An introduction to SRI: What, How and Who?

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Agenda

• What is it?
• How to do it?
• Who is doing it?
• The Road ahead
Definition

- Comes with different names:
  - Socially Responsible Investment
  - Sustainable investments
  - Ethical investments
  - Triple bottom-line, etc.

- Socially responsible investment (SRI), sometimes known as responsible investment (RI), is the integration of environmental, social and governance (ESG) factors in the selection and management of investments.

- SRI considers both the investor's financial needs and an investment’s impact on society.
## A Brief History...

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900</td>
<td>Methodist Church</td>
</tr>
<tr>
<td>1920</td>
<td>Churches and foundations</td>
</tr>
<tr>
<td>1971</td>
<td>Pax World Fund</td>
</tr>
<tr>
<td>1980</td>
<td>Mutual funds developments</td>
</tr>
<tr>
<td>2000</td>
<td>UK Law on pensions investment disclosure</td>
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<tr>
<td>2001</td>
<td>Germany – Law on pensions investment disclosure</td>
</tr>
<tr>
<td>2001</td>
<td>France – Law on pensions investment disclosure</td>
</tr>
<tr>
<td>2001</td>
<td>Swedish public funds change policy</td>
</tr>
<tr>
<td>2003</td>
<td>Belgium – Law on pensions investment disclosure</td>
</tr>
<tr>
<td>2005</td>
<td>Norway – Government Pension Fund</td>
</tr>
</tbody>
</table>

Why consider SRI?

- Managing money according to ethical criteria can be as (or more?) profitable and prudent as investing strictly for financial gain?

- SRI can directly change corporate behavior by drawing funds away from disapproved activities toward approved activities?
Why consider SRI?

- Environment and social issues represent one of the most complex challenges facing management.
- High level of technical, market and regulatory uncertainty.
- Many complex issues, stakeholders and non-financial measures to address.
- Success in this high complexity area implies ability to excel in other business areas, and thereby earn superior returns?
Sustainability Issues: Impact on the Bottom Line

- Union Carbide – Bhopal
- Exxon – Valdez
- Sandoz – Pollution of the Rhine
- Royal Dutch/Shell – Brent Spar, Nigeria
- Nike – “Sweatshops”
- Monsanto – Genetically Modified Foods
- Ford – Bridgestone tire recall on “Explorer”
- Norsk Hydro – Utkal Project in India
- ABB - Bakkun dam in Malaysia
- GE – PCB in the Hudson River
- Elf Aquitaine – Erika tanker wreckage

Source: Innovest
How to do it?

**Investment Stage**

<table>
<thead>
<tr>
<th>Pre-Trade</th>
<th>Post-Trade</th>
<th>Divestment</th>
</tr>
</thead>
</table>

**Approach?**

<table>
<thead>
<tr>
<th>Negative Screening</th>
<th>Positive Screening</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethical Norm-based Sectors</td>
<td>Best in-class Thematic</td>
</tr>
</tbody>
</table>

*Source: Eurosif*
Pre-trade Investment questions...

- Standard or Screened index?
- Multitude of providers of screened indices
- Different screening methodologies
Standard vs Screened indices

Source: www.ftse4good.com
Negative Screening: Not necessarily a detractor of performance

Source: Acadian Asset Management
## Size of the US market

Figures in USD Bn

### Socially Responsible Investing in the US • 1995-2005

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Screening¹</td>
<td>$162</td>
<td>$529</td>
<td>$1,497</td>
<td>$2,010</td>
<td>$2,143</td>
<td>$1,685</td>
</tr>
<tr>
<td>Shareholder Advocacy</td>
<td>$473</td>
<td>$736</td>
<td>$922</td>
<td>$897</td>
<td>$448</td>
<td>$703</td>
</tr>
<tr>
<td>Screening and Shareholder²</td>
<td>N/A</td>
<td>$(84)</td>
<td>$(265)</td>
<td>$(592)</td>
<td>$(441)</td>
<td>$(117)</td>
</tr>
<tr>
<td>Community Investing</td>
<td>$4</td>
<td>$4</td>
<td>$5</td>
<td>$8</td>
<td>$14</td>
<td>$20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$639</strong></td>
<td><strong>$1,185</strong></td>
<td><strong>$2,159</strong></td>
<td><strong>$2,323</strong></td>
<td><strong>$2,164</strong></td>
<td><strong>$2,290</strong></td>
</tr>
</tbody>
</table>

**SOURCE**: Social Investment Forum Foundation

1. Social Screening includes mutual funds and separate accounts. Since 2003, SRI mutual fund assets have increased (see Section II) while separate account assets have declined (see Section III) as single issue screening has waned and shareholder advocacy increased on the part of institutional investors.

2. Assets involved in Screening and Shareholder Advocacy are subtracted to avoid double counting. Tracking Screening and Shareholder Advocacy only began in 1997, so there is no datum for 1995.
US: Types of Institutional Investors

Socially Screened Institutional Investor Assets • 2005

- Public Pension: 80.9%
- Corporate: 9.2%
- Religious: 3.6%
- Foundations: 2.5%
- Endowments: 2.2%
- Hospitals/Healthcare: 1.4%
- Unions/Taft-Hartley: 0.1%
- Other: 0.2%

Source: Social Investment Forum Foundation
Size of the European Market
Figures in EUR Bn – Dec 31st 2005

Source: Eurosif
Types of Screening in the US

Social Screening by Institutional Investors • 2005

- Tobacco
- MacBride Principles
- Human Rights
- Environment
- Equal Employment
- Community Relations
- Labor Relations
- Products/Services
- Defense/Weapons
- Alcohol
- Gambling
- Faith-Based
- Pornography

SOURCE: Social Investment Forum Foundation

($ Billions)
Types of Screening in Europe

Dec 31st 2005

<table>
<thead>
<tr>
<th>FIGURE 6: SIMPLE EXCLUSIONS BREAKDOWN, € BILLION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobacco</td>
</tr>
<tr>
<td>H.R. / Norms-based screening</td>
</tr>
<tr>
<td>Others/Undefined</td>
</tr>
<tr>
<td>Weapons</td>
</tr>
<tr>
<td>Total Simple exclusions</td>
</tr>
</tbody>
</table>

Source: Eurosif
Drivers behind the growth of SRI

- Dissatisfaction with traditional security analysis
- Legal framework (e.g. UK)
- Regulatory Pressure
- Pressure from stake-holders
- Fiduciary requirement?
Obstacles to the growth of SRI

- Underperformance of investments?
- Complexity of analysis
- Lack of data (company disclosures)
- Diverging opinions on the same issues
- Complexity of setup
The Road Ahead

Fund Management

Traditional Fund Management

SRI