GRAY ISSUE

Clarifying our position on Net1

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There has been a lot of press coverage on Net1, the parent company of the current social grants payment provider Cash Paymaster Services (CPS), much of which is based on opinion. Our job is to uncover and deal in facts, treating management assertions and public opinions both with caution.

That said, a company's prospects are strongly influenced by the society it serves and we are acutely conscious of the ethical issues surrounding Net1. We have exerted considerable pressure on the board since investing in 2012 on issues of corporate governance and sustainability. In management meetings we have asked the tough questions of Net1 that you would expect about its business practices and carefully considered its answers, including references to several external investigations, which have not found evidence of wrongdoing.

We can never be sure that any company is 100% innocent and we have to use diligent research and professional judgement to evaluate the risks of legal and regulatory non-compliance at companies in which we invest.

Our clients are 16% shareholders of Net1, which makes up 0.7% of our equity portfolio. Our investment is based on the company's track record of successfully implementing reliable and robust payment technologies, which handle millions of transactions, both on- and offline, across different businesses and countries. We wield some influence over management and the board, but we are not in control of the company, nor are we the largest shareholder (this is the International Finance Corporation). We are not company insiders, and the only information we have about Net1 is publicly available.

If the facts change, our view may change. We don't think it would be good for our investors or for society for us to disinvest at this point.

Financial inclusion or predatory lending?

Poverty is a grinding problem in our country. Social grants alleviate some of the impact on the most needy, but they aren't enough to change the fact of poverty for millions of people. In some countries social welfare has been distributed in the form of food or clothing tokens or other measures to prevent poor people from 'harming themselves' by buying non-essentials, but the most effective system seems to be to give people grants and trust that they will do what is best for them.

Recent opinion pieces have asserted that Net1 used the database of grant recipients to illegally and/or improperly sell a range of additional services to them through a network of subsidiary companies. This was the specific subject of a consumer tribunal judgement in early 2015, which found no evidence of abuse; and an independent KPMG audit came to the same conclusion. The judgement is publicly available here: www.saflii.org/za/cases/ZANCT/2015/8.html

If Net1 doesn't use the grant data to improperly sell financial products to the poor, then the difficult question that remains is whether it is bad or wrong to sell financial products to the poor at all and / or to allow poor people to pay for these from their bank accounts. This is very difficult ethical territory: these products can cause harm but they also constitute financial inclusion, allowing people to access a risk safety net and basic credit at lower cost than from an informal lender.

On the whole, our society seems to believe that more financial inclusion for the poor is good, despite the harm that can be caused by entry-level consumers buying policies or borrowing money on terms they don't fully understand.

The law is aware of the risks: there are very stringent and evolving regulations that govern how this happens and, as long as a company is compliant with these, as Net1 and its subsidiaries have repeatedly been shown to be (along with the major SA banks and insurers, for example), we don't think it should be a general policy of Allan Gray not to invest in providers of financial services to the poor.

Extension of SASSA contract

There seems to be a sense that we bought Net1 shares for clients expecting to profit from the looming crisis in grant payments. This is simply not true. Our current investment case is not based on the contract being renewed after 31 March 2017. From the affidavits filed with the Constitutional Court, it looks as if Net1 has done its best to fulfil its constitutional obligations in terms of the 2014 Constitutional Court Order.

Like all sensible South Africans, we sincerely hope that a workable solution is achieved to allow for the payment of social grants to continue. Given the perceived issues with the cross selling of other products by Net1, we would welcome any additional controls or limitations imposed by a potential new contract.

Responsible investing

All businesses offer both costs and benefits to society. We spend a great deal of time weighing up the social and environmental costs and benefits that different businesses offer and thus whether their business models are sustainable. We understand our duty to clients and to communities to take a carefully considered and balanced view. Our investment choices all have a human impact.

Our voting track record and our latest stewardship report, which includes some examples of company engagement, can be found on our website:
www.allangray.co.za/responsible-investing

Commentary by Rob Dower, chief operating officer, Allan Gray