



Responsible Investing

Responsible Investing has grown tremendously during the past few years and is now estimated to account for some 17.5% of the total European asset management industry

By Ulrika Hasselgren, CEO Ethix SRI Advisors, January 2009

According to the recently published Eurosif study¹ the SRI sector has grown. But many questions have arisen – such as: what is the definition of Responsible Investments? Is it possible to obtain good returns from a Responsible Investment approach? What is an ethical fund? Should one apply an ‘active engagement policy’ or an ‘exit strategy’? What about UN PRI?

In our experience, there is no such thing as a single approach to Responsible Investing, and behind the strong growth observed in the sector lies an ever-increasing variety of policies, processes, criteria and results.

As an advisor to large institutional investors and asset managers in Europe, I will try to answer some of the questions often raised, straighten out the definitions and give some examples of Responsible Investing.

In Europe, the total of Responsible Investment assets under management (AuMs) is reported to have reached €2.665 trillion as of December 31, 2007. This represents 17.5% of the asset management industry in Europe and corresponds to a remarkable growth of 102% since December 31, 2005.

Eurosif’s study finds that the growth in the European Responsible Investment market is driven by:

- An increasing demand from institutional investors for whom Responsible Investment has become a matter of risk management – particularly around the area of climate change;
- A further mainstreaming of Environmental, Social and Governance (ESG) considerations into traditional financial services;
- External pressure from NGOs and the media;
- A growing interest from individuals, particularly wealthy individuals.

The drivers of Responsible Investment identified above confirm our experience that – within a short space of time – responsibility and sustainability issues have entered onto the agendas of most investors and asset managers as something they have to address in one way or another. The environmental or social impacts of how returns are created can no longer be ignored. This responsibility has spread to both consumers and investors.

So what is Responsible Investing? The term ‘Responsible Investing’ means that – in addition to the financial analysis of a company – one assesses how a company manages environmental, social and

1) The Eurosif 2008 SRI Market Study can be downloaded at www.eurosif.org.



governance (ESG) factors within its business. It is an approach to investing that focuses on the long-term impact of ESG issues on investment decisions, rather than concentrating solely on financial factors. ESG issues can range from renewable energy to labour standards or company disclosure practices, and are defined by the investors, based on their mission and/or values.

With this broad scope in mind, Responsible Investing based on values is nothing new. The first ethical equity fund was created as far back as 1928 by US church organisations who avoided investments in alcohol and tobacco stocks. And during the 1950's, 60's and 70's, investors were concerned by a number of issues which influenced their investments, such as divestment from weapons producers due to the Vietnam war, boycotts of South African companies due to the apartheid system, or shareholder activism against large multinationals regarding oil spills and environmental degradation.

Up until the 1990's, Responsible Investing was an issue dealt with primarily by a narrow circle of values-based investors. However, the growing awareness about the global challenges to our planet – such as climate change, poverty reduction, energy, water and food supply – has influenced not only the public debate and the consumers but also the investors and the financial industry. And with capital owners' increased awareness and concern for these challenges, the demand for investment solutions that address them increases.

This development also creates business opportunities: both for companies that can successfully manage the environmental and social risks and opportunities facing their businesses and for asset managers that can offer solutions and products to meet the needs and demands of Responsible Investors.

Finally, Responsible Investing is a growing concern. The global challenges of our world engage people.

They want to know, for example, how a company works to prevent corruption in the countries where it conducts its business; how it manages supply chain risks in low-cost countries, or how it works to minimize any negative environmental effects from its business. Today, many investors also take a position on specific issues of concern – such as cluster munitions or anti-personnel mines.

In 1987, the Brundtland Commission published its report on the links between economic development and the environment. In this report, the concept of 'Sustainable Development' was launched as a way to prevent extensive environmental pollution and increasing social rifts. 'Sustainable Development' is defined as a development that "meets the needs of the present without compromising the ability of future generations to meet their own needs". Since then, the United Nations has been a growing presence in the investment community and today constitutes an important driver for Responsible Investing. The UN has facilitated an investor-led initiative to create a set of voluntary guidelines, aimed at addressing the global challenges within the investment communities. And in 2007, the UN Principles for Responsible Investment (UN PRI) were launched. Today, several hundred asset owners, investment managers and professional service partners around the world have become signatories and work actively to integrate ESG factors into the investment process.

Definitions within Responsible Investment

There are many approaches to Responsible Investing, and our advice is first to define the scope of one's mission and whether there are guiding principles or values that should be adhered to. The next step is then to develop a Responsible Investment policy, and here there are as many policies as there are investors. A good starting point is to look at what other investors are doing. Hence, the UN PRI provides a network, with opportunities to pool resources and influence; lowering the costs and increasing the effectiveness of research and active ownership practices.



As an example, in 2000, the Swedish National Pension Fund, AP7, created its Responsible Investment policy from scratch. Having a long-term investment horizon, a large investable universe (approximately 2200 companies), and being a state pension fund, AP7 agreed that international norms for human rights, environment, labour standards, and anti-corruption should make up their values base. Traditional ethical criteria for alcohol, arms and gambling were not included in the policy as the Swedish state is the owner of these businesses.

AP7 furthermore decided on an exit strategy, meaning that they would divest from companies involved in verified breaches of the international norms. In 2001, when AP7 implemented its policy, a large number of investors – both in the Nordic region and in continental Europe – decided to follow this approach.

Today in 2009, many investors and asset managers adhere to this so-called ‘norm-based screening’ approach all across Europe. However, several investors apply the norm-based screening as a reputational risk tool and a basis for company dialogue and shareholder engagement programmes, rather than excluding the companies.

Another example is a prominent Scandinavian church, which has implemented a new investment policy that focuses on investing in companies that take social and environmental responsibility seriously and which will provide a good dividend over the longer term. This approach requires positive criteria and the ability to identify the ‘good company’ that will both contribute to sustainable global development and provide a good dividend.

The church organisation puts its efforts into influencing its external asset managers to integrate environmental, social and governance factors into their investment process. Previously, their external asset managers focused on the aspect of “black lists” and not on the

church’s positive criteria. Now the church puts less focus on traditional ethical revenue-threshold criteria for controversial business sectors and looks for the responsible companies within these business sectors. The challenge for the asset managers is to describe how their investments are aligned with the church’s policy and why they have chosen the different companies in their portfolios.

Criteria and approaches

There are many questions about what makes up a Responsible Investment, ethical or sustainability fund. And even though the number of these funds is increasing, there is no global (or national) standard for definition.

Therefore asset managers need to be very clear in their information, not only regarding the criteria that they apply, e.g. human rights and cluster munitions, but also how and where these criteria are considered in the investment process.

To start with, these funds can be a broad group of equity, mixed or fixed-income funds that invest in all types of markets. Usually, they can be sorted under one or several of the following categories:

- Active engagement funds use dialogue as a means of influencing the companies they invest in to adopt a certain direction or mode of conduct, based on identified issues of concern.
- Divestment funds avoid investment in companies whose business/products are viewed as unethical, e.g. arms, tobacco, alcohol, gambling and pornography. Factors such as human rights and labour standards can also be incorporated in divestment criteria.
- Best-in-class funds invest in companies that score highly – within their sector – with regards to environmental, social and sustainability criteria.
- Environmental funds focus on themes like clean-tech, renewable energy or water.



Responsible Investment and performance

A common presumption is that responsible sustainable investment impairs performance. According to a recent national study which assessed retail funds over a ten-year period, the ethical funds' average return was 153%, while the figure for all the funds was 105%. Today there is enough research to show that you do not need to sacrifice return in order to invest responsibly. On the other hand, the narrowing of selection criteria or restrictions placed on the investment universe can naturally increase risk and affect the outcome.

Our experience is that a good asset manager can manage both ESG criteria and different thresholds, and is also capable of finding opportunities from so-called extra financial information.

The future of Responsible Investing

We are starting to see – and expect – an increasing application of Responsible Investment criteria in more asset classes. In particular, we see it within alternative investments. Developments are already underway, as alternative investments are increasingly used in the allocations of institutional investors. We expect to see more Responsible Investment criteria being applied in real estate, hedge funds and private equity. Furthermore, there have been recent activities pointing to emerging-market equities as an asset class where there is a greater scope for positive results

Sparinvest is a prudent investor with a solid and consistent value investment process. Ethix SRI Advisors is an experienced selector. In a process where each company does what it does best, they have worked together to create the Sparinvest Ethical Global Value Fund – a fund which is open-ended and therefore available to other institutions seeking an ethical value strategy.

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from the inclusion of Responsible Investment criteria than in developed-equity markets.

Today, sustainability is one of the world's most pressing challenges, made all the more difficult by resource scarcity – whether it be scarcity of clean air and water, a diminishing oil supply or lack of land to grow food and plant trees. In this landscape, investors have an important role to play by addressing environmental, social and governance issues with an investment rationale.

Ethix SRI Advisors is a Nordic-based advisory firm helping investors to integrate environmental, social and governance factors into the investment process. Its services include policy development and RI strategy, company research, portfolio evaluation, company dialogue and engagement. Ethix SRI Advisors is an international team – innovative and solution-driven – and enjoys working closely with its clients in Belgium, Denmark, Finland, France, Luxembourg, Netherlands, Norway, Sweden and the UK.

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