

France

€2.08 billion are invested in the institutional SRI market in France.

The institutional SRI market is more developed than the retail market in France.

There is little negative screening in the traditional sense of the term. The focus is on sustainability.

The unions have played a key role in developing the market and this should continue.

The lack of pension funds leaves the door open for other institutions to set the stage.

The market is apparently moving towards the mainstreaming of SEE criteria into fundamental analysis.

I. SRI in France

SRI Priorities

SRI in France has focused primarily on SRI mutual funds UCITS (Undertakings for Collective Investment in Transferable Securities), regardless of the type of investor (retail or institutional). For the overwhelming majority of SRI funds in France, positive screening has been the choice. Although the French media has grouped all of SRI under the ubiquitous label of 'Ethical Funds', there are, in fact, few 'ethical' funds on the market in that most of the funds have opted for little or no exclusion. For cultural reasons, negative screening plays only a limited role in stock selection. However, France has always had 'social' funds that are proactive in promoting social change. Two types of these funds exist: there are eleven 'Sharing funds' for which part of profits is given to charity, and twenty-seven 'Solidarity funds' for which parts of the dividends are distributed to finance social projects (access to employment, micro-credit, job creation). There are also institutional mandates with negative screens; in addition to more traditional screens, the criteria also concern restructuring policies (i.e. the fund cannot invest in companies which have undertaken layoffs).

History

In relation to other European countries, SRI has been a more recent development in France, with noticeable market growth happening only as of 1999. Earlier funds include:

- Nouvelle Stratégie 50, created in 1983 for the sisters of the Notre-Dame-des-Chanoines de Saint-Augustin Convent in Paris and managed by La Financière Meeschaert,
- Plurial Ethique created in 1996 by the specialist fund manager Apogé,
- Institutional funds such as those created by the mutual insurer Macif with a bond fund MG Obligations in 1994,
- FCP Insertion Emploi, jointly created by the Caisse des Dépôts (CDC), the Caisse d'Épargne, and two unions CFDT and CGC in 1994.

This last fund was an innovation both in terms of the actors mobilized and its social goals. Moreover, the union of these players has proved to have had a lasting impact on responsible investing in France.

The overall market for socially responsible investing has changed radically since 1999. As an illustration of market growth, the total number of French mutual funds as of December 31, 2002 stood at fifty-nine with AUMs (Assets Under Management) at €1.16 billion. Since then, the numbers have risen to €1.742 billion¹. The number of SRI funds (retail and institutional) tripled from 2000-2002, making France the most dynamic European market in SRI even if the AUMs do not yet equal those of certain other markets (and are far behind the UK market). This growth is confirmed by the increase of non-French SRI funds on the market (from three to twenty-two in 2002). France has also seen the development and growth of SRI fund of funds (five at the end of 2002). The AUMs have tended to stagnate as market conditions move investors away from further investing in equities, which constitute a large percentage of the SRI funds. Nonetheless the dynamism has continued in the ideas that developed the market and that continue to push it forward.

The overall market for socially responsible investing has changed radically since 1999

It is perhaps possible to categorise two phases in the growth of SRI in France. The first phase was driven by the creation of the rating agency Arese in 1997, which led to an increase in the volume of funds and assets managed. The second was motivated by the trade union involvement with the CIES (Comité Intersyndical Épargne Salariale / Trade Union Alliance for Employee Savings Plans) in 2001 that served to professionalise the market and stimulate more serious reflection on the future of sustainable investing.

Although other research organisations exist on the French market, it was the creation of the rating agency Arese, at the instigation of both the Caisse d'Épargne mutual bank and CDC that jump-started

¹ The 2002 numbers are from the SRI information centre Novethic; the recent numbers are from ISR Info, a new French information site and newsletter (www.isr-info.com) dedicated to CSR, SRI and sustainability.

the SRI market. And until very recently almost all new funds used Arese to supply the extra-financial information for fund management. As the original universe analysed by the rating agency was French, the analysis reflected the cultural focus on social (especially human resources) issues rather than on the environment (four social criteria vs. one environmental criterion). This French approach had the very real advantage of mobilizing energy and resources behind a relatively new concept. Indirect consequences include the simultaneous creation of the French SIF² (Forum pour l'Investissement Responsable / Social Investment Forum) and ORSE³ (Observatoire sur la Responsabilité Sociale des Entreprises / Study Centre for Corporate Social Responsibility). The CDC also financed the creation of the information centre Novethic, which aims to educate the retail and institutional markets about CSR and SRI. Novethic has also become the primary French source of SRI information and research.

It is also important to recognize the role that unions play in the management of these savings plans

These developments also mobilized the different unions, leading to the decision of the four major unions to work together to address the subject of SRI. In January 2001, the CIES was created in order to determine and label those SRI products that responded to the unions' criteria for the Employee Savings Plans (ESP) that they were going to negotiate. Until this point, most unions had been slow to adopt a position on the principles of corporate social responsibility. As seen with the Arese criteria, there is a strong cultural bias for social priorities (human resources, lay-offs & restructuring). Internal reflection within the unions is not finalised, but the union's Request for Proposal that was tendered in 2001 shook the market especially when many key players in the market saw their bid refused (only three funds were given a label after the first Request for Proposal; since then, thirteen fund packages are now labelled). Although the Employee Savings Plan market has yet to explode as predicted, fund management companies are preparing for the day. It is also important to recognize the role that unions play in the management of these savings plans; unions or employee representatives hold up to half the seats of the Supervisory Boards.

To a certain degree, there was a convergence in these two key factors: in July 2002, a new structure was put in place for Arese. The rating agency is now known as Vigeo and is managed by Nicole Notat, former president of the CFDT, one of France's largest unions. Moreover, the capital has been opened to include other institutions, including corporations and other European unions.

SRI Laws

Three laws were passed in France in 2001 that impact SRI, fund management in general, and CSR. The French SIF, which aims to promote good practices of SRI among investors, played a key role in the passage of these laws. The first, so-called Fabius Act, passed in February 2001 aimed to increase long-term savings with tax-exempt Employee Savings Plans. One aspect of the act now requires fund managers, however on an optional basis, to specify whether they take social and environmental criteria into account in the management of these ESPs. Based on the British law (a translation in fact), it has had more impact on paper than on the markets for the moment, although the CIES labels could change this in the next year as the ESP market develops.⁴

France is now the only country to require both social and environmental reporting for all listed companies

In May 2001 a law was passed known as the 'New Economic Regulations' law that requires companies to publish social and environmental information in their annual reports. This reporting requirement has no direct impact on SRI; rather it was motivated by the SRI demands for corporate CSR information. France is now the only country to require both social and environmental reporting for all listed companies. Ultimately, the inclusion of SEE information in annual reports will entice both companies and investors to think more seriously about the subject and motivate them to draw direct links between CSR and the economic performance of the firm.

In July 2001, the government created a French Retirement Reserve Fund (Fonds de Réserves pour les Retraites or FRR) that will supplement the retirement system for the private sector. The Retirement Reserve Fund will serve as a cushion for the period in which existing worker's contributions cannot cover the pension plans of the retired (first payouts of the FRR are planned for 2017). As with the

² A non-profit organisation now representing over 50 stakeholders of the French SRI community, such as fund managers, SRI rating agencies, trade-unions, NGOs, etc. which aims at promoting SRI investment practices (<http://www.frenchsif.org>).

³ An association now grouping over 70 different actors from the French economy such as companies, trade unions, NGOs or fund managers (<http://www.orse.org>).

⁴ The law has greatly facilitated the inclusion of employees in the negotiation process, but we have yet to see a large revenue stream from SRI products included in Employee Savings Plans.

Employee Savings Plans, the FRR will also have to report on how it takes social and environmental criteria into account. The fund which has just gone to tender will require the fund managers to exercise their voting rights as part of the mandate in order to be selected. The Steering Committee is also deciding on how SRI will be integrated into the fund. The fund will be invested in early 2004 with €17 billion under management.

The French market has been relatively quick to take the initiative in terms of changing the business model for the way in which the CSR performance is evaluated. Building on a model similar to that of financial rating agencies in which companies pay to be rated, two organisations have come into existence in the last year, one French (Vigeo) and the other Franco-British (Core Ratings). For the moment, no company has published their CSR ratings though several French firms are presently being evaluated.

II. Financial Market Context

In 2001, the net assets of the institutional investment market in France totalled €2 361 billion and can be broken down as follows:

Table 1: Net Assets Of The Institutional Investment Market In France (in €Billions)

Insurance Companies	Third Party Asset Management		Pension Funds*
	UCITS	Discretionary Mandats	
895	860	530	81

Source: FFSA / AFG-ASFFI (2001 estimates)

* excludes reserves of pay-as-you-go pension schemes (CDR)

In the area of third-party asset management, France has a relatively centralised financial market, which sets the tone for institutional investment in general. While there are more than four hundred management companies (figures for 12/2001), two-thirds of AUMs are managed by just ten of them. At the end of 2002, there were €1 400 billion AUMs in France (€865 billion in UCITS which represents over 20% of the European market and €560 billion in mandates), which makes it one of the largest asset management markets in the world. One-fifth of the overall market (including asset management companies and AUMs) can be attributed to Paris-based subsidiaries of foreign managers.

While there are more than four hundred management companies, two-thirds of AUMs are managed by just ten of them

The following table gives the breakdown of the UCITS market in France into which the majority of SRI funds fall:

Table 2: UCITS Market in France (in €Billions)

At the end of 2001	Total	Equity funds	Balanced funds	Bond funds	Money Mrkt funds
	Households	23%	41%	20%	32%
Corporates	15%	6%	5%	5%	33%
Insurance Sector	31%	23%	48%	36%	18%
Investment funds	16%	20%	14%	18%	17%
Others+	15%	9%	13%	10%	18%
Total	100%	100%	100%	100%	100%

* Public administrations, foundations, financial institutions, non-resident investors

Source: Banque de France

Unlike most of the other European countries in this study, there is no institutional investor market based on pension funds in France. The national retirement system and the supplementary schemes have always functioned on a pay-as-you-go basis, greatly reducing the funds held in reserve to be managed. Institutional investors include these supplementary retirement schemes (CDRs⁵ such as Agirc and Arrco were set up by

⁵ Caisses de Retraites / Retirement Funds.

law after WWII; these mandatory funds are co-managed by trade unions and employers), Mutual Health & Welfare groups and even corporate savings/retirement plans. Recently the CDR has begun holding reserves and the FRR will function likewise. While many institutional investors have in-house investment capacity, the growing trend is to outsource fund management to asset management professionals.

For the moment, most of these demand-side investors have yet to integrate the issue of SRI, though changes in the regulatory situation should favour a more serious reflection on the subject. Several institutions have already hired in-house SRI analysts (Ionis, Isica).

III. Methodology

Data for the French institutional SRI market were collected using the common Eurosif questionnaire, with an aim of:

- Determining total assets involved in SRI.
- Assessing the typology of investors.
- Assessing the various SRI investment methods.

The first step in proceeding with the survey was to establish a list of institutions involved in SRI, with the common European goal of reaching 80% of the market. The questionnaire was sent to supply-side investors (i.e. asset managers) who have their own SRI funds. Fifty-four asset managers were identified as having retail or institutional SRI funds on the market. Twenty were identified as meaningful contacts. The response rate was 60% in terms of companies, and 80% in terms of AUMs in mutual funds. There was a focus on the largest French asset managers, those with discretionary mandates in addition to their collective management.

Whenever possible, the questionnaire was followed-up with face-to-face interviews. In addition to the information furnished directly by the fund managers, data were also provided by the information centre Novethic. This data permitted us to confirm those asset managers with discretionary SRI funds and to crosscheck numbers.

Despite all efforts to limit information discrepancies, certain biases in the study could not be completely avoided, including:

- Under-accounting because of a lack of responses to either the Eurosif questionnaire or the Novethic study,
- Under-accounting of discretionary mandates,
- Under-accounting of the institutional portion of SRI UCITS. We were not always able to determine the percentage in the mutual funds that were from institutional as opposed to retail clients.

Additionally, some uncertainties remain regarding the methods with which SRI portfolios have been evaluated, depending on how SRI criteria are applied across the range of products (stocks, public debt, private debt, monetary instruments) within a portfolio. As this was the first survey, we accepted the figures as presented by respondents.

Despite these biases, we are confident that our response rate and the overall quality of responses gives a significantly relevant view of the institutional SRI market in France and that our presented data is worth aggregating for the purposes of the European overview. Known biases are taken into account in our assessment of the market and in the assumptions we make.

IV. Findings & Interpretation

Today, the total recorded institutional SRI market comes to €2 068 billion, which is less than 1% of the French institutional market. For the aggregated numbers, collective management and discretionary mandates are grouped together.

Investment Policies

From our research, the French institutional SRI market can be broken down by the different investment policies as follows:

Table 3: Investment Policies
(in €Million)

	Negative Screening	Positive Screening	Engagement	Negative & Positive Screening	Negative Screening & Engagement	Positive Screening & engagement	Other	Total
AUMs	400	1326	0	46	0	68	228	2068

Source: FIR analysis

We estimate the market coverage at 80%. Certain explanations need to be given so as to avoid drawing incorrect conclusions. The results for negative screening came out relatively high despite there being only two discretionary mandates in question, albeit with large AUMs. One mandate is for a foundation and the other for a corporate Employee Savings Plan with an exclusion of companies that have downsized workers. Moreover, the number ignores the fact that at least 33% of the latter fund is invested in bonds for which the SRI screen is not applicable.

The numbers for funds conducting both positive screening and engagement include two mutual funds that have a policy of meeting regularly with the companies in which the fund is invested. It is very likely that other institutional funds have also developed processes whereby the fund managers meet with company management but which are not reflected in the numbers. Consequently, French SRI can be loosely seen as having a positive screening / best-in-class approach to investing, with certain funds being active with the companies in which they invest.

As seen with the results above, shareholder activism or engagement has likewise played only a minor role in that there are no engagement products on the market and the word is not commonly used. However, certain fund managers do meet very regularly with the companies in their funds to follow progress or push for change without calling it engagement. Voting is not considered as SRI engagement. Engagement in the form of dialogue will probably increase as management teams hire SRI analysts. FRR will also promote engagement with its 100% voting policy.

Investment Typology

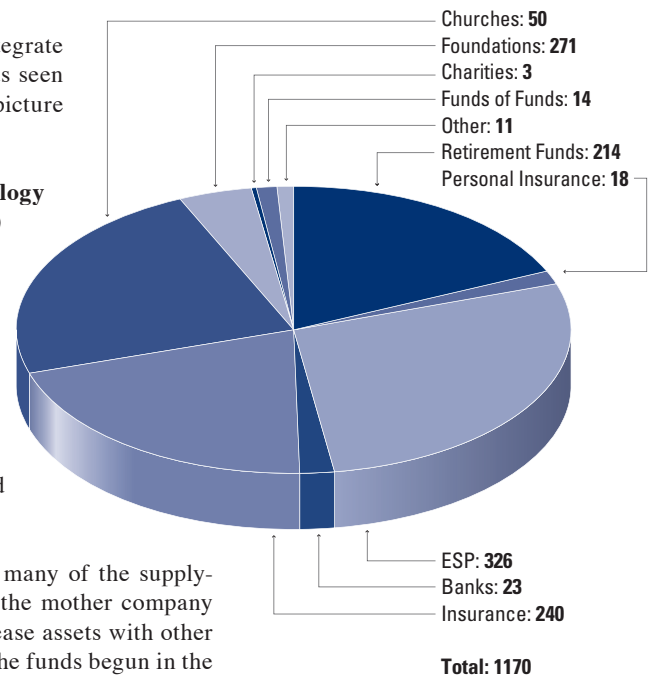
The results of the investor typology integrate less than 60% of the institutional funds seen above but they present a very general picture of institutional SRI investment:

**Table 4: Investor Typology
(in €Million)**

Source: FIR analysis

At this point, it would seem that foundations, charities and churches have yet to enter the SRI market in great numbers. However, it must be pointed out that the information is incomplete, as many of these organisations do not use the larger fund managers interviewed for this study.

Secondly, it is important to note that many of the supply-side funds are in fact mandates from the mother company and little effort has been made to increase assets with other investors. In fact, a certain number of the funds begun in the 2000 – 2002 period are today little more than the seed money from the institution, seeking to understand the new ideas behind sustainable investing.



On a more qualitative level, there are other conclusions that can be drawn from this study:

Unlike other European markets, there is no real ‘specialist’ segment amongst fund managers in France

Unlike other European markets, there is no real ‘specialist’ segment amongst fund managers in France. Although there are a few in the market (Apogé created in 1989, Branics, Ethis), most SRI products have been developed by mainstream banks and insurers without any overall SRI policy. Their management of dedicated funds with SRI criteria is more often linked to their

existing relationship with the investor than with their SRI capacity, as can be seen with Employee Savings Plans.

Most AUMs are still managed with information furnished by Vigeo though more and more investors have sought to diversify their SRI information and have contracted with other information providers both in France (CFIE, ODE⁶ - part of the EIRIS European network) and from European and American sources (Innovest, Core Ratings, Ethibel, Eiris). Certain funds establish an investment universe that includes only best in sector companies, while others overweight and underweight companies based on the fund’s priorities, leaving the final decisions of the use of the SEE information to the discretion of the fund manager. With the impetus of the CIES, asset managers have also begun hiring in-house analysts to interpret the outside information and more efficiently integrate it into fund management.

The SRI market in France has been predominantly driven by financial institutions and therefore the drive for negative screening from individuals or religious organisations has been largely absent. Moreover, the study would seem to indicate that foundations, charities and churches have not begun to turn in any significant way to SRI for the management of their assets.

Likewise, there are still a large range of institutional investors for whom SRI has yet to become part of the investment picture, including CDRs, Mutual Health & Welfare groups and smaller insurance companies. As for the larger financial groups, there has not yet been a strategic decision to use SRI for even a moderate part of its long-term investments. Today, it remains difficult to talk about institutional investors, when these companies are not yet investing their own capital.

⁶ See www.cfie.net and www.ode-asso.com for more information.

And finally, as seen in our methodology, it is impossible to separate assets under collective management between institutional and retail clients. Many discretionary mandates have been invested into the UCITS. That said, the SRI retail market in France remains relatively limited, allowing us to make assumptions about the overall market.

V. Future Trends

Market Size & Progress

Certain fund managers interviewed said that they expect market size to double within two years. One source cited the FRR, which has the potential to strongly impact SRI in terms of market volume. Other asset managers preferred not to commit themselves, either for the FRR or the market size in general. One fund manager pointed out that the small fund sizes tend to scare away investors. He also noted that many of the funds have a very small investment universe and do not demonstrate any real differences with non-SRI funds.

Certain fund managers interviewed said that they expect market size to double within two years

Fund managers cited various driving forces and strengths to their SRI funds for institutional investors including: their closeness to the customer; their knowledge of industrial risks (the case for insurers); and a strong tradition of long-term asset management for certain managers.

One recent concrete example of institutions reacting to the growth of SRI is the creation of IDEAM (Integral Development Asset Management). In July of this year, Crédit Lyonnais Asset Management, in partnership with the former executive team of ABF Capital Management, created the subsidiary IDEAM, dedicated entirely to sustainable investing. It intends to manage more than €700 million within the next three to five years and is betting on the medium-term development of the SRI market. The new business will cater to institutional investors, corporations, as well as the retail market and could set the tone for a new institutional approach to SRI.

For the moment however, most traditional financial institutions are waiting to see how the market unfolds while other non-financial players decide how to go forward. The FRR is one example of the government impacting SRI development. Unions will probably have to define and clarify their position in relation to CSR and SRI, and with their supervisory role in both social and employee funds, could also push the development of SEE criteria as inherent in good fiduciary responsibility. Likewise, social-minded organisations such as churches, charities, NGOs and foundations will be pressured to consider more responsible investing from members and trustees, despite their reticence to invest in equities at the moment.

The growth of the institutional market will at some point in the future depend on the development of the retail market that will feed into the institutional funds via ESP, retirement plans or PEA (personal equity savings plans). For the moment, the retail market has not yet been exposed in any systematic manner to the ideas behind SRI. One reason often cited is the lack of clarity and definition among the actors. Although most banks offer an SRI product, it is rare that individual points of sale actually promote these funds, predominantly for lack of knowledge amongst the sales force. However, as CSR develops, employees will have a better understanding of the notions behind the jargon and would in turn consider SRI investments (which would in turn push the institutional market). One necessary element will be training and raising awareness for employees and citizens in general.

SRI Themes

In June 2003, the French SIF organized the first 'European Forum for Responsible Investing' (Forum Européen de l'Investissement Responsable or FEIR), which united more than three hundred finance professionals (financial analysts, SRI analysts and fund managers) from Europe and the United States to listen to presentations from sixteen European companies concerning their sustainable strategies. The idea behind the project was to promote a dialogue between companies and investors that does not

distinguish between financial and extra-financial information. The French SIF has decided to continue the event the next year, in partnership with Eurosif.

President Chirac has made sustainability a key platform of his administration

Of equal importance to the professional development is the role of the government. President Chirac has made sustainability a key platform of his administration, and his Prime Minister has created two workgroups that are proposing concrete actions: one unites the various ministries, in order to break down barriers among government officials. This is known as the CIDD (Comité Interministériel pour le Développement Durable / Interdepartmental Committee for Sustainable Development). The other workgroup unites representatives from civil society, including NGOs, business, consumer groups and financial institutions. This is known as the CNDD (Conseil National du Développement Durable / National Council for Sustainable Development). The first proposals were released in June of this year. But the government has also tried to be more pro-active in tackling the issue of the environment. France has traditionally been categorised by its emphasis on social and “community” issues in SRI, which could change as French interest in the environment is growing.

Events such as the shipwrecks of oil tankers near coastlines (Erika, Prestige) and the heat wave in Europe in the summer of 2003 have forced the French population to think more seriously about global warming, the use of nuclear power and air pollution. In June 2003, the French government added the environment to the preamble of the constitution, giving it equal status with human and other rights. In addition, there is now a French Environment Charter under which all persons are responsible for preserving and improving the environment. This recent legal status should lead to greater discussion among SRI practitioners about bringing environmental issues to the forefront of their concerns.

A parallel theme that is changing how the French market is looking at SRI is corporate governance, and it is likely that the traditional markets will begin the integration of the principles underlying SRI via corporate governance. As we have seen with the FRR, fund managers are being pushed to integrate voting and even dialogue into their relationships with the companies in which they invest. Although French asset managers, and for that matter French laws, are less advanced than their British counterparts, most of those assets managers with larger AUMs were looking to create dialogue with companies, and they acknowledge that voting was on the agenda.⁷

Corporate governance and risk management could prove to be the common vocabulary that links SRI analysis to fundamental analysis, while pulling sustainable investing out of its niche and into mainstream fund management. The development of in-house competencies is pushing the market to look at ways in which SEE information can be integrated into buy-side analysis. This integration could shift the debate from an ethical to a pure risk-governance field, in direct relation with financial performance and premium. Certain fund managers (AXA IM, CLAM, Groupama AM, BNP PAM) have begun the process. Brokers such as Oddo Securities, HSBC Securities and CIC Securities now organise meetings with companies on sustainability issues. Most notably CIC Securities has also begun developing in-house capabilities to furnish clients with integrated and parallel SRI information. The result would be the blurring of barriers between traditional SRI and more ordinary long-term investing that looks to sustainability as a test for robust risk management and long-term planning. However, the professionalisation of such a market does not happen in a vacuum. There is the need for convergence amongst the various actors – financial, political, and social - to promote the opportunities, look for synergies, and share information.

⁷ *Exercising voting rights has been high on the agenda of the Association Française de la Gestion Financière for several years. AFG is the French Asset Management Association, representing investment funds and individual portfolio management (www.afg-asffi.com).*

Acknowledgements

Novethic

ISR Info

Pascale Sagnier, AXA IM

Pierre-David Labani, Confrontations

Jean-Philippe Liard, CFDT

And all the managers and analysts who gave us their valuable time in filling out our questionnaire and in helping us to better understand the French market.