United Kingdom

Over £80 billion of UK equities held by UK occupational pension funds are subject to engagement undertaken by UK fund managers in line with the pension funds' SRI policies.

Over £17 billion of UK equities managed on behalf of UK charities are subject to screening; primarily negative screening that aligns the charity's investments with its charitable purposes.

The UK institutional SRI market has expanded rapidly since changes to the 1995 Pensions Act came into force in 2000, and the Trustee Act 2000 came into force in 2001.

On the supply-side almost £200 billion of UK equity holdings are subject to SRI engagement activities as part of the fund managers' own SRI or Corporate Governance policy/guidelines (including fund managers owned by insurance companies).

The main areas of development in the UK institutional SRI market are likely to be a focus on more meaningful implementation of pension fund SRI policies, and an increase in SRI policies amongst charities.

If voluntary approaches to encourage the implementation of SRI policies fail, the UK government might find that it needs to act again if it wants to encourage Corporate Social Responsibility through SRI.

I. Introduction

The main objective of the research undertaken for this report was to estimate the size of the UK institutional Socially Responsible Investment (SRI) market. There have been previous attempts to do this, but this research aims to go one step further by:

- Breaking down SRI Funds Under Management (FUM) into activities which are subject to negative screening, positive screening and shareholder activism at the request of institutional investors in their mandates and/or Statement of Investment Principles (SIPs);
- Providing an assessment of supply side activities, i.e. asset manager's own SRI policy and/or guidelines, usually an engagement overlay or integration of Social, Environmental and/or Ethical (SEE) issues into normal investment practice.

This is a timely report as the UK institutional SRI market has seen considerable growth recently, primarily due to:

- An amendment to the 1995 Pensions Act, which came into force on 3 July 2000, requiring that trustees of occupational pension funds disclose in their SIPs the extent (if at all) to which SEE considerations are taken into account in their investment strategies.
- The Trustee Act 2000, which came into force in February 2001, requiring that charity trustees must make sure investments are 'suitable', not only financially, but also with regard to the charity's stated aims, including 'applying relevant ethical considerations as to the kind of investments that are appropriate for the trust to make'.
- The move by a number of large insurance companies to engage based on SRI criteria across all their equity funds.

The study comprised twenty-five surveys, backed up by in-depth interviews with representatives from leading fund management firms in the UK pensions and SRI industry and draws upon the results of a Just Pensions survey of current SRI practice in the UK charity sector undertaken early this year. Just Pensions is an UKSIF programme, which aims to educate and influence UK pension funds and other institutional investors about the importance of international development issues in their practice of SRI.

II. SRI in the UK

Socially Responsible Investment is investment where Social, Environmental and/or Ethical (SEE) considerations are taken into account in the selection, retention and realization of investments and the responsible use of rights (such as voting rights) attached to investments. SRI combines investors' financial objectives with their concerns about SEE issues. The UK SRI industry is split into three main markets: institutional SRI, consumer SRI and investing in social and green small-medium sized enterprises (SMEs). Institutional SRI, also known as "mainstream SRI", refers to investment undertaken within an SRI framework for a range of institutional clients, including pension funds, insurance companies, and the voluntary sector (including churches and charities).

SRI Approaches

There are two main approaches that can be used by socially responsible institutional investors, either separately or in combination:

Negative and Positive Screening

Screening refers to the inclusion or exclusion of stocks and shares in investment portfolios on SEE grounds. Screening is usually divided into "negative" screening to exclude unacceptable shares from the portfolio and "positive" screening to select companies with superior SEE performance or those that are best in their industry. Negative screening is typically the methodology used by churches and charities that have strict criteria about certain SEE issues, and an example of positive screening is passive investment through index trackers based on the FTSE4Good and the Dow Jones Sustainability Index (an option that some smaller UK pension funds are now exploring).

Shareholder Activism and Engagement

"Shareholder Activism" refers to the process by which investors seek to improve a company's performance by means of engagement/ dialogue and/or voting at AGMs (Annual General Meetings). Engagement/dialogue is typically the methodology used by institutional investors, such as pension funds and insurance companies, but is also used by some churches and charities.

In addition, institutional investors are increasingly integrating material SEE issues into the mainstream investment analysis process.

SRI: "Green" Scale

As SRI has developed over time to suit investors' demands, fund managers have expanded the range of SRI criteria and approaches that they use. Depending on how strict the investment criteria are, approaches tend to fall into one of the following three categories: dark "green", medium "green" and light "green", the first being the most strict (normally using negative screening methods), and the last having less stringent inclusion criteria, and possibly only using engagement.

History of SRI in the UK

Historically, SRI in the UK builds upon Victorian social concerns such as temperance and just employment conditions. However, the modern roots of SRI can be traced back to the 1920s when the Methodist Church wished to start investing in the stock market whilst avoiding companies involved in alcohol and gambling. Since then there have been numerous key milestones, such as regulations, movements and initiatives that have fuelled growth in the institutional SRI market. By date order, these include:

1990s – SRI: Creating New Laws & Boosting Dialogue

1997:	A group of university lecturers launches the "Ethics for USS" campaign to promote SRI as a viable investment strategy for USS (their pension fund) - USS published its new SRI policy in 2000.
1997:	17% of shareholders vote in favour of a resolution at Shell's AGM regarding Shell's social and environmental policy - engagement becomes a key trend within UK SRI.
1998:	John Denham MP, the then Pensions Minister announces proposals for the amendment to 1995 Pension Act, the SRI Pensions Disclosure Regulation at UKSIF's Annual Lecture in July.

2000s – SRI: Entering into the Mainstream & Extending Across Europe

2000:	The enactment of the SRI Pensions Disclosure Regulation, under the 1995 Pensions Act comes into force on 3 July, requiring occupational pension funds to disclose the extent to which they take into account SEE issues. Similar legislation quickly follows in other countries.
2000:	Friends Provident, through Friends, Ivory & Sime (now ISIS) adopts an SRI engagement overlay, branded Reo. Others including, AMP/NPI/Hendersons, Aviva/Morley, the Co-operative Insurance Society (CIS), Insight Investment, Jupiter and Standard Life quickly followed suit.
2001:	The Myners Review of Institutional Investment in the UK is published, advocating shareholder activism across a range of issues.
2001:	FTSE launches the FTSE4Good family of social indexes. This follows an earlier introduction of the Dow Jones Sustainability Indexes.
2001:	The Association of British Insurers (ABI) publishes new guidelines for companies asking them to report on material SEE risks relevant to their business activities.
2001:	Launch of Eurosif, the European Sustainable and Responsible Investment Forum, supported by the European Commission and the national Social Investment Forums (SIFs).
2002:	Over 250 MPs sign an Early Day Motion, which urges the government to enshrine policies in company law to ensure that companies disclose information on the SEE impacts of their business activities.
2002:	The World Summit on Sustainable Development in Johannesburg, South Africa - involves 150 countries and 700 companies - includes the launch of the "London Principles" of sustainable finance.
2002:	The Institutional Shareholders' Committee (ISC) issues a new statement of principles for investors, which include monitoring the performance of and establishing a regular dialogue with investee companies; evaluating the impact of investor activism; and reporting back to clients/ beneficial owners.

2002:	The Cabinet Office publishes its Review of Charity Law 'Private Action, Public Benefit', which proposes that all charities with an annual income of over £1million should report on the extent to which SEE issues are taken into account in their investment policy.
2003:	The Home Office accepts the recommendations made in 'Private Action, Public Benefit', stating that the Government's review of the effectiveness of the legislation requiring pension funds to disclose their SRI policies will inform the framing of the equivalent provision for charities.
2003:	The Department of Trade & Industry's Operating and Financial Review Working Group on Materiality publishes its consultation document which recommends that company directors use an auditable process to determine which social and environmental issues are material and should be reported.

III. Overview of the Wider UK Institutional Investment Industry

With the introduction of the SRI Pensions Disclosure Regulation and the move by a number of large insurance companies to apply SRI criteria across all their equity funds, SRI is gradually entering the mainstream and is becoming more reflective of the UK investment industry as a whole. The table below shows government figures for the distribution of ownership of ordinary shares in UK listed companies as at 31 December 2001. The table illustrates that institutional investors, primarily insurance companies and pension funds collectively own 50% of UK shares and therefore have significant power to influence the companies in which they invest. In comparison, UK individuals only own 14.8% of UK shares directly.

Table 1: Ordinary Share Ownership: UK Listed Companies (31 December 2001)

	% of total equity owned	£ billion
UK Institutional Investors		
Insurance Companies	20.0%	£310.6
Pension Funds	16.1%	£250.0
Unit & Investment Trusts	4.0%	£62.5
Other Financial Companies	9.9%	£153.2
Sub total	50.0%	£776.3
UK Individual Investors	14.8%	£229.9
Overseas Investors	31.9%	£496.0
Other Investors	3.3%	£51.9
Total	100.0%	£1 554.0

Source: National Statistics, 'Share Ownership: A Report on Ownership of Shares as at 31 December 2001'. www.statistics.gov.uk/downloads/theme_economy/ShareOwnership2001.pdf.

Main Fund Managers Serving UK Institutional Clients

The tables on the following page show:

- The top 20 leading asset managers in the UK occupational pensions industry which manage about 80% of the total assets held by UK pension funds.
- The top ten fund managers in the UK charity sector which manage about 50% of total assets held by UK charities.

The tables also illustrate those asset management firms that are UKSIF members, indicating that many of the key SRI players are also leaders in the wider institutional investment industry.

Table 2: Top 20 Leading Fund Managers in the UK Occupational Pensions Industry

	Fund Manager	Value of UK Pensions FUM £m	UKSIF Member/ Affiliate
1	Barclays Global Investors	67 588	Yes
2	Legal & General	67 585	
3	Merrill Lynch Investment Managers	54 340	
4	Hermes Pensions Management	46 396	Yes
5	Deutsche Asset Management	45 769	
6	Schroder Investment Management	44 778	Yes
7	UBS Global Asset Management	29 268	
8	State Street Global Advisors*	21 561	* See Note 1
9	Goldman Sachs Asset Management	21 187	
10	Hendersons Global Investors	20 041	Yes
11	Gartmore (part of RBS)	16 900	Yes
12	Threadneedle Asset Management	16 857	Yes
13	Capital International	16 581	
14	Fidelity International	15 574	
15	Scottish Widows Investment Partnership	13 405	
16	Morley Fund Management	12 605	Yes
17	Baille Gifford	11 277	Yes
18	Prudential M&G	10 732	
19	Newton Investment Management	9 273	
20	ISIS Asset Asset Management	8 932	Yes

**Note 1 State Street Global Advisors (SSGA) formed a strategic alliance with UKSIF member ISIS Asset Management in September 2001, which enables SSGA, a passive manager to offer a socially responsible engagement overlay.*
Source: Mercer Investment Consulting, 2002, 'European Pension Fund Managers Guide', Marsh & McLennan Companies

Table 3: Top 10 Leading Fund Managers in the UK Charity Sector

	Fund Manager	Approx. UK Charity FUM (£million)	UKSIF Member/ Affilate
1	CCLA	4 600	Yes
2	Barclays Global Investors	3 000	Yes
= 3	Merrill Lynch	2 600	
= 3	Cazenove	2 600	Yes
5	Schroders	2 300	Yes
6	Deutsche Asset Management	2 292	
7	HSBC	2 130	Yes
8	JP Morgan Fleming	1 700	
= 9	Gerrard	1 500	Yes
= 9	Allianz Dresdner	1 500	Yes

Source: Third Sector, 21 May 2003, p. 19

IV. Methodology

Scope of Research

A number of reports have been published that measure the growth of institutional SRI. The most recent figures that are predominantly used are Russell Sparkes'* estimates:

Table 4: Growth in Total UK SRI Assets (£Billion)

	1997	1999	2001
SRI Unit Trusts	2.2	3.1	3.5
Churches	12.5	14.0	13.0
Charities	8.0	10.0	25.0
Pension Funds	0.0	25.0	80.0
Insurance Companies	0.0	0.0	103.0
Total	22.7	52.2	224.5

**Source: Russell Sparkes, 2002, 'SRI: A Global Revolution'. John Wiley & Sons.*

The new research undertaken for this study attempts to go one step further by breaking down SRI assets into those subject to negative screening, positive screening and engagement at the request of pension funds or charities in their mandates and/ or SIPs; and an assessment of supply side activities, i.e. the asset manager's own SRI policies and guidelines, usually an engagement overlay and/or integration of SEE issues into the investment process.

Choosing & Approaching Survey Respondents

The top twenty asset managers in the UK occupational pensions market were surveyed. Additional asset managers were also selected for inclusion on account of being very active in SRI or the insurance market, as were large pension funds with in-house fund managers and active SRI policies. The standard procedure for approaching survey respondents involved telephoning all the relevant contacts at the selected asset management firms, following the call up by e-mailing them a copy of the survey and trying to meet one-on-one with all of the respondents. However, a few chose to return the survey electronically, not feeling the need to speak to us directly.

Table 5: Survey Response Analysis

Population	25
Respondents meeting for 1-1 meeting	10
Respondents replying by telephone or by email	6
Sent survey following enquiry, but not returned after follow up	6
Not contacted (could not find appropriate contact)	3
No response after initial contact	0
'Positive' coverage	64%

Source: UKSIF analysis

Survey Design & Definitions

The survey was designed to enable UKSIF to meet Eurosif's aims for the study. Initial drafts were assessed by the Responsible Investors Network[1] (RIN) and comments fed back into the final survey. The objective, to size the UK institutional SRI market, could be broken down further into:

Demand side SRI activities – detailing, in terms of asset volumes, SRI FUM for each asset manager in response to a demand made according to the institutions SIP and/or any SRI mandates, falling into the following broad SRI categories:

1) negative screening;
2) positive screening/best-in-class; and
3) engagement/shareholder activism.

Supply side SRI Activities – assessing SRI activities that are part of the fund manager's own SRI policy and guidelines, in particular with reference to shareholder engagement activities.

[1] *A group of asset managers, pension funds and other industry bodies.*

Statistical Assumptions

Although the survey was carried out in a robust and systematic fashion, it is important to highlight that due to dissimilar reporting dates and some unaudited values there can be some inconsistencies in the statistical information at no fault of the researcher. The surveys and questions used in the interviews are also subject to interpretation by the interviewees and definitions of certain SRI categories vary across fund managers. The figures reported are, however, likely to be underestimates of the whole market as only the largest asset managers were surveyed and we were only looking at UK equities. No new information was gathered for charities over the summer period.

V. Findings and Interpretation

Occupational Pension: Demand-side Engagement & Screening

Table 6: UK Occupational Pension Funds - Demand for SRI

SRI Activity	£ billion
UK Equities Holdings subject to SRI approaches	
Negative Screening Only	0.2
Positive and Negative Screening	1.4
Positive Screening Only	0.2
Engagement[2]	84.2

Source: UKSIF analysis

On the demand-side, Table 6 shows that £84.2bn of occupational pension UK equity holdings are subject to engagement at the request of pension fund's in their mandates and/or SIPs. Only a small proportion of occupational pension funds request negative screening and/or positive screening (£1.8bn). These figures clearly suggest that amongst UK pension funds there is a significant preference for engagement-based SRI approaches.

However, three years after the 2000 SRI disclosure amendment to the 1995 Pensions Act there is both strong anecdotal and research evidence (see Just Pensions' 2002 report 'Do UK Pension Funds Invest Responsibly?') that the SRI element of SIPs is often not fully implemented. This, although out of the scope of this study, has been confirmed by this research. A high proportion of the asset managers who were interviewed were concerned about how effective SIPs were in actually committing a pension fund to SRI.

Asset managers who do implement the SRI elements of pension fund SIPs often feel that there is a degree of 'free riding' in the fund management industry in this area. Given the lack of demand from pension funds for evidence that their SIP is being implemented, managers can 'get away' with doing very little; indeed, the SIP is often so vaguely written that managers do not need to do much beyond their normal investment analysis to meet them.

UKSIF acknowledges the implications of the gap between policy and implementation and is seeking to address this issue as an integral part of Just Pensions' 2003-5 work programme. The UK government is also currently assessing the impact of the 2000 amendment to the 1995 Pensions Act.

[2] *in line with pension fund SIPs and other mandates (of which £1.4bn is screened in some way)*

Charities FUM: Demand-Side Engagement & Screening

Table 7: UK Charities –Demand for SRI

SRI Activity	£ billion
Charity UK Equity Holdings subject to SRI approaches:	
Negative Screening Only	15.9
Negative and Positive Screening	1.7
Positive Screening Only	0.0
Engagement (in addition to screening)	3.3

Source: UKSIF analysis

To date, charities have taken a very different approach to SRI compared to occupational pension funds. Table 7 draws upon data from the Just Pensions report 'Do UK Charities Invest Responsibly?', which is based on a survey of over 100 of the UK's largest charities and foundations, backed by in-depth interviews with a number of key informants. The table shows that £17.6 billion of charity UK equity holdings are subject to screening. Unlike pension funds, engagement is a minority pursuit (£3.3bn). The main reason for this bias towards negative screening is coherence with a charity's chief purpose.

The Just Pensions report suggested that charities wishing to move forward on SRI will have to strike the appropriate balance between screening and engagement and that this will vary according to the size and purpose of the charity.

For the large campaigning fund-raising charities, a high public profile is a crucial means of finding donors, but brings with it far higher risks to their reputation, should they be accused of failing to practice what they preach on social responsibility. Such charities are therefore likely to see a thorough screen on their investments as an essential first step and some may want to move further and include engagement – potentially linking their investment and campaigning activities.

Smaller fund-raising charities may conclude that they do not have sufficient resources to carry out successful engagement. Moreover, if their charitable objectives are very specific (i.e. animal rights, or drug addiction), fund managers may not be able to provide an engagement service for them at an acceptable cost. In these circumstances, screening out undesirable stocks may be a more sensible choice.

For endowed, grant-making charities, reputational risk is not always such a prominent issue. For these, the business case for good corporate social and environmental performance, allied to the wider social role of the voluntary sector is likely to make engagement a more attractive option. Few endowed trusts are self-managed, so they will have to work with their fund managers to ensure policies are put into practice. They might also wish to team up with some of those groups who they fund, in order to pursue joint engagement strategies with specific companies.

UK Fund Managers: Supply-Side Engagement Activities

Table 8: UK Fund Managers Own SRI Policies – Supply-Side SRI

	Question	Yes %	No %
1.	Does your institution have a policy clearly stating why material SEE issues should be considered across ALL its UK equity holdings and why this is consistent with achieving satisfactory investment returns for your clients?	100	0
2.	Is the exercise of voting rights on SEE issues covered by this policy?	70	30
3.	Is SRI covered by your institution's Corporate Governance policy ONLY (i.e. no separate SRI policy)?	40	60

4.	Is there an internal assessment / audit of your overall SRI processes?	70	30
5.	Is SRI information externally published and reported to institutional investors?	70	30

Source: UKSIF analysis

On the supply-side almost £200bn of UK Equity Holdings are subject to SRI engagement activities as part of the fund managers own SRI or CG (Corporate Governance) policy/guidelines (including fund managers owned by insurance companies). Dialogue and shareholder voting are the most popular methods of supply-side engagement activities, although dialogue differs greatly in both its definition and extent.

Table 9: Summary of Engagement Activities

Engagement Area	Comments
Overall	Fund managers appear to conduct engagement across their portfolios, not biasing for specific sectors.
Dialogue	The most common form of engagement for most asset managers. However, the concept of dialogue differs across fund managers. Some will consider a 10 minute phone call as dialogue, whereas others adopt a deeper approach including meeting with company board members, 1:1 sessions, presentations to management and site visits. Maintaining a record of dialogue also varies across managers. Some log dialogue with companies using a formal database approach, while for some there is only an informal record.
Shareholder Voting	All fund managers interviewed vote on the vast majority of their shareholdings.
Resolution Sponsorship	A handful of asset managers sponsor resolutions, but there have only been few UK based ones in recent times.
Collaborative Initiatives	Most, but not all, the fund managers surveyed are the involved in collaborative initiatives, e.g. Institutional Investors Group on Climate Change (IIGCC) and the Pharmaceuticals Shareholder Group (PSG).

Source: UKSIF analysis

SRI Policy & Philosophy

All surveyed fund managers have a policy, either as part of their CG policy (40%), or as a stand alone SRI policy (60%) clearly stating why material SEE issues should be considered across all its UK equity holdings and why this is consistent with achieving satisfactory investment returns for their clients. 70% of asset managers conduct an internal assessment/audit of their overall SRI process and externally publish or report SRI information to institutional investors.

Those who tend to see SRI as part of CG believe that longer-term material SEE risks can, at a certain level, be addressed as part of CG activities.

Fund managers also differ in the amount of resources dedicated to SRI, including the number of people devoted to SRI and the 'space' given to SRI on the fund manager's website and in marketing material. Some managers have one staff member designated to monitor material SRI issues, possibly as part of their CG role, whereas others have dedicated teams with a wider remit.

Supply-Side: SRI in the Investment Process

The inclusion of material SEE issues in the normal investment process varies across asset managers. Whereas SEE analysis is often dealt with separately to financial modeling, there is some movement towards including SRI analysis as part of the entire investment analysis process. In some cases SRI analysts are not, in effect, a segregated group, but part of the whole fund management process, contributing to the assessment of the overall value of the company.

VI. Future Trends

The trend towards shareholder activism and engagement amongst large UK institutional investors is likely to continue. Following the Myners' Review of Institutional Investment, the UK Government stated its intention to legislate, if necessary, on shareholder activism. Late last year the industry responded to this challenge through its umbrella body the Institutional Shareholders' Committee (ISC). The ISC's new voluntary principles include: monitoring the performance and establishing a regular dialogue with investee companies; intervening where necessary; evaluating the impact of investor activism; and reporting back to clients/beneficial owners. Investment consultants and pension funds are starting to assess fund managers on their ability to meet the code in theory and in practice.

The trend towards shareholder activism and engagement amongst large UK institutional investors is likely to continue

Time will tell whether this voluntary approach will reduce the current gap between pension fund SRI policies and practice, especially as SEE issues are often viewed as being insignificant by the parts of the investment industry governed by quarterly performance targets and benchmarks. The UK government might find that it needs to act again if it wants to encourage Corporate Social Responsibility through SRI.

We also expect to see an expansion in SRI amongst UK charities. The UK Government's Home Office has recently accepted the proposal made by the Prime Minister's Strategy Unit that registered charities with an annual income of over £1million should follow the example of pension funds in reporting annually on the extent to which SEE issues are taken into account in their investment policies. The Just Pensions work undertaken earlier this year found that only 40% of the largest UK charities had policies relating to SRI.

We also expect to see an expansion in SRI amongst UK charities

However, the integration of SEE issues into normal institutional investment practice fundamentally depends on the search for the 'holy grail': is 'good' business, good business? The search should be helped in the future by the disclosure of more material SEE information through companies' Operating & Financial Reviews and other reports.

The next few years will certainly be pivotal to the future direction of UK institutional SRI.

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For further information about UKSIF, please see www.uksif.org.