

SPAIN



KEY FEATURES OF SRI

The Spanish market has experienced a phase of consolidation in the last two years but has not yet taken off. As shown in Figure 1, the total SRI industry was €30.75 billion, of which a meager 5% (€1.44 billion) would be considered Core SRI and 95% (€ 29.31 billion) would be included in Broad SRI parameters. With that in mind, total SRI AuM represents 9.42 % of the total asset management industry in Spain.

FIGURE 1



The overall figure does not reflect however the main characteristic of the Spanish market. This is due to the strong concentration of Broad assets under management in only one player in the institutional market that accounts for 96% of the total Broad SRI market.¹ For this reason, when analysing the market we will refer to adjusted values in order to neutralize the statistical bias created by this strong concentration of AuMs.

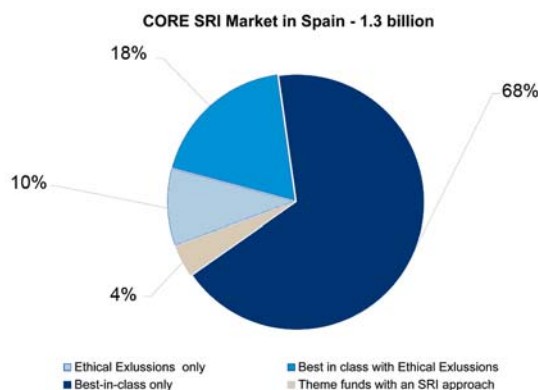
TABLE OF ADJUSTMENTS

	2005	2007	% of total
Core	1,56	1,28	4%
Broad	23,49	29,46	96%
Total Market	25,06	30,75	100%
(-) Adjustments for Core AuMs	0	0	-
(-) Adjustments for Broad AUM	22,96	28,12	-
Core adjusted	1,56	1,28	49%
Broad adjusted	0,53	1,34	51%
Total Market adjusted	2,10	2,62	100%

Main SRI practices

As shown in Figure 2, the most developed practice within Core SRI in Spain is the Best-in-Class approach which accounts for 86% of the category and can be broken down between only Best-in-Class at 68% and Best-in-Class combined with ethical exclusions at 18%.

FIGURE 2



Theme funds with an SRI focus have emerged in the Spanish market recently. They represent a mere 2% of the total adjusted SRI AuM. Renewable Energy/Energy Efficiency and Climate Change funds are the most popular theme funds.

From the negative screening perspective, Spanish funds with ethical exclusions apply on average 5 systematic exclusions. This can be enhanced by the use of ethical committees, used by 44% of the asset managers surveyed.

The bulk of Broad SRI is based on integration. 22% of asset managers in the SRI market systematically include ESG ratings in standard analysis spreadsheets. The same number of managers provide feedback on ESG issues after the mainstream analysis is compiled. Finally, only 16% of the asset managers have ESG specialists in their analysis team. This small degree of development within the fund managers on ESG issues can largely be attributed to the low volume of assets.

Engagement on SRI issues is probably the area where there is the most room for improvement in the Spanish market. Due to a less compelling regulation regarding fiduciary duties on behalf of investors, engagement is largely reserved for issues such as corporate dividend policies or corporate activity with potential dilution in terms of earnings per share. Only two out of ten asset managers have conducted any kind of engagement on ESG issues during the last two years. There is also a clear bias towards governance in terms of engagement issues (accounting for 57%) when compared to social and environmental issues, with 37% and 6% respectively.

¹ One single asset manager applies ethical exclusions to its overall portfolio as a corporate policy. The calculation of their AuMs would overstate the overall reading of the market.

Main Investors

In terms of demand for SRI investment we observe an even development in the retail (47%) and institutional (53%) segments in our adjusted calculations.² This reveals a divergence of the Spanish market compared to most of European SRI markets, dominated by institutional investors.

From the asset allocation strategy we note a very defensive offer of SRI investment. 72% of assets are invested in fixed income products of which government bonds account for three quarters. Only 26% is exposed to the equity market with a clear orientation towards large caps. This is slightly higher than the average 22% exposure of Spanish investors through mainstream investment funds at the same period. From a geographical standpoint the bulk of the investment is allocated in local currency (euro) with little exposure to other markets such as USA, Asia and emerging markets. The offer is now limited, with little diversification possibilities; this corresponds to a very conservative investment style of Spanish investors in capital markets.

MARKET EVOLUTION

The Spanish market has not yet taken off. A total AuM of €30.75 billion represents a growth of 23% (CAGR10.8%), well above the overall average annual growth. Still, this suggests a slow pace considering SRI as an emerging practice in the Spanish asset management industry.

As illustrated in Figure 3, the growth rates have been uneven among categories. Broad SRI has increased with vigour while Core SRI has decreased over the same period. Considering the SRI market as a whole, it has outperformed the overall market in terms of assets under management growth.

FIGURE 3



Source: Inverco, Dirección General del Tesoro, SpainSIF

Overall Spanish	2005	2007	CAGR 2	Total Growth
Mutual funds	245,82	238,74	-1,5%	-2,9%
Pension plans	74,69	87,58	8,3%	17,3%
Total Industry	320,51	326,31	0,9%	1,8%
Core SRI	1,56	1,28	-9,3%	-17,8%
Broad SRI	23,49	29,46	12,0%	25,4%
Total SRI	25,06	30,75	10,8%	22,71%
Adjusted Spanish	2005	2007	CAGR 2	Total Growth
Mutual funds	245,82	238,74	-1,5%	-2,9%
Pension plans	74,69	87,58	8,3%	17,3%
Total Industry	320,51	326,31	0,9%	1,8%
Core SRI	1,56	1,28	-9,3%	-17,8%
Broad SRI	0,53	1,34	58,4%	151,0%
Total SRI	2,10	2,62	11,9%	25,25%

MARKET PREDICTIONS

Key questions for the future

The key question regarding the evolution of the SRI market depends on three critical factors:

- Closing the gap: Closing the breach between the Spanish institutional market and the rest of Europe in terms of embedding SRI as a value added investment philosophy. This is necessary, especially for corporate pension funds where employees could have their money invested in companies that perform well financially while covering other areas of concern such as social performance, environmental issues and good governance. In addition, boosting growth in the institutional market would create a virtuous circle for SRI. The average share of European institutional investment versus retail is 66% of the market.³ However in Spain this figure is only 27%. A movement towards the mean would therefore imply a huge growth for the Spanish asset management industry.

² Adjusted versus overall figure: When analysing the total SRI market this would raise the institutional investors share to 96%. We should note that this particular case does not respond to a specific demand pattern from institutional investors but to an internal corporate policy.

³ Annual Asset Management Report: Facts and figures. July 2008. EFAMA. European Fund and Asset Management Association.

- **Sell, sell, sell:** Spanish financial institutions are well positioned with Spanish consumers and investors and are successful in promoting products. SRI retail products have not been one of the selling priorities of Spanish banks lately. As much as 40.2% of the household saving has been directed towards deposits, versus an 11.5% in investment funds and a 6.2% for pension plans.

A reality on the move

The figures presented in this report might understate the real situation for 2008 and 2009. Some changes are already being implemented.

- **Public pensions at the gate:** The externalisation of the management of the Social Security Reserve Fund could become a reality in the coming years. A law proposal presented by the Spanish government in the last legislature is pending for approval in the Spanish Parliament. The proposal includes the allocation of 10% of this fund (worth €47 billion⁴) in equities under the principles of socially responsible investment. This could add another €4.7 billion to the SRI market.
- **Asset managers to the rescue:** In the first half of 2008, major institutional fund managers have committed to allocating stakes of their assets under management to SRI instruments and vehicles. Furthermore, the average estimate for growth in the next two years made by the asset managers in the survey is 543%⁵. The main driver for this growth will be, in their view, the institutional market.
- **Finally, a Spanish SIF:** Another element for future SRI activity is the creation of SpainSIF, the Spanish Social Investment Forum, in 2008. The Forum aims to promote and disseminate information for SRI development.

All of these factors combined increase our expectations for high level of growth in the Spanish SRI market over the next two years.

⁴ As of 31/12/07. Source: Fondo De Reserva De La Seguridad Social. Informe A Las Cortes Generales Evolución, actuaciones del año 2007 y situación a 31-12-2007. Seguridad Social. Ministerio de Trabajo e Inmigración.

⁵ Consensus estimate, calculated as a weighted average of the growth prediction from respondents.