

PRESS RELEASE

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Futuregrowth's SOE governance review – 18 months on

At the end of August 2016, Futuregrowth made a public statement that we would temporarily suspend lending to the six largest State-Owned Enterprises (SOEs) (Land Bank, DBSA, IDC, SANRAL, Eskom and Transnet) until we could conclude in-depth governance reviews. This followed a creeping sense of governance degradation at various SOEs, culminating in clear signs of possible corruption, and evident conflict within the government itself. While seen as controversial at the time, it has subsequently become evident that good governance of SOEs is critical.

After that announcement, the Futuregrowth credit team engaged with most of the named SOEs to conduct detailed governance due diligence towards the goal of being able to advance new funds. The public letters containing the results of our completed governance due diligence for Land Bank (26 September 2016), IDC (4 November 2016), DBSA (21 November 2016) and SANRAL (5 July 2017) are available on our website: www.futuregrowth.co.za.

We built a robust analytical response to assess the SOEs, and over the past 18 months we have had the opportunity to engage with the essence of corporate governance: To understand the difference between "governance on paper" versus "governance in practice". Events during this period have re-affirmed our view that good governance is much more than a mere "tick-box" exercise. Crucially, the "who" and the "how" of governance deserves appropriate scrutiny and disclosure. Good governance is inextricably linked to Responsible Investing, and in our view, it is key to ensuring that public entities, mostly funded with public money, are sustainably managed for the long term and are able to deliver on their developmental mandates.

Futuregrowth has done the work but we believe it is suitable to share our learnings with others to make a lasting difference in public capital markets and effect positive change in South Africa. The learnings have been captured in a document, **SOE Governance Unmasked**, which will be available on www.futuregrowth.co.za on 28 February 2018. Olga Constantatos, Credit & Equity Process Manager at Futuregrowth, says, "We believe this document can play a role in helping the industry invest responsibly and keep clients' money safe."

"As we began our detailed engagements with the SOEs, it became evident that no party had previously considered SOE governance in a detailed way: investors, rating agents, financiers, and the public had all taken for granted that the legislative controls were robust and sufficient. In considering various analytical tools we found some "tick box" governance, but not a lot of deep analytical methods on which we could build. Thus, our work became a greenfields exercise in learning about SOE governance." The Futuregrowth team are not forensic or governance auditors, and we were naturally limited in our ability to assess the veracity of the governance of the more troubled SOEs.

We have been asked why we chose to focus on these SOEs in particular. Our scrutiny of these six arose from them being regular issuers of debt on public capital markets. Issuers of listed equity and debt are subject to the discipline of markets, as well as to public comment and opinion. By definition, issuing listed instruments means taking money from the public, and we believe that calls for a much higher standard of information, transparency and scrutiny. As a developmental investor, who acts on behalf of our clients' funds, we are a substantial funder of national development through the SOEs, and our clients are holders of SOE debt.

Further, SOEs, by their very nature as publicly-funded entities, are not subject to the same market discipline nor shareholder oversight as other entities. The web of control governing SOEs is different from private firms in that participants' economic interests may be distorted for personal gain or patronage, and SOEs can easily be subject to political pressures. Each SOE has a unique mandate to fulfil, often occupies a near-monopoly position (e.g. water, electricity, transport), may be able to pass its costs onto consumers, and does not necessarily have to make a profit to stay in business. SOEs can become a burden on the

state, and therefore all citizens. These factors all serve to elevate the importance of appropriate governance policies, processes and procedures for SOEs. Olga adds, " 'Sunlight is the best disinfectant' and, as such, we encourage increased public and timely disclosure of key lending and procurement decisions, conflicts of interest, transactions with PEPs, and all deviations from policy."

Futuregrowth is a partner in funding national development. We have been proud to play a role in channelling South Africa's pension fund savings toward national development for over twenty years. We fully recognise that South Africa's SOEs play various critical roles in national development. Notably, we believe SOEs should offer functions that the private sector cannot. Among these might be:

- i. a subsidy by way of a lower required return-on-equity;
- ii. the ability to take in, and channel, government funds towards specific desired outcomes;
- iii. a longer time-horizon for returns;
- iv. the ability to mobilise large-scale capital for projects and initiatives;
- v. the task of creating enabling environments for development;
- vi. cross-subsidisation to test new ideas; and
- vii. the ability to take greater risks than any private company.

Clearly, the SOEs take on human, social and national imperatives. Without derogating from the SOEs' developmental goals, our focus is on sustainability and efficiency. Andrew Canter, CIO at Futuregrowth adds, "The simple fact is that every wasted or stolen Rand is a Rand which cannot build a road, buy a locomotive, electrify a house, or educate a child. It is untenable for investors to allow the nation's savings to be absconded, and it is incumbent on all responsible investors to play their appropriate role in allocating capital to sustainable enterprises."

Futuregrowth remains grateful to those entities that productively engaged with us, and for their ongoing co-operation and willing assistance.

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