Sustainability rating systems

Michael J Kelly UK Head of Corporate Social Responsibility

AUDIT ▪ TAX ▪ ADVISORY

Areas to be covered

- History of systems covering more than finance
- Examples of differing methodologies
- Future development of rating systems

History of rating systems

- Background in exclusion of sectors or industries
  - No alcohol or tobacco
  - No nuclear industry or armaments
- Funds have been active in this area for at least fifty years
  - Origins in religious groups who took a moral stand on issues
  - Later expanded to anti-apartheid and other issues
- More recently funds created with specific environmental and/or social as well as financial objectives

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SRI Methodologies: Dow Jones Sustainability Indices

- Best in class approach
- Management of social and environmental risk
- Management of social and environmental opportunities

- Process
  - Survey based
  - Press cuttings monitored
  - NGO input solicited

SRI Methodologies: FTSE 4 Good

- Developed in collaboration with EIRIS (part of Ethical Investment Research Services)
  - EIRIS was launched in 1983 by a group of churches and charities
- Questionnaire based approach
- Focus on high level commitments covering;
  - Human rights
  - Environmental protection
  - Labour rights
- Negative screening excludes some sectors

SRI Methodologies: Innovest

- Traditional style of approach includes
  – Research sold to investors and fund managers
  – Buy, sell, hold communicated to investors
- Contingent aspects of balance sheet considered
  – Includes potential clean up costs
  – Includes potential opportunities and managers ability to apply them
- Environmental overview is unique aspect

SRI methodologies: SERM Rating Agency

- Direct and indirect costs of potential environmental and safety risks calculated to produce gross risk
- Mitigants calculated to give net risk
- Measured against market capitalisation to produce risk to capital ratio
- Reported along bond rating scale AAA to C-
- Ability to exploit new markets not included in calculations

Conclusions from Methodologies

- Broad range of methods to support SRI
- No generally accepted methodology for:
  - Accounting for environmental risk
  - Accounting for social risk
  - Calculating the quotient of environmental times social risk

- Results of this has been
  - Increased dialogue with companies
  - Lack of agreement as to what ‘engagement’ means

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Future developments

- Asymmetry of information
  - Sarbanes Oxley Act
- Shareholder activism
  - Institutions voting their shares
- Surveys and questionnaires declining
  - More probing discussions emerging
- Increased regulations
  - Companies Act; Operating and Financial Review
  - Stock Exchange; disclosure for listing documents

Questions for LATF

- How will this external environment be best used to the Regions' advantage?
- There are no SRI Funds in Europe for such as Sustainable Property – how can this type of gap be used to direct FDI?
- What are the natural aspects of the current Latin American capital markets that can be used to promote SRI?