the **Task Force on Climate-related Financial Disclosure Framework** (TCFD). STANLIB encourages our companies to adopt the TCFD as a framework for reporting climate-related risks and, at December 2022, 48% of them were doing so.

STANLIB believes that diversity is not only a matter of social justice but also the foundation of any sustainable business. In SA we have been actively promoting the **representation of women** at board and management level.

At the beginning of 2022, only 36% of our portfolio companies' board members were women and anecdotal evidence suggests an even lower percentage in senior management. We questioned all our boards on their plans to improve gender diversity at board and management level. One year later, the percentage of women board directors had risen to 37%. Separately, we have established a baseline for women representation at senior management level: 26% of the members of JSE listed companies executive committees are women.

The **pay gap** is perhaps the most concrete expression of gender inequality. STANLIB believes that, as a basic issue of fairness, it is imperative for companies to equalise pay for men and women in comparable roles. We have asked our companies to address gender pay gaps more transparently in their reporting.

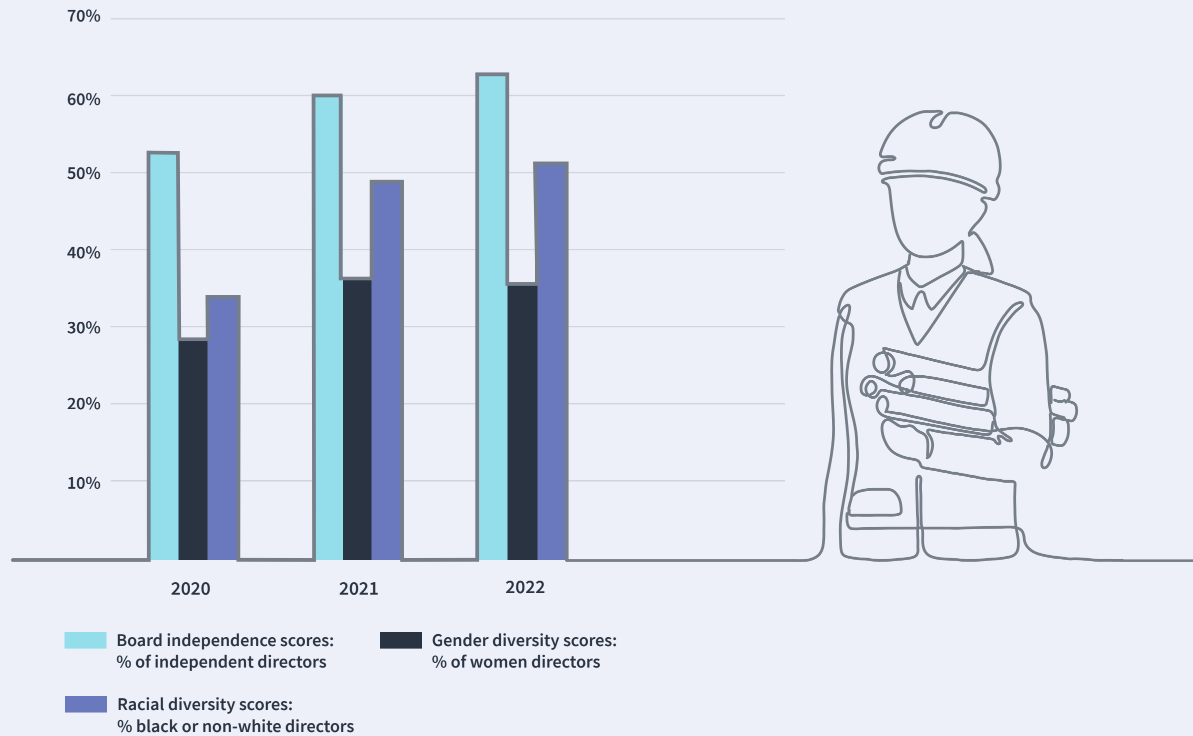
We also focus on the gap between executive management salaries and the wages of the workforce. The necessity of retaining executive talent in a competitive market is often given as the reason for extraordinary wage gaps. In addition, headline executive compensation numbers can be misleading, inflated by share-based incentives, granted years before, which vest after a period of strong share price performance. The resulting 'gain' is reported as part of the recipient's compensation for that year. Furthermore, 65% of the companies in our universe have international operations - in these cases, executive remuneration is either entirely or proportionally benchmarked to international peers. In all cases, detailed analysis is required to make an accurate comparison.

All the companies that we engage with are sensitive to pay gaps. In general, we see minimum wages rising faster than general and executive pay, and companies are introducing various ways to cap executive remuneration. STANLIB advocates the capping of share price-related upside to avoid "super-paydays". Linking executive pay to share price performance notionally aligns management's interests with those of shareholders but can result in excessive pay-outs.

Load shedding is a painful reminder that South African companies rely on the supply of utilities that they cannot control. STANLIB focuses on water as a critical business input that is vulnerable to climate change and therefore a risk for our companies. SA is a water-scarce country, where a number of small municipalities have run dry. In 2018, the City of Cape Town was days away from 'Day Zero'. We cannot control the rainfall but we can encourage our companies to be more efficient in the ways that they use water. We asked our boards to improve reporting on their sources and uses of water, savings, storage, and ways of ensuring fragile communities have access to clean water.

In terms of corporate governance, we asked nomination committees to intensify their attention to **board effectiveness** through the lens of tenure and diversity by race, gender and age. Without appropriate qualifications, skills and experience, the directors cannot effectively staff the committees through which the board governs the company. It is therefore in shareholders' interests for a board to have its directors independently assessed, to make changes where required to increase the board's effectiveness, and to report back to shareholders accordingly.

*The data relating to board independence and diversity shows a positive trend:*




We recently sent our 2023 Stewardship Engagement Letter to our investees. In this year's report, we include the STANLIB ESG Ratings for the first time, and we look forward to sharing the feedback and insight from our discussions with our investees. There is a broad distribution of ESG performance among them, as the chart below shows.

## *Universe ESG Ratings*

# Remuneration: a hot topic, and not just for shareholders

In line with the King Code on Corporate Governance, the rules of the JSE require a company to allow shareholders to vote at every annual general meeting (AGM) on its remuneration policy and the details of how its executives were paid (an 'implementation report'). Unlike in other countries such as the UK, however, these shareholder votes are 'advisory' rather than binding. If more than 25% of shareholders vote against either the policy or the report, JSE rules require the company to engage formally with shareholders, but it is under no legal obligation to make changes as a result.

South African institutions may be frustrated at their lack of influence in this area of governance but increasing disclosure of remuneration practices has still been a force for improving corporate governance. Company leaders argue that a non-binding vote gives investors moral leverage while giving boards the space to adopt best practice on remuneration. Binding AGM resolutions on remuneration are the next step.

STANLIB engages not only with companies but also with regulators to ensure that executive remuneration is fair, sustainable and aligned with the long-term success of the company. STANLIB will consider voting against the remuneration policy where:

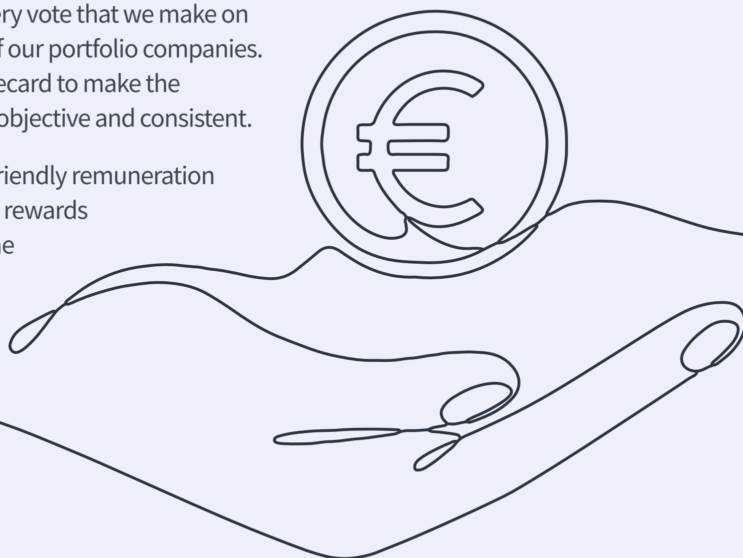
1. Executive remuneration is excessive compared with the company's competitors.
2. Executives are not subject to a strong performance management process.
3. Performance targets are not aligned with long-term shareholder value creation.
4. The remuneration policy lacks transparency.
5. Non-executive director remuneration is not paid primarily in cash.

STANLIB has developed a transparent, structured approach towards remuneration, aligned with the principles of responsible investing that we embrace. To this end, we have devised a detailed policy and guidelines which inform every vote that we make on the remuneration policies of our portfolio companies. We have also created a scorecard to make the process of evaluation more objective and consistent.

In principle, a shareholder-friendly remuneration policy is defined as one that rewards management for growing the net worth of the company over time. In this spirit, STANLIB supports management performance targets related to profitability in general, and return on invested capital and equity in particular. We also like share price performance to be an explicit trigger for executive rewards.

These KPIs should be part of the short- and long-term incentive structures. We have recently added ESG to our wish list of remuneration key performance indicators (KPIs). We believe effective managers can reduce emissions and narrow gender wage gaps while delivering a strong bottom line.

Progressive boards understand that alignment between the interests of shareholders and executives is one of the foundations of long-term shareholder value and that it should be in their interest to communicate what they have achieved. However, it is often hard for investors to unearth the details of management incentives and to judge whether KPIs were met. We therefore encourage our portfolio companies to present management incentives in a 'report card' specifying relevant targets, the level of achievement and the percentage of the incentive that was paid. We also ask for information on the following year's goals. Most companies disclose short-term profitability targets but ESG-related KPIs are less transparent, and most companies are still reluctant to share future KPIs. We think on balance there is room for improvement in disclosure.



It is important to incentivise management to maintain a long-term mindset. Short-term earnings growth, and thereby share price performance, can be pursued at the cost of the business's long-term success. More complex compensation structures are therefore required: long-term share incentives should vest over time and be subject to claw-back if profitability or share price performance underperforms over some future period. These are onerous for board and management to implement however, and relatively unattractive for candidates if similar companies do not yet insist on them.

**STANLIB has identified 12 aspects of a company's remuneration policy which define alignment with shareholder interests. We are interested in whether executive compensation is dependent on the following six factors:**

1. Profitability as a driver of short-term incentives
2. Profitability as a driver of long-term incentives
3. Balance sheet returns as a driver of short-term incentives
4. Balance sheet returns as a driver of long-term incentives
5. ESG outcomes as a driver of short-term incentives
6. ESG outcomes as a driver of long-term incentives

and the extent to which the company:

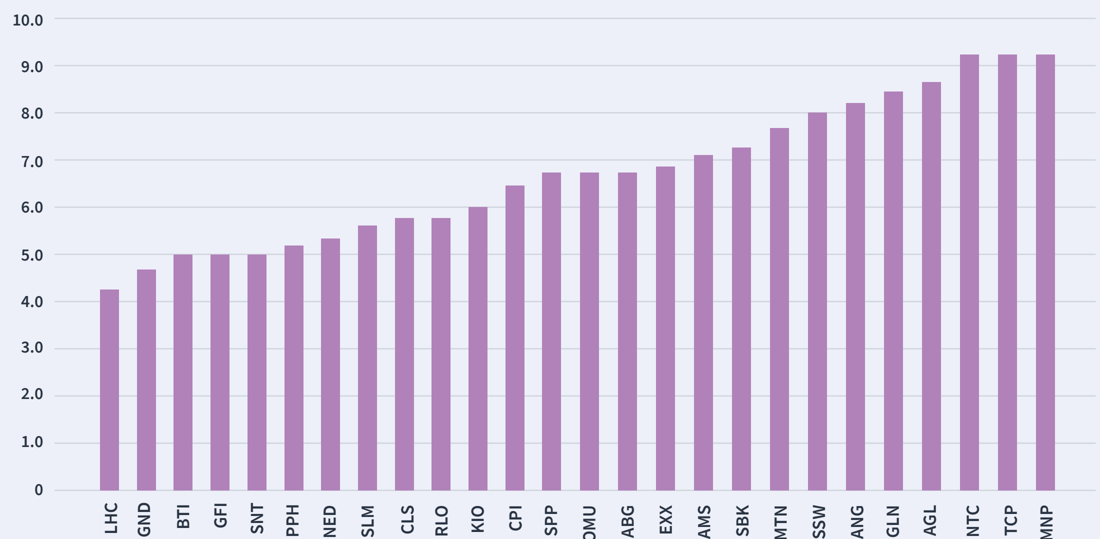
7. Produces a report card
8. Uses forward-looking KPIs in remuneration structures
9. Vests stock on a staggered and qualified basis
10. Uses 'malus' and clawback provisions
11. Is aligned with shareholder interests
12. Makes ESG outcomes a driver of long-term incentives

Many of these KPIs are subjective rather than empirical but we have devised a scoring system (either 0, 0.5 or 1) to indicate compliance. The two charts below show:

- how well the portfolio is meeting each of our KPIs (100% = every company scores 1 on a given KPI)
- how well each company is meeting our KPIs on average (100% = scores 1 on every KPI).

### *Portfolio quality by STANLIB remuneration policy KPIs*

### *Portfolio company quality across STANLIB remuneration policy KPIs*



An area that attracts a lot of attention, especially in the financial press, is the quantum of a CEO's pay package. Viewed in isolation, these numbers are often sensational and can sometimes seem out of touch with the reality of the average South African.

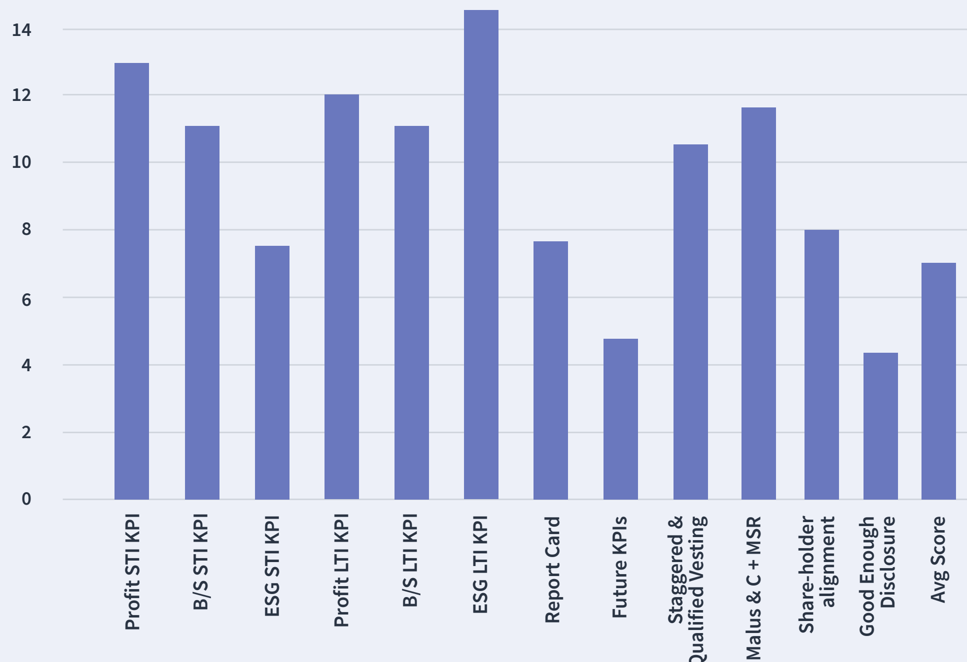
Defining 'fairness' as it relates to remuneration is fraught with difficulty. At STANLIB, we try to assess it more in absolute terms and less in a relative sense. A useful intuitive measure is the gap between the compensation of the CEO and the average wage of employees. This ratio can then be compared with that of other companies in the same sector.

It is also important to remember that a CEO's remuneration is often reported as a single number. This is a crude way to express compensation, which often comprises salary, benefits and a cash bonus for the previous year's performance. It may also include the present value of shares awarded but that will only vest over a number of years, if various performance targets are achieved, and they could be more or less valuable depending on the price of those shares at the vesting date. Reporting on compensation is not yet consistent enough for investors to usefully compare CEO pay across companies and industries. We will continue to encourage our portfolio companies to produce compensation report cards to improve transparency for investors.

We should also highlight a perverse consequence of greater transparency around compensation: CEOs who are already well-paid can pressure their boards for a pay rise by pointing to bigger packages awarded to their peers at other companies. This phenomenon can create an upward spiral in executive remuneration. The best defence against it is a strong, independent compensation committee which judges fair executive remuneration in relation to the profitability of the firm and the wage gaps of its peer group.

**STANLIB takes remuneration seriously: during the last 12 months we voted against our portfolio companies' remuneration policies 60% of the time.**

*Remuneration Scorecard Legend*




## Legend

**Profit STI KPI:** income statement-related short-term incentive key performance indicators. This would include indicators such as headline earnings per share growth or operating profit margin expansion.

**B/S STI KPI:** balance sheet-related short-term incentive key performance indicators. This refers to a return on capital or equity metric included in the short-term incentive key performance indicator.

**ESG STI KPI:** we prefer ESG KPIs within STIs and long-term incentive KPIs. Good examples of short-term ESG KPIs are increasing gender equality at senior management level within the next year or reducing $CO_2$ emissions by a certain percentage within 12 months.

**Profit LTI KPI:** a long-term incentive KPI that ensures growth in profitability over a three-year period, for example, where the vesting of the award is conditional upon reaching the target set.

**B/S LTI KPI:** as with the long-term profitability target, the long-term balance sheet KPI can require a multi-year achievement of a return on equity objective.

**ESG LTI KPI:** here the awarding of the long-term incentive can, for example, be conditional upon reaching a $CO_2$ emission target reduction over a three-year period.

**Report Card:** this refers to the Remuneration Implementation Report, the level of transparency with which the final KPI outcomes are disclosed, and the size of management incentives paid.

**Future KPIs:** shareholders are demanding that the board share forward-looking KPIs and not just last year's report card.

**Staggered and qualified vesting:** shareholders want to know that rewards are paid over multiple years and that the vesting of these awards is subject to sustained achievement of a relevant KPI. This better aligns management outcomes with shareholder outcomes.

**Malus and clawback provisions:** enable companies to recover incentives paid in the event of adverse outcomes or misstatement of facts. **Minimum shareholding requirements** are there to ensure management owns shares in quantities that ensure shareholder alignment.

**Good enough disclosure:** refers to the ability of the reader of the Remuneration Report to make informed decisions on the fairness of pay, the alignment between pay and performance, KPI transparency and accountability.

**Average score:** the average score of all the companies assessed in the period under review.

# The STANLIB G Score

It is worth reiterating that directors are the shareholders' representatives, elected to protect and advance their interests as the owners of the company. Their responsibilities are:

- to set the strategy and recruit an executive team that can execute it;
- monitor performance across multiple KPIs and hold executives accountable;
- ensure that the company operates in a legal, sustainable way; and
- be sufficiently well-informed about the company and its industry to be an effective ally for the executive team.

If the board is the shareholders' agent, then it is incumbent on institutional investors like STANLIB to make sure that the directors possess the appropriate profile, skills and experience to govern the company effectively and protect the owners' interests.

STANLIB has created a systematic approach to assessing the quality of company boards. The 'G score' is our proprietary standardised scoring system, which allows us to compare the boards of different companies and measure one board's improvement or deterioration over time.

### The key factors in our assessment of board quality are:

- Independence, tenure and capacity to serve
- Ethnic, skills and age diversity
- Relevant experience and skills

## Independence, tenure and capacity to serve

The issue of independence is crucial. A board must simultaneously be close enough to management to know what is going on in the business while maintaining an appropriate distance. Sometimes it is in the shareholders' interest to replace a CEO or their team. If board directors are personally too close to management, they may find themselves conflicted and reluctant to do what is required. As shareholders, we rely on the board's internal and external board member assessments of director effectiveness and independence. Tenure, or the length of time that a director has continuously served, is also an important factor in determining independence. As a rule of thumb, we think that a new director takes three years to become fully effective but starts to lose their independence as they approach 10 years of tenure. At that point, we change our rating for the director from 'independent' to 'non-independent', lowering the overall independence score of the board.

## Ethnic, skills and age diversity

We regard ethnic diversity as an important factor in a board's ability to be effective, especially in SA. Stakeholders increasingly expect companies to show leadership in transformation, and an ethnically-diverse board with an appropriate range of skills has a better chance of successfully engaging with management, labour and government. The G Score measures the racial and gender diversity of the board and the diversity of skills among its members.

We also see the benefit of age diversity for a board. Companies' customers, employees and other stakeholders are multi-generational and the board should reflect this, together with skills and racial diversity.

## Relevant experience and skills

STANLIB regards qualifications and previous experience as important indicators of a director's ability to add value to the board.

We see the number of directors as another factor in a board's ability to perform. Boards typically have four or five committees, each of which can require up to four members. To avoid a situation where all the committees are staffed by the same individuals, which can impact independent thinking, we believe the optimal board size is between 10 and 13 directors.

### *Here are the 'rules' of the STANLIB G Score:*

**1** Executives are deemed suitably qualified when appointed. Scores can deteriorate if track record disappoints. Scores range from 1 to 3.

**2** Tenure scores start at 1 and peak at 3 in the third year. For non-executives, the score fades incrementally after year 10.

**3** 13 is the optimal number of directors on the board; the score is impaired when the number is below 9 or over 14.

**4** A board is deemed to be sufficiently independent if 51% of its members are deemed independent. Our median score for independence is 61%. Scores range from 1 to 3.

**5** Gender diversity scores peak at 50%. Currently mean universe gender diversity is 37%. Scores range from 1 to 3.

**6** Suitability scores blend qualifications, skills, committee appointments and the number of directors. Scores range from 1 to 3.

**7** Where there are founders (or other shareholders) with high voting control structures, we adjust ratings down, based on the level of ownership and effective control.

# Governance Case Studies

## Richemont

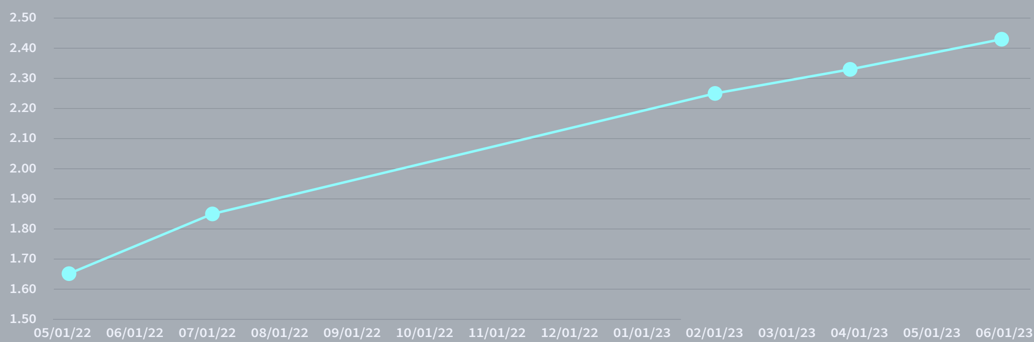
A significant moment in STANLIB's journey as an engaged Richemont shareholder was the meeting we requested with the lead independent director in 2021 to discuss corporate governance. Our view at the time was that Richemont's board was too large, but also too narrowly-skilled, not diverse enough and insufficiently independent. The lead independent director assured us that an agreement had been reached to make the board smaller, more diverse, more skilled and more independent, but that the process would take several years, so investors would need to be patient.

Two years later we are pleased to see that there has been substantial change to the Richemont board, which is reflected in the almost 50% improvement in our G score. Today the board is younger, more ethnically-diverse, broader in experience and dramatically better balanced by gender.

Richemont still ranks relatively poorly within our investment universe, however. The large share of the vote controlled by Johann Rupert is a persistent negative. Further improvements to gender diversity and a smaller board would further improve the G Score. The passage of time will also help: today there are five directors with fewer than three years' experience on the board. As these members settle in, the rating will improve. We are satisfied that our engagements and the efforts of the lead independent director to improve the effectiveness of the board are bearing fruit.

The first chart below shows the improvement in Richemont's G Score over time; the second shows its current position (blue dot) in the universe of companies in STANLIB's client portfolios.

*STANLIB G Score - Richemont*




*STANLIB G Scores*

## External Management function at Investec Property Fund

### Background

The Investec Property Fund was one of the last remaining REITs to be managed by an external party. Rather than having its own executive team, the fund is run by an Investec entity on the basis of a management agreement. Such agreements typically incentivise the management company to grow the fund's asset base (which in SA has often been defined as its enterprise value, i.e., market capitalisation plus debt) without reference to the quality or sustainability of the REIT's rental income.

In theory, this creates the risk of an 'agent-principal' problem, whereby the interests of the management company are misaligned with those of shareholders, who think of value on a 'per-share' level. Despite supporting the notional benefits of external management for several years, management recently accepted that shareholders' interests would indeed be best served by internalising the management function of the REIT.

### STANLIB engagement

We had consistently raised the external management issue with the company for several years so we were pleased when the fund moved the management function in-house by acquiring the management company from Investec. This was the development we had been hoping for, but it was naturally important for us and our fellow shareholders that the fund paid a fair price for the acquisition.

We engaged extensively with the fund to understand the justification for a price which looked expensive in a global context. STANLIB was one of the few institutional investors that held an overweight position in the stock. We maintained our holding throughout our discussions with management and leveraged our longstanding commitment to the stock to influence management's thinking.

### The outcome

On 1 March 2023, the Investec Property Fund announced the internalisation of its asset management function across SA and Europe by acquiring the Investec entity for R975 million.

From the beginning, we felt this valuation was too high, particularly compared with transactions of this nature in other countries. We therefore engaged the fund in detail and at length, particularly on the premise that the management entity should be valued based on a 'normalised' level of cash flows (i.e., higher than that being achieved at the time). We disagreed, and spent significant time and effort challenging the fund's position.

One month later, after extensive discussions with STANLIB and other shareholders, the Investec Property Fund announced a R125 million reduction in the headline consideration to a more reasonable R850 million. STANLIB had also pressed the fund to align shareholders' interests with those of the Investec entity (i.e., agent-principal problem). Investec agreed to defer R125 million of the consideration as an earn-out, conditional on the future growth of the fund's portfolio.

In our view, internalising management has created value for the fund's shareholders, primarily by eliminating the 'agent-principal' problem. We were naturally pleased that the fund was willing to change its approach in response to our concerns, vindicating our commitment to consistent engagement as an active investor. We will continue to engage the fund on the alignment of interests between shareholders and management on a range of financial and operational metrics.

# Case Study - Steinhoff

## A watershed moment and case study for South African financial markets

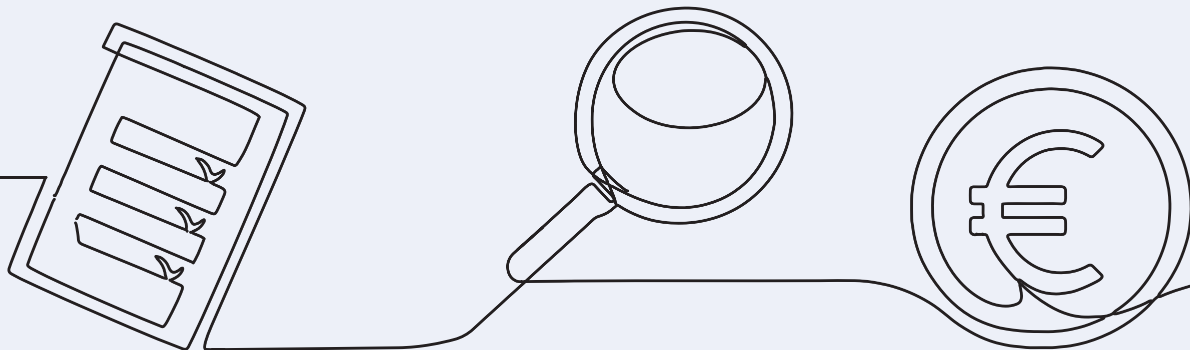
Financial markets were blindsided by the news in December 2017 that Steinhoff's CEO, Markus Jooste, and other parties had been inflating the company's earnings with fictitious transactions for over a decade. At the time the news broke, 18 investment banks published research on Steinhoff, 10 of them rated the stock as a 'buy' and the other eight rated it as a 'hold'. None of them were advising their clients to sell the stock. The company was also a favourite of many investment managers.

STANLIB was slightly overweight Steinhoff in its South African equity funds. This reflected our positive investment thesis, focused on Steinhoff's transformation from a manufacturer to a vertically-integrated discount retailer with a multinational operation and growing economies of scale, following the acquisition of Pepkor.
Following the decline of Steinhoff, STANLIB took an action to join the class action together with other shareholders, which has resulted in mitigation of client losses.

Steinhoff was not the first multi-year fraud perpetrated at the heart of the financial establishment. As in previous scandals, the revelation of Steinhoff's deception inevitably put the spotlight on the gatekeepers who protect investors from fraud, including the auditors.

The chain of events was started when the auditors initially refused to sign off Steinhoff's 2017 financial statements.

***Chronology of key events:***



### *4 December 2017*

The Supervisory Board of Steinhoff confirms that the 2017 consolidated **financial statements** would be **released** in unaudited form on 6 December 2017.

### *6 December 2017*

Steinhoff announces that new information had come to light warranting an **independent investigation** into accounting irregularities and the resignation of its CEO, Markus Jooste, with immediate effect.

### *7 December 2017*

Steinhoff announces that the board was giving further consideration "to the validity and recoverability of certain assets of the company which amount to circa **€6 billion**".

Steinhoff later confirmed that previous years' accounts would need to be restated and an independent investigation discovered fictitious or irregular transactions totalling €6.5 billion between 2009 and 2017. After the publication of the report, Steinhoff wrote down the value of its assets by more than $12 billion.

Between the close of trade on 5 December 2017 and the close of trade on 8 December 2017, Steinhoff's share price fell by more than 80%. Following the announcement, STANLIB's portfolio managers immediately took the decision to sell all their positions in Steinhoff. Even though the share price had already declined, the risk remained that fraud could be a terminal event for the company. Liquidating our positions, even at a loss, was the sensible thing to do on behalf of our clients. The legal implications for Steinhoff were predictably massive: the group faced approximately 90 separate legal proceedings in the Netherlands, Germany and SA, with combined claims of over R136 billion. In addition to proceedings against the group itself, cases were brought against current and former directors and executives.

In August 2018, LHL Attorneys filed an application for SA's first-ever class action in the field of securities law. Almost two years later, in June 2020, the South Gauteng High Court dismissed the application but the proceedings still represent a milestone in the history of South African law on collective redress. Parts of the court's reasoning were widely regarded as disappointing, particularly its opinion that shareholders who acquired shares on the basis of misleading and untrue statements could not be compensated for damages due to the principle of 'reflective loss'.

In January 2018, a class action lawsuit was initiated in the Dutch courts by the law firm BarentsKrans against Steinhoff and Deloitte SA.

Later that year, in common with many other South African asset managers, STANLIB joined the case as the most likely way to recoup some of the losses experienced by our clients. At the end of 2021, Steinhoff proposed a settlement, which was accepted by counterparties and approved by the courts in both SA and the Netherlands.

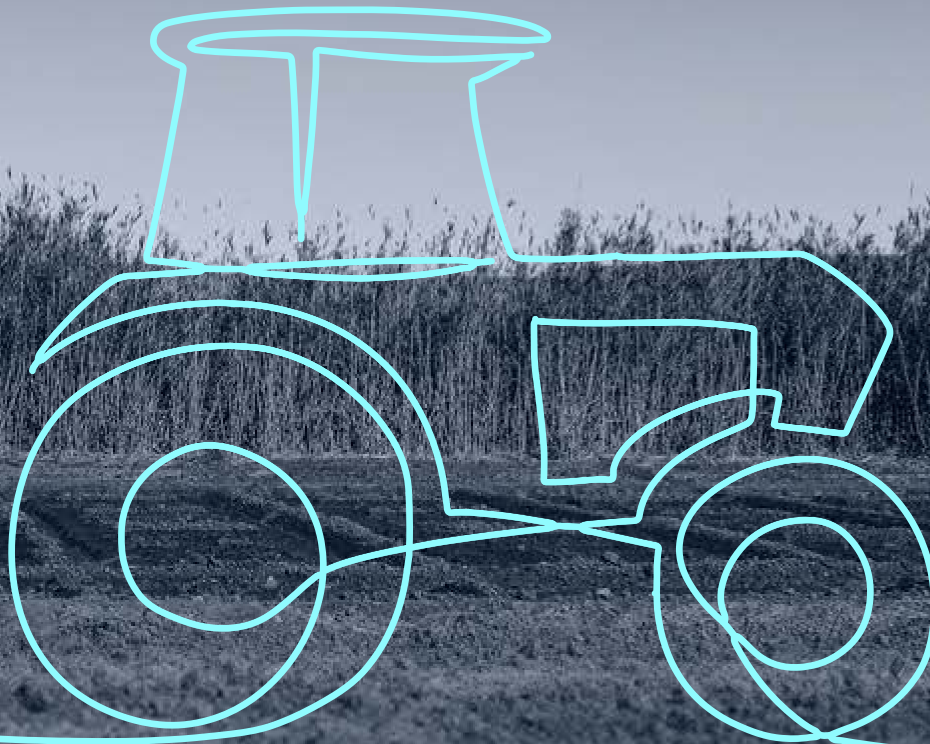
The total estimated losses of STANLIB's claimants were €59 110 103, while the total estimated expected recovery was €8 567 919. Settlement payments are being distributed in two tranches, the first of which has been received. STANLIB has already distributed just over R142 million to our clients.

In the immediate wake of these disclosures, Steinhoff's survival as a going concern was in doubt, and meaningful compensation for the company's injured shareholders seemed a distant prospect. Accepting that its very survival depended on a global resolution of all pending and threatened litigation stemming from the fraud, Steinhoff invited its major stakeholders to participate in a settlement process.

The negotiations were complicated by the number of parties involved and their conflicting interests and settlement strategies. Steinhoff's precarious financial condition, which deteriorated further after the onset of the Covid-19 pandemic, presented additional challenges. Despite these challenges, the parties ultimately reached a settlement that received almost unanimous support from Steinhoff's financial creditors and defrauded shareholders.
The settlement will provide significant compensation to investors while ensuring Steinhoff's long-term survival.

## 15 February 2022: The end of the legal disputes with a billion-euro settlement

Just over four years after the scandal broke, the company reached a €1.43 billion global settlement with plaintiffs, including the investors who had bought the stock in the market and previous owners of companies acquired by Steinhoff in return for stock. This is an astonishingly swift conclusion to one of the most complex disputes in the history of international securities law. The Steinhoff litigation and its resolution were unprecedented in terms of scale, complexity and the value of the settlement.



# Background to the Land Bank
## and STANLIB's investments

**Throughout the Land Bank's default and restructuring, STANLIB participated constructively, while defending the interests of our clients. Within the broader SOE space, we will continue to demand standards consistent with responsible lending practices.**

The Land and Agricultural Development Bank of SA (the Land Bank) was founded in 1912 with the mission to finance South African farmers and foster a transformed, competitive and profitable[2] agricultural sector by promoting sustainable agricultural reform. By 2019, the Land Bank had grown its gross loan book to around R45 billion, i.e., almost 30% of the agricultural sector's debt.

STANLIB's specialist debt franchises (Credit Alternatives and Fixed Income) have participated in the Land Bank's debt issuances for a number of years. Our portfolio managers took a positive view of the bank's credit, not least because of explicit government support, and were attracted to the strategic importance of the bank to the country.

## What went wrong and why?

By late 2019, the market's confidence in the Land Bank had been eroded by the bank's inability to make permanent appointments in senior management positions. The senior team on the investor roadshow for the October 2019 bond auction were the acting CEO, acting CFO, acting Chief Risk Officer (ERM) and acting Chief Risk Officer (Credit)[3] . The bond issue was subsequently cancelled when it became clear that investors would not support it.

Moody's downgraded the bank twice in the first quarter of 2020, citing management instability, and the Land Bank found itself unable to refinance debt maturing in the first months of 2020 (despite the availability of a R5.7 billion government guarantee, of which only R1.4 billion had been used at the time). In April 2020, the bank formally announced that it was defaulting on payments of interest and capital to all its financial creditors.

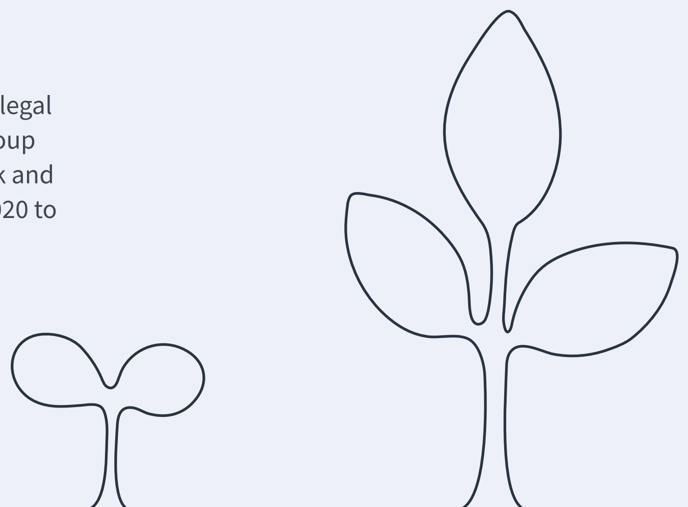
## How did STANLIB react to the Land Bank's governance failure and resulting defaults?

Following the ratings downgrades and the subsequent default in March and April 2020 respectively, STANLIB's two specialist debt franchises formed a working group which combined their resources in terms of credit, legal and work-out/restructuring. The working group also proactively engaged with the Land Bank and its advisers between April and September 2020 to make available an emergency liquidity facility for the bank, together with other potential funders of the proposed facility. The Land Bank ultimately declined to use the emergency liquidity facility, since it had already received a R3 billion cash injection from National Treasury in September 2020.

STANLIB representatives were appointed as members of the Noteholder Representative Committee established in the wake of the default to represent the interests of noteholders. We were actively involved in discussions with National Treasury, other funders, the Land Bank itself and its advisers. STANLIB fully participated in the Noteholder Steering Committee (responsible for discussing and co-ordinating key elements of the noteholders' response to debt restructure) and supported various noteholder-driven initiatives to strengthen the terms of the Liability Solution (such as supporting the appointment of an independent reviewer and the proposal that the Land Bank Act be amended to allow any creditor to place the bank in business rescue).

In the course of our interactions with the Land Bank and the other parties, STANLIB made it clear that its participation in any solution to the bank's situation would depend on permanent appointments in all key management positions.

*[2]Land Bank Integrated Annual Report 2019*
*[3]Land Bank Fixed Income Investor Roadshow presentation, September 2019*



## What has happened to the Land Bank since its default?

Since the default, the Land Bank has continued to finance South African farmers, recently launching a Blended Finance Scheme in collaboration with the Department of Agriculture, Land Reform and Rural Development. Governance has improved and the bank achieved an unqualified audit in 2022.

In its April 2023 update to the Select Committee on Finance, the bank confirmed that it is solvent, liquid and up to date with all interest due. The bank's asset base has shrunk by about a third and the non-performing loan ratio has increased to over 53% at February 2023, but the cost-to-income ratio has dropped significantly and the net interest margin has improved. Since its default in 2020, it has repaid R18 billion of capital, reducing its outstanding balance by 45%.

Restructuring the Land Bank's liabilities was always going to be a complex affair however, involving more than sixty financiers in various jurisdictions, who hold various instruments with a range of maturities. Three restructurings (Liability Solutions) have been proposed but failed to gain the necessary approvals. The fourth is currently under negotiation.

## How has STANLIB protected its clients' interests during the restructuring so far?

STANLIB held the Land Bank accountable to its stated commitment to adhere to INSOL principles, which ensure that all lenders are treated fairly. This resulted in significant capital reductions of all the local Land Bank exposures, as international DFIs received amortising debt repayments. To date, the Land Bank has made five repayments of principal since its default in 2020.

STANLIB has also insisted that the Land Bank honour its commitment to pay default interest of 2% in excess of contractually-agreed coupon rates. This ensured that the return on Land Bank instruments has been commensurate with its increased risk profile since the default.

STANLIB was instrumental in the appointment of an independent adviser to review the quality of the Land Bank loan book. This independent view allowed us to value defaulted Land Bank instruments which were no longer being traded on an exchange with visible pricing. Ensuring that our funds reflect accurate pricing is critical in treating our clients fairly, as they invest and disinvest in our funds in the normal course of business.

Having refrained from doing so for two years in support of the restructuring process, in 2023 STANLIB became the only South African asset manager holding Land Bank debt to call on the government guarantee. This was successful and repayment was made on 31 March.

### What has STANLIB learnt from the Land Bank default?

Our assumption that government will continue to support strategically-important SOEs has been proven correct. The government has remained committed to the Land Bank, not least by making a R3 billion equity injection. At the same time, the government's slowness to act, whether due to regulatory and policy hurdles or the budgetary process, was a material factor in the Land Bank's default.

Our view on the importance of a credible and stable management team was also reiterated. The inability to fill senior management positions with permanent incumbents for extended periods of time erodes the market's confidence, creating an existential risk for a regular issuer of debt like the Land Bank. Key roles being occupied by acting appointments (or left vacant) are a red flag for existing investors who should engage with the issuer accordingly.

In addition, it is clear that investors lending money to SOEs must have a detailed understanding of the laws governing each one and its constitutional documents.
The statutory matrix comprising the founding statute, the Public Finance Management Act and Companies Act, has different implications for each state-owned entity (SOE), creating unique outcomes for creditors in the event of default. While the Land Bank acted responsibly in the absence of enforceable business rescue and insolvency laws by treating all financial creditors equally, this need not necessarily have been the case and the approach is vulnerable to 'hold-out' creditors who choose not to join the process.

**The quality and stability of an SOE's management, the mechanics of its relationship with government as its shareholder, and its financial standing independent of the government are all critical factors in the decision to lend to SOEs.**

## The future of the Land Bank

The process of putting the Land Bank on a sustainable, fundable footing will require new approaches to the bank's assets, liabilities and equity. On the asset side, the bank could right-size and reposition its loan book by selling off certain loan portfolios to other commercial lenders in the agricultural space, including major South African banks. On the liability side, the bank would ideally increase the maturity of its debt, which is relatively short-term at the moment, by terming out the existing maturity profile and curing the existing default, by offering existing investors an opportunity to switch into a new note programme. This would ideally be partially guaranteed by the government or benefit from some other form of credit enhancement. On the equity side, the bank needs to strengthen its balance sheet to be able to execute its transformational and developmental mandate. A further equity investment by National Treasury would form part of this solution.

In our view, the current key point of negotiation is whether a government guarantee (either partial or full) is an adequate substitute for standard commercial lending terms for an entity such as the Land Bank. Government guarantees will always improve any SOE's ability to access capital, but they also allow the SOE and its stakeholders in government to avoid the discipline that the market imposes on commercial borrowers to the benefit of investors and taxpayers.

# SA's electricity crisis – some discussion points

SA's severe and persistent electricity shortfall is the most important social, political, and economic challenge facing the country. It is negatively impacting all aspects of daily life at a time when the economic fundamentals of the country have already deteriorated significantly, with a predictable impact on employment. In the first quarter of 2023, the unemployment rate was measured at an incredible 32.9%: 7.9 million people were officially unemployed and millions more were under-employed.

Recently, the South African Reserve Bank calculated that load shedding has cut SA's growth rate by more than 2% a year, and that stage 6 load shedding costs the economy around R800 million a day in lost business activity.

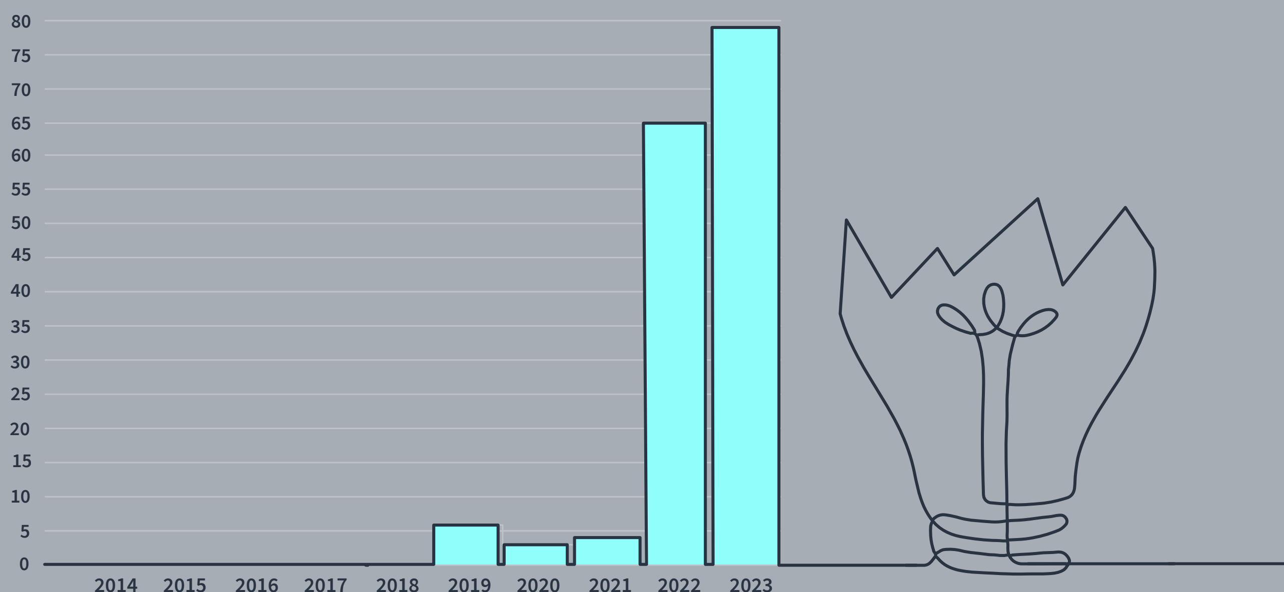
At this stage, Eskom can only provide around 24 000 MW to 27 000 MW, meaning that the country needs between 6 000 MW and 9 000 MW of additional power during the winter months to avoid load shedding on a daily basis.

## Load shedding: more frequent, more severe

In 2018, SA experienced load shedding on only 14 days of the year. This rose to 30 days in 2019, 54 days in 2020, 75 days in 2021, 206 days in 2022 and, by May 2023, 144 out of 145 days.

Load shedding has also become more severe. In 2021, SA incurred only four days of stage 4 or higher load shedding. This rose to 65 days in 2022 and 78 days by May 2023. Citizens now commonly experience load shedding for 10 hours every day. Electricity demand is highest when South Africans try to stay warm during the winter season.

### *South African load shedding: stage 4 and higher*



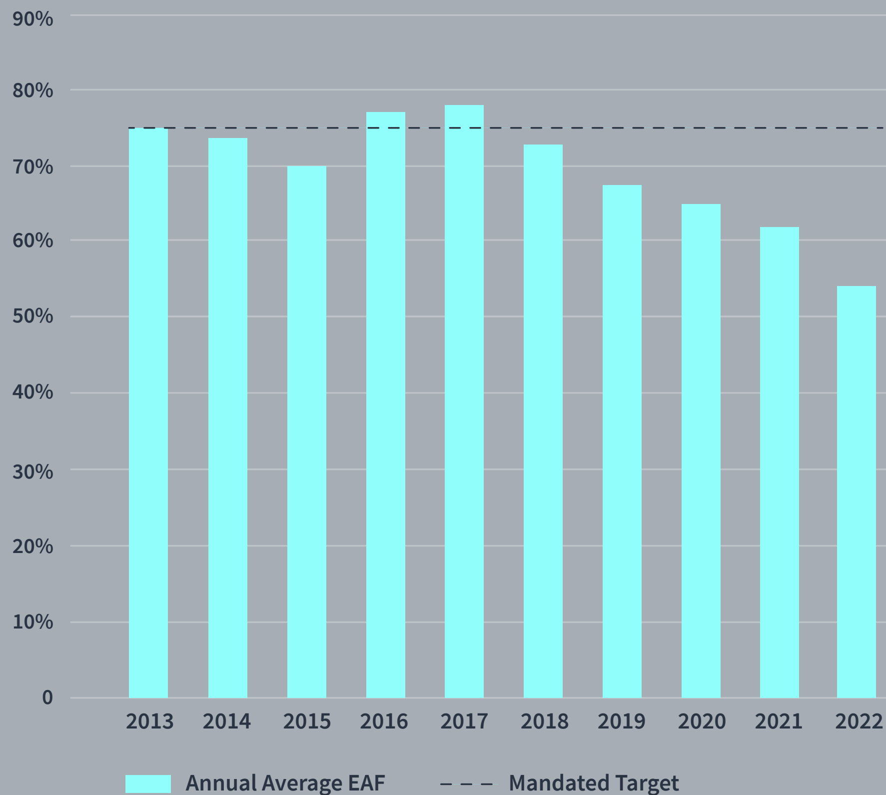

*Source: Eskom*

## Eskom's Energy Availability Factor continues to decline

Unfortunately, due to a myriad of factors, including a lack of planning, poor maintenance, corruption, vandalism, a significant skills deficit, and misguided policy, Eskom's Energy Availability Factor (EAF) declined to a mere 58% in 2022, down from 61.8% in 2021 and 65% in 2020 and well short of its 75% target level. So far in 2023 the EAF has continued to deteriorate, falling to a reported 53% (and possibly to below 50% at times) towards the end of Q1.

The decline in Eskom's EAF has been exacerbated by major flaws in the design of Eskom's newest power stations, namely Medupi and Kusile.

*Eskom's annual average energy availability factor (EAF)*




*Source: Eskom*

## Policy response: ambiguous

The government's response so far has lacked urgency, policy clarity and effective implementation.

Any political will to resolve the crisis has been confounded by policy incoherence. The Minister of Public Enterprises, Pravin Gordhan, and the Minister of Mineral Resources and Energy, Gwede Mantashe, both claim oversight/control over Eskom.

In January 2023, Minister Mantashe outlined his own four-pronged plan to bring an end to the country's electricity crisis:

- Contract energy ship-mounted gas-fired power plants
- Import more electricity from neighbouring countries
- Speed up plans to increase the operational efficiency of Eskom's fleet of power stations
- Address the skills shortage at Eskom.

He believes that these four interventions will take the country out of the energy emergency within six to twelve months. Unfortunately, his proposals are vague on timelines, costs, and impact. The scope to import electricity from neighbouring countries is extremely limited, while the plan makes no mention of the role of the private sector in delivering a vast improvement in the country's renewable energy capacity.

Subsequently, President Ramaphosa appointed Dr Kgosientsho Ramokgopa as the new Minister of Electricity. While Dr Ramokgopa has the skills to help improve the country's electricity supply, the task ahead is substantial, and it is unclear whether he has the necessary authority and political backing to implement the changes required.

## A practical and realistic plan is desperately needed

Any realistic strategy to alleviate the worst of SA's electricity crisis within a reasonable timeframe (three years) will have to achieve four things:

1. Improve Eskom's energy availability factor (or at least ensure that the existing EAF does not deteriorate any further).
2. Encourage the development of rooftop solar energy at a household level.
3. Facilitate large-scale private sector renewable energy projects outside the Renewable Independent Power Producer Programme (REIPPP).
4. Develop government-endorsed renewable energy projects that connect directly to the grid – this would require an upgrade to the existing electricity transmission network.

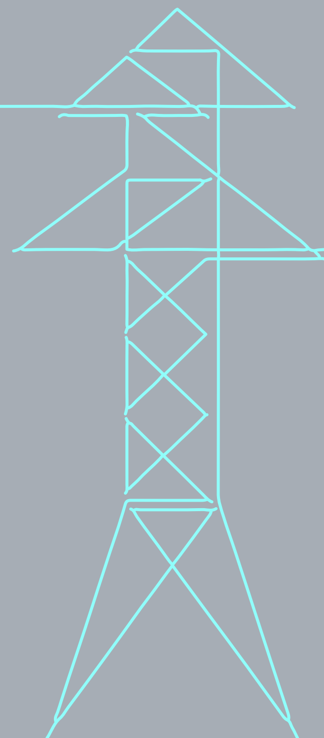
## Improving Eskom's EAF

In recent years, Eskom's planned and unplanned outages have intensified. They now include prolonged outages at four power units at Kusile (which partly relate to a flue-duct collapse in October 2022), Medupi's power unit 4 (which was taken off-line for repairs in August 2021 and is expected to return to service in August 2024) and the planned maintenance and refuelling of the Koeberg nuclear power station.

Koberg nuclear power unit 1 (which normally provides around 920 MW) is on a long-term planned maintenance outage to replace its three steam generators. At this stage, the unit is expected to return to service on 6 August 2023. Later this year, Koeberg's second nuclear power unit is expected to undergo a similar long outage to replace its three steam generators.

While it is possible that the second unit at Kusile will be back in service by the end of 2023, and the repair at Medupi 4 is accelerated, there remains a significant risk of further unplanned outages at other power units. The President's decision to deploy 880 army personnel to protect SA's power stations sends a grim message: Eskom's historic difficulties are compounded by a criminal ecosystem which has grown wealthy on looting the nation's electricity generator. The alleged poisoning of recent ex-CEO André de Ruyter is a frightening example of the lengths to which this criminal element will go to defend its subversion of Eskom.

Eskom is desperately in need of a full-time CEO as well as strong candidates to fill key vacancies in senior management. It also needs to increase the skills of the workforce at its major power stations, rid its supply chain of corruption, create centres of excellence within the power grid that can be replicated throughout the organisation, and urgently work with the Minister of Electricity to clarify the path forward. If progress is made in these areas, it is possible that Eskom could improve its EAF in 2024, helped by the return of the damaged power units at Kusile, the completion of maintenance at Koeberg and the acceleration of repairs at Medupi 4.



## Encouraging the development of rooftop solar energy at a household level

In the February 2023 National Budget, Finance Minister Enoch Godongwana announced a package of tax incentives to encourage households and businesses to invest in renewable energy. In particular, the Minister provided the following tax incentives:

- Individuals can receive a tax rebate to the value of 25% of the cost of any new and unused solar PV panels, up to R15 000. To qualify, the solar panels must be purchased and installed at a private residence within the 2023/2024 tax year.
- Businesses can claim a 125% deduction for all renewable energy projects, with no thresholds on generation capacity. This incentive will be available for three years.

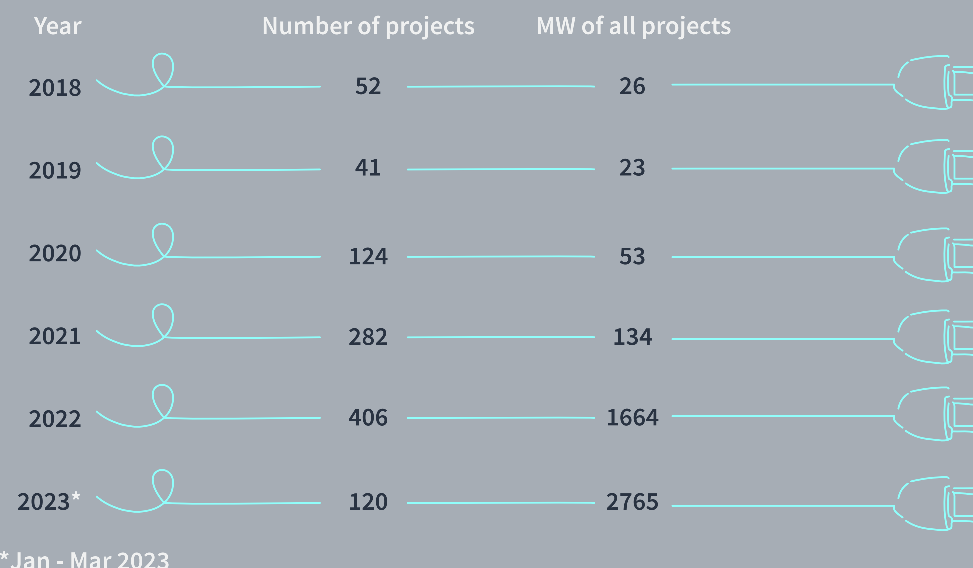
These incentives are laudable but lack ambition, given the urgency of the electricity crisis. Fortunately, the private sector has seen the economic opportunity in renewable energy and responded with a surge of investment. SA is now importing more than R1 billion of solar panels a month, and this is likely to increase further during the remainder of 2023. In addition, anecdotal evidence suggests that lead times for the installation of solar equipment have increased substantially and a wide array of small businesses have entered the industry.

We expect the growth in household renewable energy will continue at a rapid rate over the next year or two. Load shedding is a daily headache, the domestic price of electricity is set to increase by 18% this year and the affordability of solar energy is improving. In absolute terms, however, the cost of a solar installation remains beyond the reach of most homeowners at this stage.

## Development of large-scale private sector renewable energy projects that are outside the REIPPP

The necessity of being licensed has historically been a major disincentive for large-scale independent power producers (IPPs) in SA. Happily, Schedule 2 of the Electricity Regulation Act has been amended. Initially the limit was raised to 100 MW, but then it was scrapped altogether. Predictably, this change has triggered a very significant and extremely welcome acceleration in private investment in renewable energy projects – which is likely to intensify over the next few years.

SA's energy regulator, NERSA, maintains a list of privately-registered renewable energy projects, a summary of which is provided below. It is clear that the private sector has responded to the deregulation of the sector, most notably in the average size of new projects.



## The following are examples of the private sector moving to renewable power in SA:

- **Gold Fields** is one of the first movers in SA. It has already commissioned 50 MW of solar power at its South Deep mine, equivalent to 2% of current energy needs. Gold Fields' target is to achieve 100 MW of renewable energy in the medium term, using a combination of solar and wind generation while also exploring new forms of energy storage.
- **Anglo American (SA)** has signed an agreement with EDF Renewables to jointly develop a regional renewable energy ecosystem designed to supply 100% of Anglo American's South African power needs from solar and wind technologies. The jointly-owned company will launch a mature pipeline of more than 600 MW of wind and solar projects in 2023. The ecosystem is intended to generate 3-5 GW of renewable energy by 2030, with an explicit commitment to the principles of the Just Energy Transition. These include the inclusion of local equity partners, the development of South African value chains linked to renewable power, and the delivery of positive impact for local communities.
- **Sasol**, as the largest private sector emitter of greenhouse gases in SA, has committed to Net Zero by 2050 and to reduce Scope 1 and 2 emissions by up to 30% by 2030. To achieve these goals, it will transition from coal to renewable power as the energy source for its coal-to-fuel process. For its first phase, to be operational by 2025, Sasol has signed power purchase agreements for 550 MW of power, and an additional **600 MW** will be procured by 2030 from partner Air Liquide. Over the longer term, Sasol is committed to producing green hydrogen as a replacement for fossil fuels. It is envisaged that this would be commercialised at some point before 2050.

## Further develop government-endorsed large-scale renewable energy projects within the REIPPP

Although the development of renewable energy in SA dates back to 2003, it only started to take shape in 2010 with the release of the Integrated Resource Plan (IRP) 2010-2030. The purpose of the IRP 2010 was to set out the nation's preferred energy mix over the next 20 years.

To facilitate the adoption of renewable energy, as originally detailed in the 2010 IRP, the REIPPP was established – which is now in the process of finalising Bid Window 5, while moving ahead with Bid Window 6 – see table below.

Since the first project came on line in November 2013, only 6 323 MW of renewable energy has been procured through the REIPPP, with 5 661 MW of generation capacity added to the national grid. Unfortunately, the further development of the REIPPP has been limited by a lack of transmission capacity, but hopefully this constraint can start to be addressed, since the early success of the REIPPP was impressive.

*SA Renewable Independent Power Producer Programme*

| Bid Window | Number of Projects | Capacity | Progress |
|---|---|---|---|
| Bid Window 1 | 28 | 1415 MW | All Connected |
| Bid Window 2 | 19 | 1033 MW | All Connected |
| Bid Window 3 & 3.5 | 18 | 1628 MW | 17 Connected |
| Bid Window 4& 4b | 26 | 2205 MW | 25 Connected |
| IPP Risk Mitigation | 11 | 2000 MW | 3 projects under construction |
| Bid Window 5 | 25 | 2583 MW | 13 PPAs signed |
| Bid Window 6 | 6 referred | 1000 MW | 6 of 56 bids announced |

Source: Eskom

Out of the 6 000 MW of power built in the first four rounds of the REIPPP, 800 MW is "stranded" in the North Cape due to lack of transmission capacity

The further development of large scale renewable power projects is severely hampered by the lack of transmission capacity

## Private equity investment in energy projects

Over the past decade, private equity investors, such as STANLIB's Infrastructure Investments Fund, have played a meaningful role in financing the growth of SA's renewable capacity by investing in IPPs that supply renewable energy to Eskom through the REIPPP.

While the REIPPP has created the conditions for significant private-sector investment in the South African power sector, new investment opportunities are emerging in the commercial and industrial (C&I) sector, residential rooftop and storage.

Growing demand for renewable energy is mainly driven by the pain of load shedding, but two other factors have unleashed pent-up demand:

- Hardware cost: renewable energy equipment is getting cheaper, particularly for the rooftop photovoltaic (PV) market, and easier to install.
- Availability of finance: large commercial banks have started to offer financing products designed for the residential and commercial rooftop PV market, making these energy solutions more accessible. Zero-capital power purchase agreements are also becoming more popular in the market.

Table 4: Rooftop solar PV market size

| Rooftop Segment | Residential | Commercial and Industrial | Agricultural |
|---|---|---|---|
| Compound annual growth rate (2020-2022) | 30% | 60% | 45% |
| Installed capacity 2022 (MWp) | 90-120 | 450-600 | 120 - 160 |
| Total installed capacity (MWp) | 250 | 1 650 | 400 |
| % of total market | 11% | 72% | 17% |

*Source: GreenCape Energy Services (2023) Market Intelligence Report*

## Rooftop solar PV and energy storage

The amendment to the Energy Regulation Act (ERA) has eased the regulatory environment, resulting in SA's total rooftop solar PV market growing from 1.5 GWp to 2.3 GWp.

Developments in the battery storage sector will impact SA's energy market over the next 5-10 years. Although battery prices are high, development in this segment is being driven by load shedding. Although it is still in its early stages, SA has taken the lead in battery manufacturing in Africa, with access to the primary resources needed as well as the investments required to enable accessible and affordable clean energy.

## Load shedding as an ESG opportunity

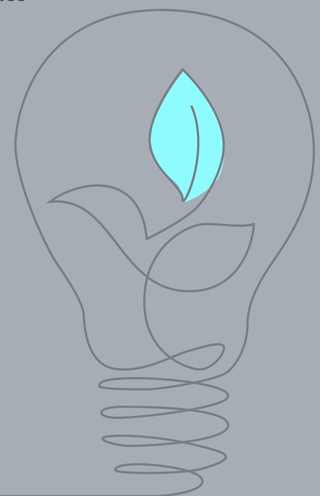
The energy crisis has created a compelling case for South African corporates to integrate renewable energy for business continuity. This in turn provides an opportunity for environmental, social and corporate governance investors to play a critical role in a stable energy supply, as the country plans to transition towards cleaner energy sources in the long term.

Serious engagement with ESG principles is now a basic requirement for any business with institutional investors. The STANLIB Infrastructure team believes that proper implementation of ESG is the foundation of sustainable value creation and have made it a factor in their investment process.

The STANLIB Infrastructure team has been able to make a positive contribution in the communities in which its investee projects operate. These socio-economic development (SED) projects are designed to empower individuals by investing in education and skills development initiatives to create employment opportunities and ultimately promote economic growth.

The negative impact of load shedding on critical services, such as clinics and schools, is amplified in smaller, underprivileged communities. To alleviate some of this pressure, SED projects in certain areas of the country are pursuing initiatives to provide back-up power solutions for critical services which currently lack back-up when load shedding occurs.

The following examples illustrate STANLIB's commitment to the principles of responsible investing and the value of ESG.

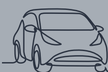


## Highlights of the year (12 months to June 2022):

STANLIB Infrastructure Fund of Fund's renewable energy portfolio accounts for c. 24% of SA's installed renewable energy grid capacity

4 000 000 MWh of renewable energy was produced in 2022

>3.6m tonnes of greenhouse gas were mitigated



Equivalent $CO_2$ emissions of c.487 000 people

>R111 million was invested in enterprise development and socio-economic development initiatives

## Conclusion

It seems likely that South Africans will continue to suffer daily load shedding for the rest of 2023, but the solutions outlined above could turn the tide of the energy crisis by the end of 2024.

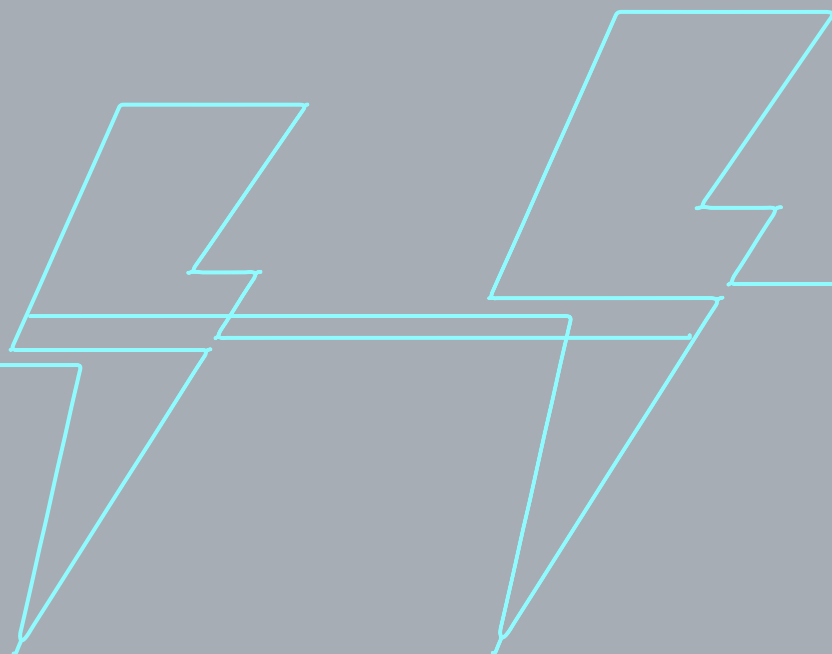
Successfully completing repairs and scheduled maintenance at Eskom's coal-fired and nuclear plants would be a major positive, and we expect growth in the household and corporate investment in renewable energy to accelerate. Should these stars align, it is possible that SA will be able to mostly eliminate load shedding by the middle of 2025.

Importantly, this optimistic scenario assumes that Eskom can halt the deterioration in its EAF, finally embrace fiscal discipline and make progress in ensuring long-term financial stability, now that government has agreed to assist with a significant portion of its debt, as well as improve the electricity transmission capacity of the country.

Unfortunately, the government has failed to clearly communicate policy direction on the energy crisis. The public turf-war between different ministries claiming authority over the power sector only contributes to the uncertainty. The predictable result is the erosion of business confidence and the shelving of capital investment plans.

Ultimately, the ANC's ideological opposition to the private sector's involvement in energy generation needs to confront the reality of Eskom's failure. SA deserves a modern policy framework which is fit for purpose and clearly articulated.

Based on current evidence, it seems very unlikely that SA's energy supply will have recovered sufficiently by 2025 to meaningfully lift economic growth on a sustainable basis. In other words, inadequate and unreliable electricity supply is likely to depress the country's economic growth and job creation for years to come.



# STANLIB Infrastructure Investments: continuing to make an impact

Infrastructure is the backbone of the economy, connecting people, facilitating commerce and enhancing quality of life. Investments in infrastructure can increase the nation's potential to deliver stable, inclusive growth. Investors in infrastructure can gain exposure to diversified, stable and risk-appropriate returns.

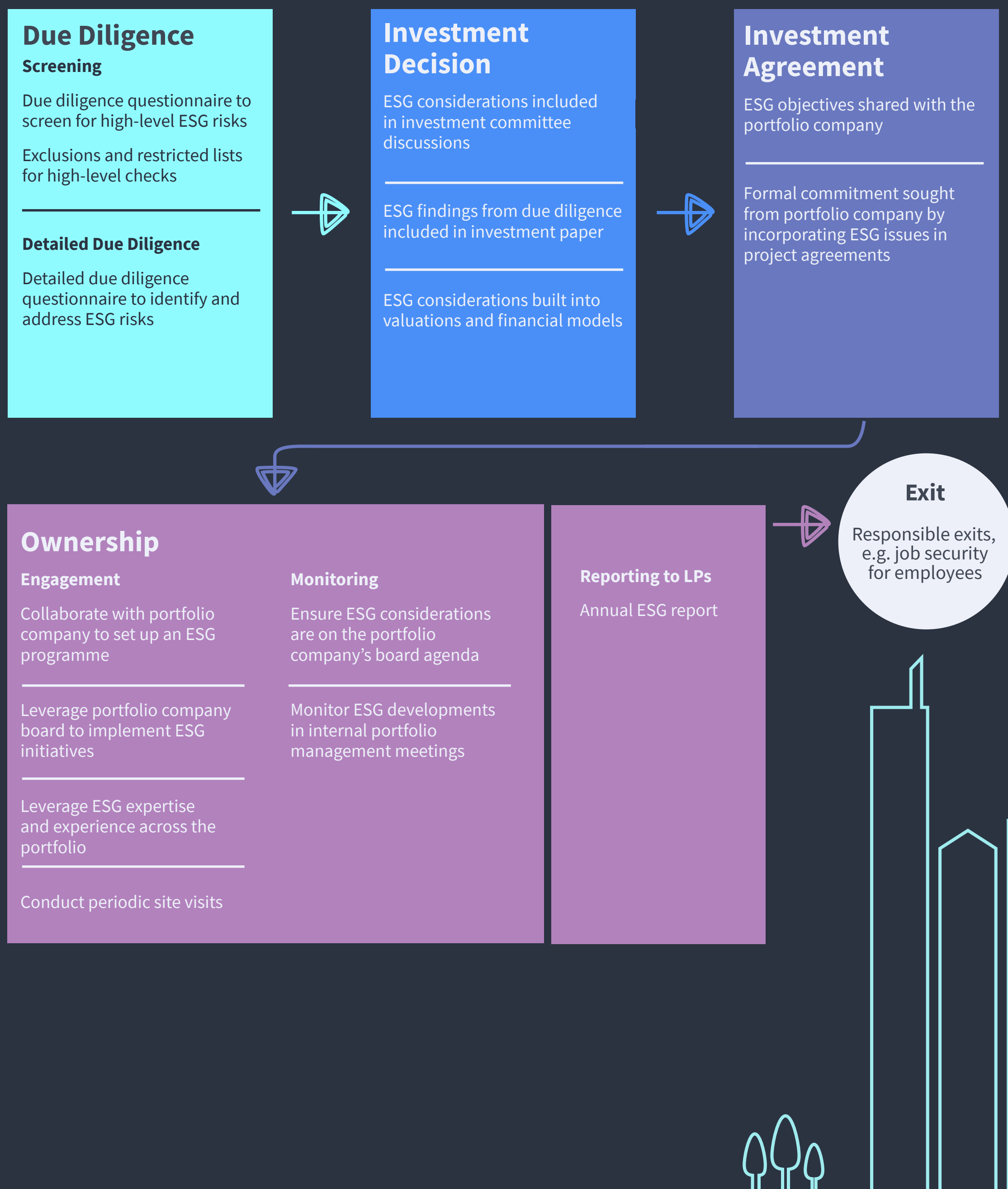
Our Infrastructure Investments team incorporates ESG considerations into its investment process to ensure that the projects we support create sustainable value for surrounding communities.

# Our Approach

STANLIB Infrastructure Investments promotes socially responsible and environmentally sustainable business practices and implements the highest standards of corporate governance and responsibility.

# Integrating ESG factors into the investment process

STANLIB Infrastructure Investments proactively incorporates ESG factors into our investment process



# Our Funds

## An overview of our funds

The STANLIB Infrastructure Fund of Funds offers institutional investors 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: 47% | Fund II: 83% |
|---|---|
| **Portfolio of assets:** R2.2 billion | **Portfolio of assets:** R6.9 billion |
| > Portfolio comprises minority equity shareholdings in 4 solar PV plants and 1 wind plant with a total installed capacity of 347 MW | > Portfolio is well diversified across underlying assets and across sectors with a bias towards renewable energy (45%) and digital infrastructure (37%) |
| > Projects have an average operating history of c. 8 years | > Exposure to 22 underlying assets, providing investors with a diversified pool of infrastructure investments |
| > Exposure by value is 66% to solar PV and 34% to wind | |

** As at 30 June 2022*

*Geographic Location of Projects*

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

STANLIB

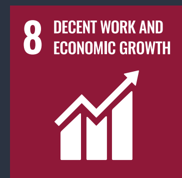
# Our commitment to the UN SDGs

We support the objectives of the United Nations' seventeen Sustainable Development Goals (SDGs) and use them as a framework to measure our ESG achievements. While all the SDGs support global goals, we focus on four of them.

## Key SDGs STANLIB focuses on

**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.

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

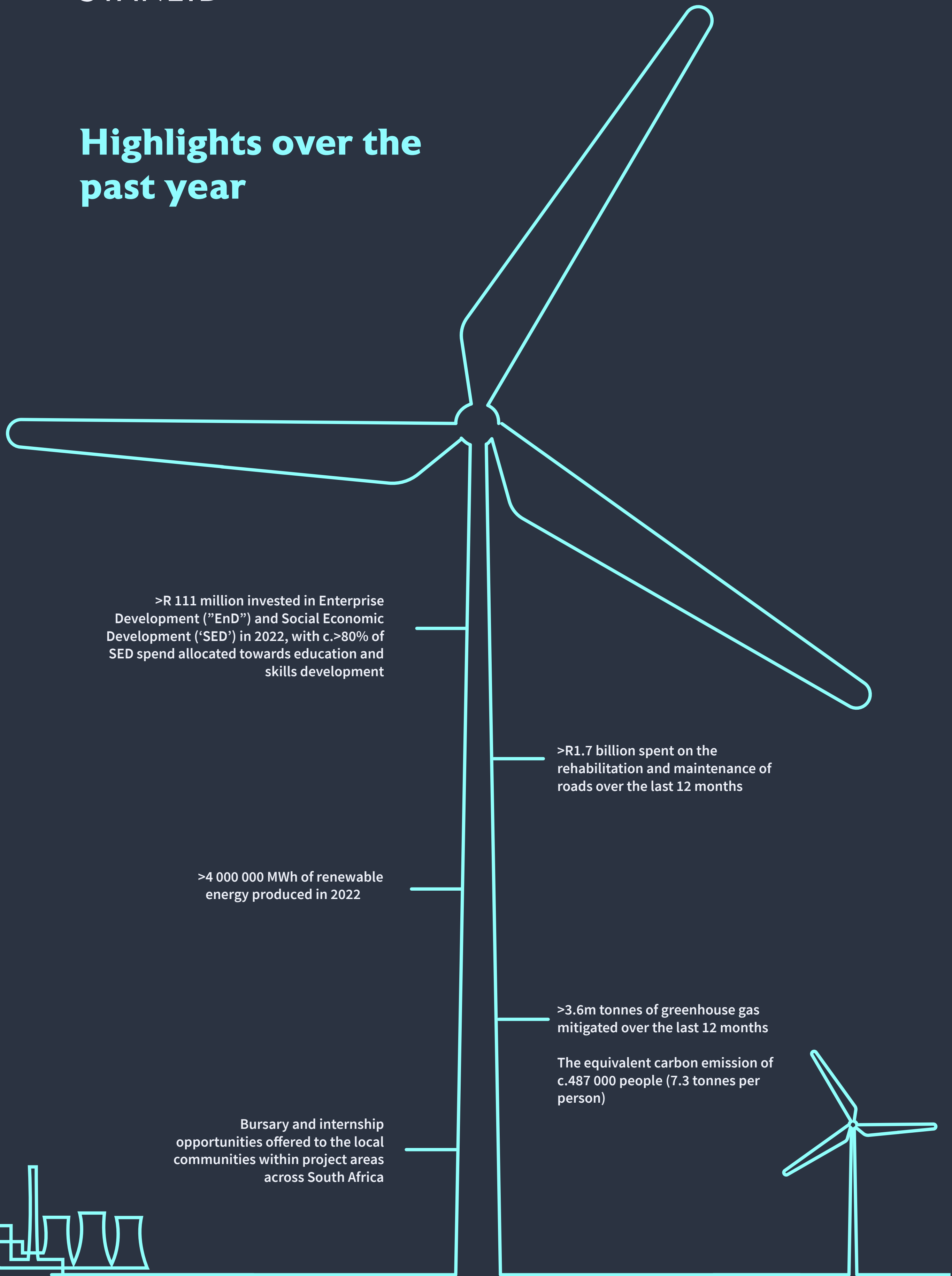
To address this challenge, and in line with our mandate, we invest in renewable energy projects. In addition, we promote investments into surrounding communities (through investee companies' CSI or SED spend) which enhances the use of affordable and clean energy.

**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 environmentally-sound technologies; and
- increase access to information and communications technology.

STANLIB

# Highlights over the past year



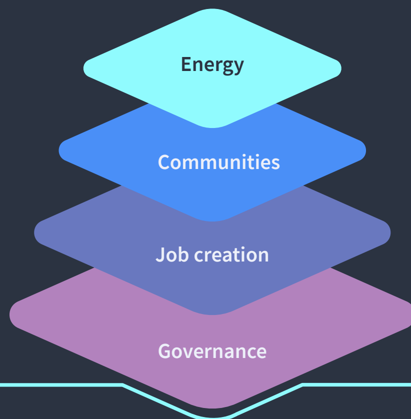
STANLIB

# Impact in 2022

**STANLIB Infrastructure Fund I** was established in May 2013 with a mandate to make long-term equity and equity-related investments in greenfield and brownfield infrastructure projects located in sub-Saharan Africa, principally in SA.

Fund 1 was a founding investor in five renewable energy assets in the Eastern and Northern Cape which were selected in rounds 1 and 2 of the renewable energy programme. Their total installed capacity is 347 MW.

## *STANLIB Infrastructure – Fund I Impact*[1]




### Energy

- Renewable energy portfolio accounted for c. 6% of the installed renewable energy capacity in South Africa[2]
- c. 804 000 MWh of renewable energy produced in 2022
- c. 706 000 tonnes of greenhouse gas mitigated over the 12 month period

### Communities

- c. R4.8 million invested in enterprise development
- R26 million contributed towards socioeconomic development (SED) within local communities, 66% of which was allocated to education and skills development
- R188 million[3] spent on local procurement, B-BBEE procurement spend accounted for 76% of this

### Job creation

- 150 full-time-equivalent employees across projects, including permanent and contract employees[4]
  - 86% black employees
  - 27% women
  - 58% youth

### Governance

- Balanced boards, with c. 50% of directors being women
- Quarterly reporting to the Department of Minerals and 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 sub-committee level e.g. Audit and Risk, Social and Ethics, and Remuneration committees

*[1]12-month period starting July 2021 – June 2022. [2]Based on operational projects in South Africa. [3]Illustrates spend from renewable energy projects only. [4]Measured in person months for renewable energy projects. Source: IPP Projects database; CO2 emissions per capita: knoema.com*

STANLIB

**STANLIB Infrastructure Fund II** has a diversified portfolio of 20 mature renewable energy projects with a total installed capacity of 1 163 MW. The portfolio also includes the only three privately-owned toll road concessions in Southern Africa which connect key transportation corridors through Gauteng, the ports of Durban and Maputo, as well as the Botswana border. The Fund is invested in SA's agricultural infrastructure via a grain storage and logistics company, and in the country's digital infrastructure sector via a leading optical fibre network owner which services the business and domestic sectors.

## *STANLIB Infrastructure – Fund II Impact*[1]

### Sector impact

**Renewable energy:**

- 3.3m MWh of renewable energy generated in the last 12 months
- 2.9m tonnes of greenhouse gas mitigated
- Projects account for c. 19% of installed renewable energy grid capacity in South Africa[2]
- 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 SA

**Digital Infrastructure market share:**

- Fibre to the home: c. 36.3% of homes passed market share
- Mobile backhaul: 34%
- Metro and national long distance: 47%
- Fibre to business: 23%

### Communities

- R23 million invested in enterprise development
- R57 million contributed towards socioeconomic development (SED) within local communities, 90% of this was allocated to education and skills development
- R780 million[3] spent on local procurement, of which B-BBEE procurement spend accounted for c. 82%

### Job creation

- 3 300 full-time-equivalent employees across projects, including permanent and contract employees[4]
  - 82% black employees
  - 43% women

### Governance

- Balanced boards, with c. 24% of directors being women
- Quarterly reporting to the relevant government departments
- 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 sub-committee level e.g. Audit and Risk, Social and Ethics, and Remuneration committees

*[1]12-month period starting from July 2021 – June 2022.[2] Based on operational projects in SA.[3] Illustrates spend from renewable energy projects only.[4] Measured in person months renewable energy projects. Source: IPP Projects database. CO2 emissions per capita: knoema.com. All data based on project-level information, not on a see-through holdings basis.*

# Khanyisa Impact Investment Fund update

**The Khanyisa Impact Investment Fund's (Khanyisa Fund) impact mandate is increasingly resonating with the largest asset allocators in SA. Having reached the fund's first close, our focus is turning from raising funds to deploying capital into some exciting projects.**

The Khanyisa Fund offers investors reliable income and capital preservation and the reassurance that their capital is creating sustainable positive impact for SA. We designed it to focus on three areas, namely:

1. Infrastructure (including social infrastructure)
2. Financial inclusion
3. Agriculture

These three themes cover everything from housing to farming, from internet connectivity to supporting SA's universe of small businesses. In short, the fund can invest in sectors which have been hit hard by the pandemic and which, with the right support, can rebound the fastest. Our themes also touch the fabric of daily life in SA and the deep foundations of its economy. With this opportunity set, the fund is perfectly positioned to create meaningful impact.

One of the most conspicuous opportunities to emerge during the pandemic is in the housing sector. Increased economic hardship during the crisis highlighted the shortage of adequate housing and shelter for individuals and communities, especially those considered too wealthy for government subsidies but too poor for normal housing finance. The Khanyisa Fund is making investments in the housing sector to address this critical need. Correctly structured, the fund's investment can provide sustainable income and capital preservation for its investors while increasing the supply of safe and affordable housing. This is a perfect example of the social impact that the Fund was created to pursue.

One impact of the pandemic felt in every country in the world was a step-change in the importance of internet connectivity. Under lockdown, the world was forced to embrace remote work, virtual communication, e-commerce and digital service delivery. Many of these domestic and work habits have outlived the pandemic, making reliable internet access a necessity of modern life. In this context the uneven distribution of internet access, particularly among SA's less prosperous communities, is a major threat to the stable, inclusive growth that the country needs.

By providing capital to build telecommunications infrastructure, the Khanyisa Fund can help bridge this digital divide, giving individuals and businesses outside the big cities better access to the opportunities and resources found online. By funding the growth of connectivity, the fund can foster inclusivity and empower individuals and communities to participate fully in the digital economy.

In addition to housing and telecommunications, non-bank financial services also gained prominence during the pandemic. As traditional banking systems faced disruptions and challenges, alternative financial service providers emerged to support individuals and smaller businesses in accessing capital and managing financial transactions. The Khanyisa Fund's focus on this sector recognises the importance of financial inclusion and the need to empower under-represented communities. It also recognises the crucial role played by SA's 1.75 million small and medium-sized enterprises (SMEs), who account for a third of the value added in the economy and 30% of the nation's formal employment.

By investing in innovative, tech-enabled providers of non-bank financial services, the fund can promote inclusion, growth and resilience, especially for marginalised groups who may have limited access to traditional banking services.

The Khanyisa Fund's goals are aligned with the United Nations 17 Sustainable Development Goals (SDGs), particularly number 8 (Decent Work and Economic Growth) and number 10 (Reduced Inequalities).

The Khanyisa Fund's impact mandate should make it attractive to the world's Development Finance Institutions (DFIs), government funds with a mission to support overseas development. Many of them have recognised the significance of impact investing and the need to support sustainable development in emerging markets. As the fund continues to build a track record of measurable impact and solid returns, and consistently communicate it, we expect to attract investment from DFIs over time. Khanyisa is not wholly reliant on DFIs, however. We are also designing and bringing to market solutions that will allow institutional investors to access unlisted credit instruments like Khanyisa at scale.

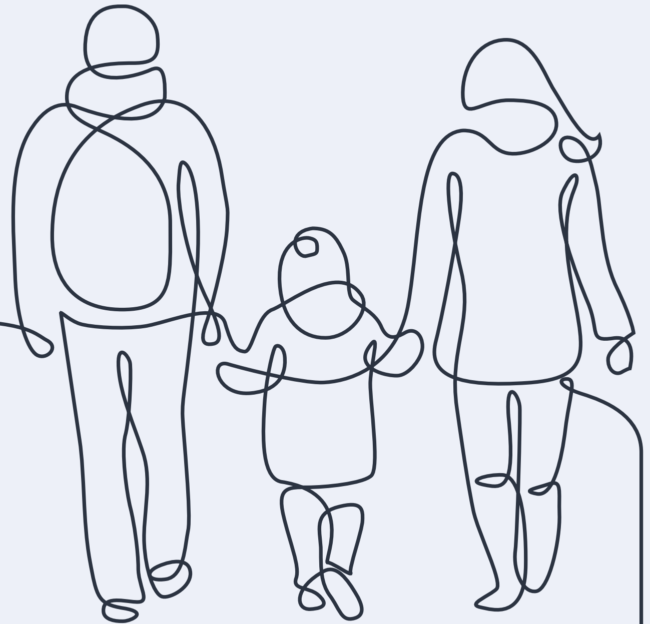
Impact investors and other stakeholders increasingly demand transparency, accountability and evidence of tangible impact. The Khanyisa Fund will meet these requirements by defining clear and comprehensive metrics to measure the fund's performance against ESG and overall impact criteria. By doing so we hope to make Khanyisa a 'user-friendly' asset for allocators who are themselves accountable to stakeholders for the impact achieved by their portfolio as well as their financial returns.

Khanyisa is actively cultivating partnerships with government agencies, philanthropic organisations and development organisations to strengthen its capacity to create impact and access capital. Collaborating with these entities can provide additional resources, expertise, and networks that can accelerate the fund's growth and reach.

## Conclusion

Launching the Khanyisa Fund during the Covid-19 pandemic was a challenge, but the pandemic itself raised awareness of the deficits in SA's physical, social and economic infrastructure which our fund aims to address. The Khanyisa Fund's focus on sectors heavily impacted by the crisis, such as housing, telecommunications and non-bank financial services, positions it to lift up the marginalised and contribute to sustainable, inclusive development.

We have designed Khanyisa to be a leader in impact investing, with best-in-class origination, execution, impact measurement and client communication. We believe that in time the fund will make a significant difference to the life of the nation and that many investors will join us on our journey.



# Outlook
## for 2023

**South Africans live in an imperfect world. Many injustices need to be addressed and many improvements can be made to our physical and social environment. STANLIB's size and profile give us the privilege of influence, which we exercise within the framework of our fiduciary responsibilities: we only act to protect and grow our clients' hard-earned savings.**

We believe that by integrating ESG into our investment process, engaging directly with management and voting actively, we can create sustainable long-term value. ESG is a relatively new way of thinking and we know that best practice will continue to evolve. We remain open to new ideas.

STANLIB communicates its policies and responsible investing activities to all stakeholders as one of our overarching ESG Guiding Principles. We have published an annual Stewardship Report since 2019. In each issue we reiterate our commitment to our ESG philosophy by disclosing our focus areas for the following year.

**In 2023 we aim to:**

- **Improve ESG data quality** by supplementing our internal ESG work/rating with an external vendor. This will support improved and more consistent disclosure at an entity- and portfolio-level.
- **Focus on how STANLIB can make a positive difference as a business** by aligning our own CSI initiatives with the demands we make of our investee companies.
- **Maintain climate change action momentum** by continuing to encourage disclosure by investees, through thought leadership and actively considering climate-related initiatives and commitments.
- **Actively consider collaboration opportunities,** including with peers, industry bodies and other initiatives, wherever we believe collective action can make a positive impact across our client portfolios.

Appendix

# STANLIB G Rating methodology

**The STANLIB G score is a multi-dimensional approach to assess and measure the key factors that we deem important, so that we rate the effectiveness of a board in fulfilling its mandate to govern in the best interests of the company on behalf of its shareholders.**

**The key factors that impact our assessment of boards are:**

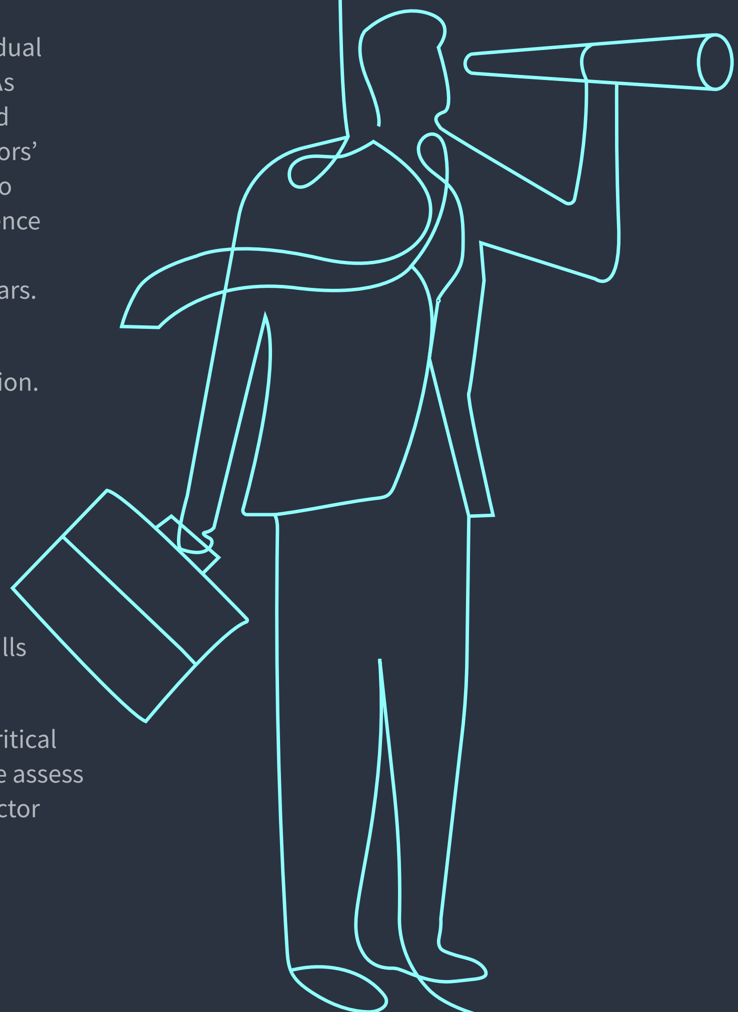
- Independence, tenure, and capacity to serve;
- Ethnic, skills and age diversity; and
- Relevant experience and skills.

Our requirement for a board to be deemed independent is defined by the ability of individual directors to exercise independent judgment. As shareholders, we rely on a board's internal and external board member assessments of directors' effectiveness and independence. Tenure is also an important factor in determining independence and STANLIB deems directors to no longer be independent once their tenure exceeds ten years.

Diversity is a key factor in board effectiveness, especially in SA, with its history of discrimination. We measure the racial and gender diversity of a board and consider the skills diversity of the individual members.

Boards should also be age diverse. Companies' customers, employees and other stakeholders are multi-generational and the board should reflect this, together with skills and racial diversity.

Qualifications and past work experience are critical factors in the suitability of a board director. We assess the mix of skills and experience that each director brings to the board.



The number of people on a board can also impact its effectiveness. Boards may have between three and five committees that each require up to four members. To ensure that committees are not staffed by the same people, which can impact independent thinking, our view on the optimal board size is between 10 to 13 directors.

Tenure, which also impacts independent thinking, is also assessed and scored on an individual basis. We think a new director becomes 'effective' after three years on the board and that they become less so as they approach ten years of service; at that point we would regard them as no longer independent, impacting the overall independence score of the board.

### *The G score rules:*

1. Executives are deemed suitably qualified when appointed. Scores can deteriorate if track record disappoints. Scores range from 1 to 3.
2. Tenure scores start at 1 and peak at 3 in the third year. For non-executives, the score fades incrementally after year 10.
3. 13 is the optimal number of directors on the board; the score is impaired when the number is below 9 or over 14.
4. A board is deemed to be sufficiently independent if 51% of its members are deemed independent. Our median score for independence is 61%. Scores range from 1 to 3.
5. Gender diversity scores peak at 50%. Currently mean universe gender diversity is 37%. Scores range from 1 to 3.
6. Suitability scores blend qualifications, skills, committee appointments and the number of directors. Scores range from 1 to 3.
7. Where there are founders (or other shareholders) with high voting control structures, we adjust ratings down, based on the level of ownership and effective control.

STANLIB

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