Foreword

Conducted during 2003 in eight countries, this study highlights the scale of European Institutional SRI across these countries. Although SRI continues to experience global growth, this report clearly shows that in Europe, it is also a movement composed of multiple approaches and drivers. Each national state’s respective culture, financial market structure and legal framework influences the complex shape of SRI in contemporary European society.

Nevertheless, readers of the study will find that even if contrasts still exist from nation to nation, European SRI is showing signs of beginning a long road from obscurity into the financial mainstream. Eurosif hopes that this study will offer insights into Institutional SRI, but at the same time, provoke continued debate about what is Socially Responsible Investment and how it can best be integrated into sound mainstream financial management.

We are pleased to support Eurosif in its research and publication of this inaugural assessment of Socially Responsible Investment among European Institutional Investors. This excellent study provides more clarity and greater understanding for all interested parties about the current state of Institutional SRI in Europe. This report will serve not only the SRI community but also the mainstream financial service providers interested in better grasping the current debate taking place across Europe.

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Insight Investment - UK
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Jupiter Asset Management - UK
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Nextra (Gruppo Intesa) - Italy
Oikocredit - The Netherlands
SAM - Switzerland
Standard Life Investments - UK
Triodos Bank - The Netherlands
UBS AG - Switzerland
Universiteit Nyenrode (EIBE) - The Netherlands
Vigeo - France
World Wide Fund for Nature (WWF-UK) -UK

1 As of September 2003
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I. Europe
I. SRI in Europe

Social Responsible Investment has undergone tremendous developments in Europe in the last few years. The movement was originally initiated as early as the 1920s in the UK when the Methodist Church began avoiding “sin stocks” in its investment policy. By the 1960s, this financial-moralist movement had started to spread to the Continent, as churches and religious groups placed their financial investments in line with their views and principles. While this “niche” has remained a leading example for the SRI world, in the 1990s, SRI began a new phase of development. At the root of this more recent movement were social activists, the public’s broader consciousness of sustainable development issues, and the growing perception of social responsibility by governments, corporations and investment institutions.

Today, many players debate the impact of SRI strategy on long-term investment performance. The key concern is the relationship of the benefit generated by socially responsible management in comparison to its cost of implementation. Contradictory studies have been published with no conclusive evidence either way.

Presently, there is a duality to European institutional SRI:

- It maintains a steadfast niche market.
- It is gaining momentum in being accepted by the financial sector.

This European section focuses on describing the SRI arena and then exploring these two directions in greater detail. It concludes with a look at upcoming trends occurring in the field.

SRI Overview

SRI encompasses a wide number of extra-financial criteria within the realm of Corporate Social Responsibility (CSR). The sector’s various applications range from a passive respect of one or many of those criteria to an active approach where investors directly promote social responsibility with the companies in which they invest. This in turn may foster advancement of these practices by setting up a competitive system among companies, whereby good CSR practice will place the company high on the list of possible investments.

Table 1: A Broad Scope of Responsibility: What is Socially Responsible?

<table>
<thead>
<tr>
<th>Corporate governance/board membership</th>
<th>Environmental and social performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sustainability and related reporting</td>
<td>Human Resources management</td>
</tr>
<tr>
<td>Political involvement</td>
<td>Worker’s/Contractor’s rights</td>
</tr>
<tr>
<td>Intellectual property</td>
<td>Socio-Economic impacts in developing countries</td>
</tr>
<tr>
<td>Business risk assessment + Reputation risk assessment</td>
<td>Community involvement</td>
</tr>
<tr>
<td>Procurement policy and practice</td>
<td>Social-ethical or moral issues</td>
</tr>
<tr>
<td>Environmental and social impact of products</td>
<td>Compliance with SEE regulation</td>
</tr>
<tr>
<td>Environmental and social management</td>
<td></td>
</tr>
</tbody>
</table>

Source: Eurosif analysis

Note: This study does not cover community investment and micro-finance. Though these are often referred to as socially responsible investments and have historical clout in countries such as France, Italy and Spain, we have chosen not to cover those funds that redistribute a share of the profits they make, both because their market-size is relatively small and because, being a very particular type of financial product, they would deserve a study of their own.

CSR Performance And Investment Universe

SRI is applicable to any type of financial product (stock, bond, public debt, etc.) though in practice it is mostly applied to stocks (equity securities). Although recent studies have tackled the issue of SRI in private equity, the current focus remains on the equity markets, both in reality and in this survey. The qualification of CSR performance in Europe is now a largely professionalised system using a...
combination of resources:

- Specialised rating agencies provide non-financial analysis to the market,
- More and more financial companies set up their own SRI analysis departments,
- Market indexes, such as the FTSE4Good or DJSI 600, supply fund managers with dedicated investment universes where selection for an index is based both on financial and non-financial performance,
- NGOs provide their own expertise and assessments of issues and corporations.

Depending on the fund’s orientation and commercial scope, each asset manager practicing SRI relies on a combination of these resources to pick stocks within a fund’s universe using mathematical models. Alternatively, funds practicing engagement may use information a posteriori.

Of course, funds that use simple negative screens will rely on less elaborate sources.

**Retail vs. Institutional**

The SRI market is usually split between retail and institutional investment. Retail covers individual savings and investments, while institutional covers basically everything else.

This study focuses on the institutional SRI market, mainly because retail information is more freely available in many countries and is therefore not so urgently required at present. Simultaneously, no comprehensive study of the institutional sector exists yet.

Another significant reason to focus on this sector is the comparative weight of institutional over that of retail. As this report points out later, institutional SRI in its various forms has taken the lead on many of the sector’s trends and issues.

There is a major difference between retail and institutional SRI. Retail investment reflects an individual’s financial and non-financial choices, which means it is possible to tailor one’s investments to one’s views and principles.

Institutional investment on the other hand, where volumes per investment are presumably larger than on the retail front, is more complex in SRI terms:

- The most restrictive vision of institutional investment applies to companies investing with their own funds (shareholder’s funds, equity). These could be insurance companies, banks, corporations, etc.
- To this we add a category of investors considered as institutional because they are not individuals: churches, foundations, and charities, whose investment capacity is somewhat smaller than the above category, but who do represent an “individualised” vision of ethics.
- The third layer is made up of investors investing money on behalf of others: these are mainly pension funds and other retirement financing systems. While the volumes they invest may reach very large proportions and be decisive on markets, their noticeable difference with the prior examples is the fact that they represent multiple stakeholders. In effect, investment decisions are not made by a sole financial officer, but rather by a group of empowered people very often including union and investor representatives.

And as we will see, these are decisive elements in the issues of why institutional investors have become active on the SRI front.

**What Pushes Institutional Investors to Be Active on the SRI Front?**

History and analysis point to multiple reasons for the development of institutional SRI.

**Demand-side**
As described earlier, the first movers on the market were institutions with strong identification with their values, such as religious groups, acting on internal agendas. Some other sensitive groups, such as unions, later began using their powers in order to push their own SRI agenda where possible. As it turns out, in several countries such as the UK, France and the Netherlands, employee representatives nowadays have been granted significant power in the management of pensions or employee savings plans. This has been a deciding factor in the move of these latter funds towards SRI.

Supply-side
From a supply-side perspective, the offer of SRI products by asset managers has grown rapidly in volume as well as in diversity.

Product differentiation is manifold:
- Across investment vehicles: pooled funds, segregated funds, funds of funds, multi-management, trackers (ETFs),
- Investment universe: sector, area, SRI criteria,
- Range of SRI criteria application across financial instruments (stock, private debt, public debt, monetary),
- Typology of SRI method used: screening, engagement, etc.

As we will see, the SRI methods that are used are gaining more significance as investors turn less towards issues per se than towards the way these issues are dealt with and the overall efficiency of SRI.

On another level, the invested amounts on the institutional market makes custom-made products more profitable. Asset managers are ready to tailor investment products to the needs of their customers. As a consequence, the SRI institutional market has two faces: one is quite visible, as it comprises market-tradeable products such as pooled funds. The other is not so readily visible as SRI takes place within the framework of party-to-party mandates and in every day investment practice.

Legal and Regulatory Context
Most regulatory developments took place in the last ten years in response to the demand for SRI products and regulatory changes in the fields of transparency and disclosure.

Disclosure laws compelled listed companies to be transparent about their SEE policies across the continent. In the fund management sector, investments are also subject to disclosure policies as in the case of the Statement of Investment Principles (SIP) in the United Kingdom, and similar regulation in France or Germany.

During the same period, more powers were given to unions in pension investment policies in the Netherlands and in France. Unions used this power to create labels or dedicated investment policies reflecting their SRI interests.

Moreover, because of the series of financial scandals that took place in recent years, there is an increased demand for SRI. Enron-type events opened the public’s eyes to transparency and corporate governance issues. As a consequence, management and shareholder responsibilities have gained importance on the political agenda. Switzerland, for example, has a law on reporting obligation about the use of voting rights. At this level, as at many others, mainstream corporate financial concerns meet with those of the SRI world.

Interestingly, self-regulation is also part of the picture, as insurance companies in the United Kingdom or in the Netherlands have created SRI guidelines through their trade bodies. These initiatives either make up for the absence of local regulation, or simply add to the arsenal of available rules on SRI markets.

Tables 2 and 3 take a closer look at the current regulatory framework and key dates in SRI history.
Table 2: Framework Drivers and Their Local Applications

<table>
<thead>
<tr>
<th>Law/Rule</th>
<th>UK</th>
<th>NL</th>
<th>FR</th>
<th>DE</th>
<th>IT</th>
<th>ES</th>
<th>AT</th>
<th>SW</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate disclosure</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment disclosure (Pension Funds or equivalent)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reporting of voting rights</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Governance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Union empowerment</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade body guidelines</td>
<td></td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Union Codes</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* UK = United Kingdom; NL = Netherlands; Fr = France; De = Germany; It = Italy; Es = Spain; At = Austria; Sw = Switzerland
Source: Eurosif analysis

Table 3: Key Dates in European SRI Development

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2000</td>
<td>Amendment to 1995 Pensions Act requiring SRI disclosure in the UK</td>
</tr>
<tr>
<td>July 2000</td>
<td>UN Global Compact</td>
</tr>
<tr>
<td>July 2000</td>
<td>Dutch union FNV calls for pension funds to draw up investment codes</td>
</tr>
<tr>
<td>January 2001</td>
<td>Regulation requiring disclosure in Belgium</td>
</tr>
<tr>
<td>May 2001</td>
<td>French law makes SEE reporting mandatory</td>
</tr>
<tr>
<td>June 2001</td>
<td>European Union begins development of CSR Strategy for Europe</td>
</tr>
<tr>
<td>October 2001</td>
<td>Association of British insurers issues SRI disclosure guidelines</td>
</tr>
<tr>
<td>January 2002</td>
<td>Regulation requiring statement of SEE principles for private pension funds in Germany</td>
</tr>
<tr>
<td>June 2002</td>
<td>Dutch insurance companies create Code of Conduct including social responsibility</td>
</tr>
</tbody>
</table>

Sources: Morley Insight and Eurosif Analysis

Scope of Research and Methodology

This survey was conducted with a mix of idealism and pragmatism. Stated aims were combined with making use of available resources and taking into account the diversity of the surveyed markets.

Countries were surveyed individually by the local SIFs (Social Investment Forums) (UKSIF in the UK, VBDO in the Netherlands, FIR in France, FFS in Italy, Forum-NG in Germany, Austria and Switzerland) and a group of people in Spain representing academia and the corporate world. The surveys were conducted on the basis of a commonly defined framework, combined with their own previous and current research.

The Eurosif questionnaire was intended to identify the main players on the SRI market, along with the methodology they used for their investment. It was to be submitted to asset management companies, who could best give an overall assessment of the market as they manage multiple investments, and were easier to identify than the institutional investors. Some of the latter were nevertheless also surveyed, as in the UK, when it was relevant. Results were then to be put into perspective with overall assessments of local institutional markets.

It was first commonly agreed that covering 80% of the markets would give credibility to the answers. As it turns out the response rate has been variable, perhaps reflecting both imperfections in surveying methods as well as different national transparency cultures across Europe.

On the negative side, we failed to survey Sweden, whose SRI market is quite developed. We also had some difficulties in taking into account some transnational asset managers who were not always able to supply a breakdown of the sources of their AUMs (Assets Under Management) by country.

Accordingly, the presented results must be treated cautiously. We are however confident about presenting quantitative values as they have proven to be consistent with one another, and with soft

Scope and application of the laws or rules in this table vary.
assessments of the market.

Table 4: Response Rate by Country

<table>
<thead>
<tr>
<th>Country</th>
<th>Response Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fr</td>
<td>80%</td>
</tr>
<tr>
<td>Nl</td>
<td>79%</td>
</tr>
<tr>
<td>It</td>
<td>78% as market share</td>
</tr>
<tr>
<td>Uk</td>
<td>64%</td>
</tr>
<tr>
<td>De</td>
<td>30%</td>
</tr>
<tr>
<td>Es</td>
<td>Na</td>
</tr>
</tbody>
</table>

Source: Eurosif

Definitions, Data and Analysis

There is no single definition of SRI from a pragmatic point of view. Rather, there are layers. We chose to differentiate three of those layers:

- The first layer, or the core, is made of elaborate screening practices. This includes both positive screens (such as best-in-class) and extensive exclusions.
- The second layer is made up of simple exclusions (negative screening), which resembles risk management. Typically, this includes screening for tobacco only or activity in Myanmar (Burma) only. Almost all Dutch pension funds use these kinds of screens.
- The third layer consists of all engagement practices. These do not establish a selection of funds through criteria as in screening, but rather exert their power at the corporate governance level to push for issues that are connected with CSR among other things. On occasion, engagement may be combined with screening. Many UK pension funds practice engagement.

This segmentation becomes remarkable when looking at the size of the SRI institutional market in Europe:

Table 5: Views of the Institutional SRI market in Europe (in €Billion)

<table>
<thead>
<tr>
<th>Core SRI</th>
<th>Adding SIMPLE EXCLUSIONS(^3)</th>
<th>Adding ENGAGEMENT(^4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>34</td>
<td>218</td>
<td>336</td>
</tr>
</tbody>
</table>

Source: Eurosif Analysis

As we see, the market in the widest sense is almost ten times larger than that of the 'core' definition. These different analyses open the way for two complementary visions of the market.

Vision 1: SRI Remains a Growing but Niche Market

At its core, institutional SRI is approximately €34 billion. This approach removes engagement practices and simple exclusions of asset managers. This view reflects the difficulty of measuring engagement in the absence of a common definition, law, or reporting obligation, as is the case in the UK as well as in other European countries. Asset managers are free to do and report what they want and investors are free to believe them. There is no doubt about the existence of dialogue and other exchanges between

\(^3\) Simple exclusions are mostly made up of Dutch pension funds. Eurosif chose to retain only those with a formal written SRI policy.

\(^4\) This diagram does not include the fact that 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).
asset managers and corporations, and some of the former are known for their sophisticated engagement policies. Yet in most cases, their extent and efficiency (as is the case for simple negative screens) as bolstering good SEE practices or sustainable management is not explicitly known.

Similarly, the core approach to SRI suggests that simple exclusions are often regarded both by their practitioners as well as by market observers as a part of risk management rather than as an SRI practice.

In the context of the ongoing SRI debate, this approach results in a conservative view of the market and is thus less subject to contention.

As shown in Table 6, using the core market approach, the United Kingdom is the most developed institutional SRI market in Europe. Afterwards, Germany, France, the Netherlands and Switzerland are of similar sizes. Finally, Austria, Italy and Spain close the ranks as less developed markets.

<table>
<thead>
<tr>
<th>Country</th>
<th>Market Share (€ Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>8%</td>
</tr>
<tr>
<td>France</td>
<td>9%</td>
</tr>
<tr>
<td>Germany</td>
<td>8%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>8%</td>
</tr>
<tr>
<td>Austria</td>
<td>1%</td>
</tr>
<tr>
<td>Spain</td>
<td>0.5%</td>
</tr>
<tr>
<td>UK</td>
<td>69%</td>
</tr>
</tbody>
</table>

Source: Eurosif Analysis

It is interesting to note that in the more restrictive view of the SRI market, the domination of the UK is not the consequence of pension fund involvement, but rather of its charities practicing elaborate negative screens, which alone account for 82% of the UK market.

**Vision 2: SRI is Becoming Mainstream**

In this enlarged view of institutional SRI, Eurosif calculates institutional SRI among European investors as €336 billion. The figures suggest that SRI has already entered the mainstream financial markets in countries such as the UK and the Netherlands. This approach posits that engagement practices and simple exclusions are increasingly being accepted and adopted by the greater financial community.

Comparing AUMs subject to engagement for pension funds in the UK to the total UK share ownership of their pension funds produces an SRI ratio of 24%. Similarly in the Netherlands, almost all of the pension funds surveyed for this study said they applied at least simple negative screens in their fund selection, either as a form of risk management or an ethical statement (i.e. the Doctor’s Pension Fund screens out Tobacco).

See the Netherlands’ country report for more information.

These facts may be viewed as a good sign for the future of SRI, since the high penetration rate of these practices point to investors and asset managers viewing them as causing little or no financial risk and possibly helping build company value. Table 7 illustrates these points when looking at the size of these two countries in the overall European market.

<table>
<thead>
<tr>
<th>Country</th>
<th>Views of Country’s Size on the Institutional SRI Market (€ Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>54%</td>
</tr>
<tr>
<td>France</td>
<td>0.6%</td>
</tr>
<tr>
<td>Italy</td>
<td>0.1%</td>
</tr>
<tr>
<td>Germany</td>
<td>0.9%</td>
</tr>
<tr>
<td>UK</td>
<td>44%</td>
</tr>
</tbody>
</table>

Source: Eurosif Analysis

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6 Social, Environmental and Ethical
7 Sources: Eurosif and UKSIF research. Since SRI mostly applies to stock, we believe it makes sense to use share ownership as a comparing element.
The mainstream vision is supported qualitatively from a recent Europe-wide Thomson Extel & UKSIF SRI Survey of Asset Managers of the supply-side investors.

Managers were first asked what share of their business is devoted to SRI with the following results:

### Table 8: SRI as a Portion of Total Assets Managed

<table>
<thead>
<tr>
<th>What percentage of the total assets managed by your company is managed upon an SRI basis?</th>
<th>Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-2%</td>
<td>31.91%</td>
</tr>
<tr>
<td>2-5%</td>
<td>8.51%</td>
</tr>
<tr>
<td>5-10%</td>
<td>14.89%</td>
</tr>
<tr>
<td>over 10%</td>
<td>44.68%</td>
</tr>
</tbody>
</table>

Source: Thomson Extel UKSIF

On another issue, 92% of respondents expected their involvement on the SRI market to increase, and 71% expected the percentage of their total broker commission devoted to SRI to increase in the coming years. This is certainly a positive outlook on the future of the market. The importance of the UK market is clear in this study--the volumes of SRI AUMs suggested in these figures indicates that many respondents come from the UK market, where engagement practice is claimed by asset managers for about €285 billion in AUMs.

Another compelling finding of the survey came when asset managers were asked why companies address social and environmental issues. While 81% agreed with “to assist brand value and reputation,” there was a far greater consensus of “to increase appeal to investors” and even disapproval of “to reduce cost/liabilities.” Combined with the position generally brought forward by SRI investors, this suggests an asymmetry of vision between investors and corporations at the other end of the spectrum, with investors having overall greater expectations from CSR on their investments than corporations themselves.

### Trends

#### Pension Funds Driving SRI Market Growth

Although charities have played an important role in driving the institutional SRI market in the UK, growing evidence indicates that pension funds and similar retirement systems have taken a leading role in developing the European SRI market, whether engagement and simple exclusions are taken into account or not. And everything points to this influence increasing in the future.

As the pension fund market continues its growth in Continental Europe, trade unions are taking an increasingly active role in institutional SRI. In many countries, unions have an important say in how pension money is managed, and their interest in this area is continuing to develop.

Another relevant element is the fact that pension funds have a long-term view in the way they want their money managed. This fits the argument that SRI concerns along with sound corporate governance would enhance long-term company performance.

Finally, it is fairly well known that SRI has been led not by debt instruments, but through the equities markets. It is significant that the weight of equities in overall pension investment still differs greatly from country to country as reflected in Tables 9 and 10 on the following page. Nevertheless, pension systems across Europe are gradually moving away from debt and increasing their share of equity holdings. As this shift continues, SRI as a percentage will increase in pension fund holdings.

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9 Our figure encompasses solely the engagement that is specifically required by pension funds, thus giving some credit to the actual practice as well as to its SEE orientation.
The role of churches, charities and foundations, which can be described as institutions with agendas (as is the case for the union’s involvement in pensions), will remain fundamental, albeit with more meagre means than the public pensions. They do tend to be strong advocates of their specific causes and as such are essential in the visibility of the market to outsiders. They can also act as market leaders and thus play a pivotal role in developing SRI.

Cultural Attitudes to SRI Converging Over Time
As detailed in the country reports within this study, each nation has had a cultural starting point in SEE issues (see table below). While these tend to remain strong, market maturation, growing public awareness and, from the supply-side’s point of view, the development of mainstream SRI products are coming together to broaden the scope of national concerns. Corporate governance also is a key issue affecting all of Europe. Thus, SRI practitioners are increasingly tackling issues that transcend national frontiers. This results in some of the key issues helping to drive a more common perspective on SRI over time.

Table 11: SRI Cultural Development

Source: Eurosif analysis

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10 The figures for the UK in this table include institutional and individual pension money.
11 The figures for the UK in this table include institutional and individual pension money.
SRI Strategies Evolving, but not Always in the Same Direction

Positive screening will increase in some countries more than others. It already plays a significant role in markets such as France and Italy. Eurosif expects its growth to continue in continental Europe. It is appealing because its approach fits into the global financial culture and encourages “sustainable” competition between corporations aiming to be among the best-in-class and thus attract investment. Many rating agencies and sustainability indexes see their future in the development of this practice. Cynics however tend to believe that positive screening is inefficient since it is for now only applied in small amounts in comparison to the overall institutional market or even to the pension funds market (i.e. less than 1% of pension fund equity holdings in France, 0.3% in the UK, 0.17% in the Netherlands) and the original investment universe is restricted.

Critics of positive screening find more potential in engagement practices since they are not subject to these restrictions. At the current time, a key question on the engagement approach is whether it can be translated from its national base in the UK successfully into other European nations. Within Continental Europe, the Netherlands has been showing signs of using this approach successfully in some of its fund management, but the practice remains limited. Most likely, an engagement approach will be hindered in the near term by its lack of visibility and measurable results.

Finally, the debate around simple exclusions as a strategy exemplifies the debate on SRI. Many SRI practitioners discount it as “real” SRI and say that it is just the basic entry point. This may ignore the fact that simple screening is also arguably an effective entry point into the financial mainstream as it is easily defined and largely defendable. At a minimum, it is a simple tool for risk management for a broad range of institutional investors. It may also serve as a means for SRI and financial communities to create an improved understanding of each other’s perspectives.

Conclusions

Today, the potential for market development is enormous. At the moment, core SRI is only 2.1% of total European pension fund equity holdings.\(^2\)

The main element shaping the future of institutional SRI is how sustainability issues can successfully be integrated into long term financial management of public funds. The strength of debates on corporate governance, transparency and disclosure suggests that to a large extent, SEE might become a mainstream analysis factor for the financial markets. The development of engagement practices beyond the scope of SRI mandates on the UK market is certainly a positive sign. Additionally, anecdotal evidence such as the fact that an asset management provider surveyed in this study is now including SEE data in its international electronic financial analysis platforms also witnesses the power of this trend. Thus, recent events support that institutional SRI is growing in Europe.

How long it will take to fully bloom across the continent is a matter of years, taking into account the future growth of public awareness, the strength of the regulatory context, and the central issue of profitability.

\(^2\) Sources: European Pension Fund Managers Guide 2002 by Mercer Investment Consulting and our own research.

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14 SRI among European Institutional Investors - 2003 Report Eurosif
## Glossary of SRI Practices

This glossary aims to define, as precisely as possible, certain SRI terms that are used throughout this report and in the world of SRI. In general, these terms are used in a consistent manner across Europe, however individual country reports will be more specific about the terms used when necessary.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Best-in-class</strong></td>
<td>Approach where the leading companies from each individual sector or industry group with regard to Corporate Social Responsibility criteria are identified and included in a portfolio.</td>
</tr>
<tr>
<td><strong>Community investing</strong></td>
<td>Financing that generates resources and opportunities for economically disadvantaged people in urban and rural communities that are under-served by traditional financial institutions.</td>
</tr>
<tr>
<td><strong>Corporate governance</strong></td>
<td>A generic term that describes the ways in which rights and responsibilities are shared between the management and the shareholders.</td>
</tr>
<tr>
<td><strong>CSR</strong></td>
<td>Corporate Social Responsibility</td>
</tr>
<tr>
<td><strong>Demand-side investor</strong></td>
<td>An institutional investor who invests in the institutional market.</td>
</tr>
<tr>
<td><strong>Dialogue</strong></td>
<td>This is one form of engagement. It is a continuous exchange between company management and SRI investors about corporate, environmental and social performance and steps that could be taken to improve it. This can be done in a ‘passive’ form of exchanging information and filling out questionnaires, or in a more ‘active’ form when the investor encourages the company to change their practices.</td>
</tr>
<tr>
<td><strong>Divestments</strong></td>
<td>When companies are sold from a fund portfolio because they no longer meet the SRI criteria for that fund.</td>
</tr>
<tr>
<td><strong>Engagement</strong></td>
<td>An asset management policy that seeks to actively influence companies towards better social, environmental and ethical practices. This approach appears in two forms: dialogue (see definition) and shareholder activism (see definition).</td>
</tr>
<tr>
<td><strong>Ethical funds</strong></td>
<td>Funds based on moral and ethical criteria which often use negative screening.</td>
</tr>
<tr>
<td><strong>Exclusion</strong></td>
<td>See negative screening.</td>
</tr>
<tr>
<td><strong>Institutional investor</strong></td>
<td>Entity with large amounts to invest, such as investment companies, pooled funds, brokerages, insurance companies, pension funds, investment banks and endowment funds. Institutional investors are covered by fewer protective regulations because it is assumed that they are more knowledgeable and better able to protect themselves. They account for a majority of overall volume.</td>
</tr>
<tr>
<td><strong>Negative screening</strong></td>
<td>An approach that excludes sectors or companies from a fund if involved in certain activities based on specific criteria, such as arms manufacturing, publication of pornography, tobacco, animal testing, human rights, etc.</td>
</tr>
<tr>
<td><strong>Negative criteria</strong></td>
<td>Describes the characteristics of activities a company could be involved in which would be used in the negative screening process.</td>
</tr>
<tr>
<td><strong>Positive criteria</strong></td>
<td>Describes the characteristics of activities a company could be involved in which would be used in the positive screening process.</td>
</tr>
<tr>
<td><strong>Positive screening</strong></td>
<td>An approach that rules out companies involved in negative screening type activities, yet also requires companies to demonstrate an active positive contribution to sustainable development. The most commonly known SRI indices are based on a positive screening approach.</td>
</tr>
<tr>
<td><strong>SEE</strong></td>
<td>Social, Environmental and Ethical</td>
</tr>
<tr>
<td><strong>Shareholder activism</strong></td>
<td>This is one form of engagement. It is the exercise of shareholder powers through general “protest” voting at Annual General Meetings, or the support of SRI-related shareholder resolutions.</td>
</tr>
<tr>
<td><strong>Shareholder advocacy</strong></td>
<td>Generally speaking, promoting and defending the rights of shareholders with regards to corporate governance. These efforts include dialoguing and filing with companies on issues of SRI concern.</td>
</tr>
<tr>
<td><strong>Shareholder filing</strong></td>
<td>The practice for shareholders to file resolutions at Annual General Meetings in order to defend their views.</td>
</tr>
<tr>
<td><strong>Sharing funds</strong></td>
<td>Funds which give part of their profits to charity.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
</tr>
<tr>
<td>----------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Sin stock</td>
<td>Stocks encompassing investments in tobacco, alcohol, nuclear, military, gambling, pornography, etc.</td>
</tr>
<tr>
<td>Solidarity funds</td>
<td>Funds that distribute part of their dividends to finance social projects such as access to employment, micro-credit, job creation.</td>
</tr>
<tr>
<td>SRI</td>
<td>Socially Responsible Investment. Also used to mean Sustainable Responsible Investment in some cases.</td>
</tr>
<tr>
<td>Supply-side investors</td>
<td>An asset manager who provides a service and invests money on behalf of others.</td>
</tr>
<tr>
<td>Sustainable investment</td>
<td>Investments made in the spirit of long-term durability and do not compromise the ability of future generations to meet their needs.</td>
</tr>
<tr>
<td>Voting</td>
<td>This is a form of engagement. A policy of a fund to exercise its voting rights as investors to influence company policy.</td>
</tr>
</tbody>
</table>

Source: Eurosif analysis

Acknowledgements
Thomson Extel

References
Figures in the Europe section are based on information provided in each country report.
Arthur D. Little, January 2003, ‘Improving Communications between Investors and Companies on SRI’.
Deloitte & Touche, 2002 ‘Socially Responsible Investing Survey’.
HSBC, 2002, ‘Sustainability and Securities’.

www.oecd.org
www.eurosif.org
www.ecb.int
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.


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:


<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>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.</td>
</tr>
<tr>
<td>1997</td>
<td>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.</td>
</tr>
<tr>
<td>1998</td>
<td>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.</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>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.</td>
</tr>
<tr>
<td>2000</td>
<td>Friends Provident, through Friends, Ivy &amp; 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.</td>
</tr>
<tr>
<td>2001</td>
<td>The Myners Review of Institutional Investment in the UK is published, advocating shareholder activism across a range of issues.</td>
</tr>
<tr>
<td>2001</td>
<td>FTSE launches the FTSE4Good family of social indexes. This follows an earlier introduction of the Dow Jones Sustainability indexes.</td>
</tr>
<tr>
<td>2001</td>
<td>The Association of British Insurers (ABI) publishes new guidelines for companies asking them to report on material SEE risks relevant to their business activities.</td>
</tr>
<tr>
<td>2001</td>
<td>Launch of Eurosif, the European Sustainable and Responsible Investment Forum, supported by the European Commission and the national Social Investment Forums (SIFs).</td>
</tr>
<tr>
<td>2002</td>
<td>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.</td>
</tr>
<tr>
<td>2002</td>
<td>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.</td>
</tr>
<tr>
<td>2002</td>
<td>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.</td>
</tr>
</tbody>
</table>
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)

<table>
<thead>
<tr>
<th>% of total equity owned</th>
<th>£ billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Institutional Investors</td>
<td></td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>20.0%</td>
</tr>
<tr>
<td>Pension Funds</td>
<td>16.1%</td>
</tr>
<tr>
<td>Unit &amp; Investment Trusts</td>
<td>4.0%</td>
</tr>
<tr>
<td>Other Financial Companies</td>
<td>9.9%</td>
</tr>
<tr>
<td>Sub total</td>
<td>50.0%</td>
</tr>
<tr>
<td>UK Individual Investors</td>
<td>14.8%</td>
</tr>
<tr>
<td>Overseas Investors</td>
<td>31.9%</td>
</tr>
<tr>
<td>Other Investors</td>
<td>3.3%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
</tr>
</tbody>
</table>


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

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

*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.


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

<table>
<thead>
<tr>
<th>Fund Manager</th>
<th>Approx. UK Charity FUM (£million)</th>
<th>UKSIF Member/ Affiliate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. CCLA</td>
<td>4,600</td>
<td></td>
</tr>
<tr>
<td>2. Barclays Global Investors</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>= 3. Merrill Lynch</td>
<td>2,600</td>
<td></td>
</tr>
<tr>
<td>= 3. Cazenove</td>
<td>2,600</td>
<td></td>
</tr>
<tr>
<td>5. Schroders</td>
<td>2,300</td>
<td></td>
</tr>
<tr>
<td>6. Deutsche Asset Management</td>
<td>2,292</td>
<td></td>
</tr>
<tr>
<td>7. HSBC</td>
<td>2,130</td>
<td></td>
</tr>
<tr>
<td>8. JP Morgan Fleming</td>
<td>1,700</td>
<td></td>
</tr>
<tr>
<td>= 9. Gerrard</td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>= 9. Allianz Dresdher</td>
<td>1,500</td>
<td></td>
</tr>
</tbody>
</table>

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)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>SRI Unit Trusts</td>
<td>2.2</td>
<td>3.1</td>
<td>3.5</td>
</tr>
<tr>
<td>Churches</td>
<td>12.5</td>
<td>14.0</td>
<td>13.0</td>
</tr>
<tr>
<td>Charities</td>
<td>8.0</td>
<td>10.0</td>
<td>25.0</td>
</tr>
<tr>
<td>Pension Funds</td>
<td>0.0</td>
<td>25.0</td>
<td>80.0</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>0.0</td>
<td>0.0</td>
<td>103.0</td>
</tr>
<tr>
<td>Total</td>
<td>22.7</td>
<td>52.2</td>
<td>224.5</td>
</tr>
</tbody>
</table>


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

<table>
<thead>
<tr>
<th>Population</th>
<th>25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Respondents meeting for 1-1 meeting</td>
<td>10</td>
</tr>
<tr>
<td>Respondents replying by telephone or by email</td>
<td>6</td>
</tr>
<tr>
<td>Sent survey following enquiry, but not returned after follow up</td>
<td>6</td>
</tr>
<tr>
<td>Not contacted (could not find appropriate contact)</td>
<td>3</td>
</tr>
<tr>
<td>No response after initial contact</td>
<td>0</td>
</tr>
<tr>
<td>‘Positive’ coverage</td>
<td>64%</td>
</tr>
</tbody>
</table>

*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 (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

<table>
<thead>
<tr>
<th>SRI Activity</th>
<th>£ billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Equities Holdings subject to SRI approaches</td>
<td></td>
</tr>
<tr>
<td>Negative Screening Only</td>
<td>0.2</td>
</tr>
<tr>
<td>Positive and Negative Screening</td>
<td>1.4</td>
</tr>
<tr>
<td>Positive Screening Only</td>
<td>0.2</td>
</tr>
<tr>
<td>Engagement(^2)</td>
<td>84.2</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>SRI Activity</th>
<th>£ billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charity UK Equity Holdings subject to SRI approaches:</td>
<td></td>
</tr>
<tr>
<td>Negative Screening Only</td>
<td>15.9</td>
</tr>
<tr>
<td>Negative and Positive Screening</td>
<td>1.7</td>
</tr>
<tr>
<td>Positive Screening Only</td>
<td>0.0</td>
</tr>
<tr>
<td>Engagement (in addition to screening)</td>
<td>3.3</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>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?</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>2. Is the exercise of voting rights on SEE issues covered by this policy?</td>
<td>70</td>
<td>30</td>
</tr>
<tr>
<td>3. Is SRI covered by your institution’s Corporate Governance policy ONLY (i.e. no separate SRI policy)?</td>
<td>40</td>
<td>60</td>
</tr>
</tbody>
</table>
4. Is there an internal assessment / audit of your overall SRI processes?

5. Is SRI information externally published and reported to institutional investors?

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

<table>
<thead>
<tr>
<th>Engagement Area</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>Fund managers appear to conduct engagement across their portfolios, not biasing for specific sectors.</td>
</tr>
<tr>
<td>Dialogue</td>
<td>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.</td>
</tr>
<tr>
<td>Shareholder Voting</td>
<td>All fund managers interviewed vote on the vast majority of their shareholdings.</td>
</tr>
<tr>
<td>Resolution Sponsorship</td>
<td>A handful of asset managers sponsor resolutions, but there have only been few UK based ones in recent times.</td>
</tr>
<tr>
<td>Collaborative Initiatives</td>
<td>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).</td>
</tr>
</tbody>
</table>

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.

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 £1 million 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.

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.

Acknowledgements

The UK Social Investment Forum (UKSIF) would like to thank Muqu Karim, a Wharton MBA student, for working on this project on a voluntary basis over the summer and Cassie Higgs, Just Pensions Project Manager, for providing the contextual information in the report. We would also like to thank UKSIF members and affiliates who took part in the survey.

For further information about UKSIF, please see www.uksif.org.
Pension funds are the most important institutional investors in the Netherlands. Approximately 1% of pension fund investments (€3.1 billion) are SRI. Almost all Dutch pension funds use negative screening in their SRI investment policy, mostly for risk prevention purposes. Therefore this has not been counted here, otherwise it would dramatically alter the figures.

Trade unions are important stimulators and motivators for SRI when dealing with pension funds.

Trade associations and non-government bodies provide SRI initiatives, codes and guidelines while there is little government legislation.

SRI by other institutional parties (insurance companies, charities, etc.) is still in its early stages in the Netherlands and so figures are not yet available. Nevertheless, most institutional investors have an SRI policy under development.
I. SRI in the Netherlands

SRI Priorities

In the Netherlands, important SRI issues vary from human rights concerns to environmental interests to animal welfare and to the weapons industry. Every investment fund or institutional investor makes his or her own choices about what issues are most important, depending on the definition of SRI being used. However these all have a common thread, which is to include the “three P’s”: People, Planet and Profits. This illustrates the idea of combining social, ethical and environmental concerns with a financial objective.

Among institutional investors, negative screening is common practice. Best-in-class is only practised by some ‘front-runners’. Engagement activities are at a beginning stage, as only one pension fund uses this strategy.

Driving forces in the Dutch institutional SRI market are the large pension funds ABP (Algemeen Bedrijfs Pensioenfonds / General Pension Fund for Public Employees) and PGGM (Pensioenfonds sector zorg en welzijn / Pension Funds for the Health Care and Social Work Sector), as well as the trade unions FNV (Federatie Nederlandse Vakbeweging / Dutch Trade Union Confederation) and CNV (Christelijk Nationaal Vakverbond / Christian National Trade Union Confederation). Besides these parties, other leading advocates in the Dutch SRI world are rating agencies (i.e. DSR, SNS Asset Management), government agencies (i.e. Departments of Environmental Affairs, Department of Economic Affairs), research institutes (i.e. Nyenrode University, Groningen University), consultancy firms (i.e. DHV, CREM), accountants (i.e. KPMG, VBA) and NGOs.

History

In the Netherlands, the retail market, rather than the institutional market, has been the driver of the SRI market. In the early stages, savings plans were much more popular than investment schemes. In 1960, the ASN Bank was founded, followed by the Triodos Bank in 1980. Both brought savings products to the Dutch market. They are still market leaders in the ethical savings sector.

The first SRI fund in the Netherlands was developed in 1991 (ABF - Het Andere Beleggingsfonds / The Other Investment Fund). SRI has been growing rapidly ever since. Today there are seventeen SRI funds in the Netherlands. In 1995 the Dutch Tax Office introduced the “Green Savings and Investment Plan”. This created very strictly “green” investment categories, such as wind energy, solar energy, and organic farming attractive to private investors. According to the so-called Green Project Directive, since 1996 these savings and investments have grown to account for 50% of all SRI. (a total of eleven of these funds as of the end of 2002).

As the interest in SRI began to grow, the importance of shareholder engagement also increased. SRI funds and private investors did not only want to invest well, they also wanted to ask questions and raise their voices as shareholders. In 1995, institutional and private socially responsible investors organized themselves as VBDO (Vereniging van Beleggers voor Duurzame Ontwikkeling / Dutch Association of Investors for Sustainable Development).

On behalf of its members, VBDO started by raising questions about corporate responsibility at the annual shareholder meeting for Royal Dutch/Shell. In the years following, VBDO visited numerous companies to enquire about their SRI policies. This led to an increase in the number and quality of corporate sustainable reports. In 1998, VBDO also started the National SRI Forum. In addition to sustainable reporting, it deals with issues such as market development, engagement strategies, and codes of conduct for SRI funds.

Today, SRI funds continue to be successful, social awareness is on the rise, and socially...
responsible companies are projecting ever-better long-term performance. As a result, pension funds have started showing a growing interest in SRI and are starting experimental portfolios and shareholder engagement plans.

This can clearly be seen when examining the activities of ABP and PGGM:

ABP and PGGM are the largest Dutch pension funds and among the top five in continental Europe. They drafted SRI policies in 2000 and 2001, as a result of the urgent request of Dutch trade unions, FNV and CNV, in 1999 and 2000.

The association of Dutch insurance companies drew up a code of conduct addressing SRI issues in 2002.

Market Rules And Legislation

With the growing interest in socially responsible savings and investment in the Netherlands, there has been a demand for ethical banks as well as standard financial institutions to offer socially responsible savings and investment products. Some of these have set up dedicated subsidiaries for this purpose. A variety of financial products for this branch have sprung up.

In order to ensure transparency and legitimacy, various sets of rules and regulations have been created to legislate the retail market financial products. For example, for certain “green” funds they must invest or lend at least 70% of their money to projects approved by the Dutch government. The deposit of these monies is “fiscally facilitated”, which means that it is tax deductible. At the end of 2002, half of all socially responsible savings investments were operating based on such directives.

There are no such rules governing the institutional market. Instead of legislation, the practitioners in the institutional market create their own policies and codes of conduct.

(1) The ABP and PGGM Investment Codes

The ABP drew up its Code for Prudent Investment Policy in 1997 and revised it in 2000. The ABP is one of the world’s largest pension funds. At the end of 2002 it was managing assets of about €136 billion.

The ABP code makes a distinction between three aspects of prudent investment:

1. Mapping out the investment process in terms of statutes, regulations, and investment plans;
2. Corporate social responsibility, in which the aim is to gain the greatest possible yield for participants in the pension funds (within limits of risk which the ABP board finds acceptable);
3. The role of shareholders and demands concerning corporate governance — demands for transparency, independent supervision, accountability, and shareholder rights within the companies where investments are made. As a shareholder, the ABP places emphasis on the business’s long-term goals as they relate to sustainable economic growth.

Recently, the ABP added an article to its investment code, which states that the ABP will promote the integration of criteria of a social, ethical, and environmental nature in its investment process. This is because there are signals that better yields can be gained when greater importance is attached to these factors. To test this out, two investment portfolios (American and European) were created, both of which invest according to the best-in-class method — enterprises performing best within their sector according to social, ethical, and environmental aspects.

PGGM provides pensions for employees at 15,000 organisations in the Netherlands and manages assets of about €45 billion. PGGM’s social responsibility is laid out in its Corporate Governance Policy. The aim for maximum yield at an acceptable risk is essential, taking into account a number of general criteria where necessary. PGGM avoids investments in countries where fundamental human rights are being violated. This is also the case for companies whose main

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1 Source: IPE “Responsible Investing” supplement, February 2003
activities involve the production of weapons. Beyond that, its preference goes to countries and companies offering social added value and who follow United Nations guidelines. See the Case Study about PGGM at the end of this report for more information.

(2) SCGOP

SCGOP (Stichting Corporate Governance Onderzoek Pensioenfondsen / The Foundation for Corporate Governance Research for Pension Funds) wishes to support participant pension funds in formulating and carrying out corporate governance policy. The foundation was set up in 1998 by a number of large-scale pension funds. In its own words, “The Foundation understands corporate governance to mean a set of approaches for companies and their immediate stakeholders — specifically boards of directors, commissioners, and providers of capital. The Foundation wishes to make a contribution in such a way that these approaches are developed in the Netherlands. This should then give rise to a number of rules for good management and supervision and rules dictating the division of tasks, responsibilities, and authorisation that brings about a well-balanced influence by those involved in the company and greater enterprise. To this end, the premise applies that boards of directors and commissioners must be prepared to express their accountability to the shareholders.”

(3) FNV & CNV’s Investment Policies

Both Dutch trade unions CNV and FNV are directly involved in the coordination of their 83 industrial sector pension funds, of which the ABP and PGGM are the largest. Furthermore, trade union officers from the CNV and FNV are represented in many business pension funds on behalf of the employees. In 1999, the CNV drew up an investment code for pension funds, consisting of three sections.

In Section A, criteria are formulated based on the principle that investments can be excluded in the event of negative criteria, such as human rights violations or failure to meet International Labour Organisation standards.

Section B includes minimal criteria that companies must live up to, such as safe and healthy working conditions or an active environmental policy.

Section C contains guidelines through which pension funds can play an active role in working to create a sustainable society. These include accountability of pension funds concerning their investment policy, the ability to challenge an organisation concerning its social responsibility and the investment of a limited portion (1%) of the portfolio in activities that take an innovative approach to contribute to a just and sustainable society.

Following PGGM and ABP’s lead, in mid-July 2000 the FNV called upon the pension funds to draw up an investment code. The FNV memorandum Goed Belegd (‘Well Invested’) states that, in 2004, all pension funds must have an investment code and, in 2007-2008, more than 50% of the capital in the pension world should be invested in a sustainable manner.

The FNV’s policy concerning the socially responsible investment of pension funds distinguishes between three approaches of sustainable investment, which are in line with the CNV system:

1. **Minimum (negative) approach** — The exclusion of specific countries or companies, regardless of their yield, such as countries where human or union rights are violated and enterprises with a particularly poor social or environmental policy.

2. **Positive (best-in-class) approach** — Investments in enterprises that score well in terms of social or environmental policy, and where a link is created to designated yield requirements (working towards a win-win situation).

3. **Dialogue approach** — A dialogue between the pension funds, the companies they are investing in, and social interest groups at home and abroad concerning human and union rights, and current and future environmental policy.
II. Financial Market Context

The Dutch investment market can be divided into three main sectors: pension funds, insurance companies and investment companies.

### Table 1: Dutch Investment Market (in €Billion per End of Year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension funds *</td>
<td>428</td>
<td>435</td>
<td>445</td>
<td>436</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>297</td>
<td>266</td>
<td>264</td>
<td>244</td>
</tr>
<tr>
<td>Investment companies **</td>
<td>93</td>
<td>114</td>
<td>123</td>
<td>104</td>
</tr>
</tbody>
</table>

Source: VBDO analysis
* the two largest pension funds: ABP & PGGM; together make up 42% of total pension funds assets
** including retail funds, private asset management, charities, etc.

### Pension Funds

Pension funds are the most important, large-scale institutional investors. At the end of 2002, the sector controlled about €428 billion, 40% of which is invested in stocks and shares.

There are eighty-three industrial sector pension funds, including the ABP and the PGGM, which represent more than three quarters of all employees and retired people. There are about 850 other business pension funds that represent the interests of about 12% of employees and pension beneficiaries. Finally, about 10% of all employees and retired people have arranged individual contracts with insurance companies.

### Charities

These organisations collect money so that they may give it to a specific worthy cause related to the organisation’s purpose. In many cases, charities control quite large assets, which they invest in stocks and bonds.

The Central Bureau for Fund Raising (CBF) is an independent foundation that has been monitoring the collection of money for worthy causes since 1925. According to the CBF’s annual publication, the assets of 155 charitable causes bearing the CBF seal of approval amounted to €1.44 billion at the end of 2001. Assets for the ten richest charitable causes, which make up 62% of the total charity assets, can be seen in the table below. It is not known how these charities invest their assets in a sustainable manner. In the future, VBDO will do further research into the subject and report its findings.

### Table 2: Total Assets of the Ten Richest Charities in the Netherlands at the End of 2001 (in €Million)

<table>
<thead>
<tr>
<th>Charity</th>
<th>Volume total assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vereniging tot Behoud van Natuurmonumenten in Nederland</td>
<td>198.4</td>
</tr>
<tr>
<td>Stichting Leger des Heils Fondsenwerving</td>
<td>145.8</td>
</tr>
<tr>
<td>Koninklijke Nederlandse Redding Maatschappij (KNRM)</td>
<td>119.4</td>
</tr>
<tr>
<td>Vereniging het Nederlandse Rode Kruis</td>
<td>107.1</td>
</tr>
<tr>
<td>Stichting Prins Bernhard Cultuur Fonds</td>
<td>106.6</td>
</tr>
<tr>
<td>Nederlandse Vereniging tot Bescherming van Dieren</td>
<td>61.1</td>
</tr>
<tr>
<td>Stichting Nederlandse Kankerbestrijding-KWF</td>
<td>58.2</td>
</tr>
<tr>
<td>Vereniging Bartiméus</td>
<td>54.4</td>
</tr>
<tr>
<td>Stichting Vrienden van het Sophia</td>
<td>25.4</td>
</tr>
<tr>
<td>Nederlandse Stichting voor het Gehandicapte Kind (NSGK)</td>
<td>24.9</td>
</tr>
<tr>
<td>TOTAL</td>
<td>901.3</td>
</tr>
</tbody>
</table>

Source: VBDO
III. Methodology

This report was compiled using VBDO’s own research, as well as a number of other studies that have been done around SRI in the Netherlands. Our scope covered mainly pension funds, insurance companies and charities. We were able to gather a large amount of qualitative and quantitative information on the pension fund sector with a 79.1% response rate. For the insurance and charity sectors we have expressed our first impressions about SRI in these areas since the current information is not extensive.

Information about the institutional SRI market was gathered by contacting the fund managers of pension funds. Some large fund managers (i.e. F&C Netherlands, AZL) manage the assets of several pension funds at the same time (this can vary from 20 to 40 funds). Therefore, they could provide information about the investment policy of all these small pension funds and it was not necessary to contact each one of them individually.

For obtaining background information, recent research studies have been used and several websites on insurance companies, charities, pension funds, etc. have been consulted.

During the research process it became clear that almost all pension funds use negative criteria in their selection process. For example, the doctors pension fund excludes tobacco firms from their portfolio. Since this method of SRI has become more or less common practice among institutional investors, mostly for risk prevention purposes, it has not been counted as being SRI. Otherwise, Dutch pension funds would score an unrealistically high percentage of almost 100% for SRI funds.

One of our main sources of information was Nyenrode University and the Association of Investment Analysts (VBA). In April 2003, they published the results of a study about sustainable investment by pension funds in the Netherlands entitled “Tussen meerwaarde en moraal” (Between Added Value and Morality). The study included a questionnaire that was sent out to 300 pension funds to learn how they deal with the issue of sustainable investment. Is sustainable investment a pension fund’s task and responsibility and, if so, how should this be given substance?

Forty-four pension funds responded (representing 68% of the total invested pension assets in the Netherlands). The large-scale and industrial sector pension funds are relatively over-represented among the respondents.

VI. Findings & Interpretations

Current Trends in the Netherlands

- Institutional SRI market is approximately 1% in the Netherlands with a total of €3.1 billion (pension funds only).
- Negative screening has become more mainstream (among pension funds) and therefore less important for SRI practices.
- Pension funds have a growing interest in SRI, and this interest is increasingly being translated into policy.
• In their policies, pension funds are paying attention chiefly to moral and judicial issues (such as human rights, corruption, and living up to legislation) while environment, transparency, and corporate governance have little or no importance.

• Engagement activities are still in their infancy in the Netherlands.

• Insurance companies and charities are in the process of developing SRI policies; but these have not yet been put into practice.

• It is important to have sufficient access to sustainability information from businesses in order to assess risk.

• According to pension fund responses to the Nyenrode University and VBA study, legislation is neither necessary nor desirable to stimulate sustainable investment.

In the Netherlands, sustainable investment by pension funds accounts for about half (€3.1 billion) of the amount saved and invested in sustainability on the retail market.

The Amount of Sustainable Investment by Pension Funds

Pension funds form the single largest group of institutional investors in the Netherlands (€428 billion). The results of this study reflect 81.8% (€350 billion) of all pension funds.

At this time, interest in sustainable investment is growing slowly among pension funds. A large number have started accounting for their investment policy. Furthermore, a large number of funds (including the two largest, ABP and PGGM) have announced that they will invest in an increasingly sustainable manner over time.

Sustainable investment by pension funds takes place at a variety of levels. The first step consists in ‘negative screening’. Most pension funds choose to exclude a limited number of companies that are either conducting harmful activities or are present in countries carrying out such activities. VBDO research has shown that almost all pension funds apply negative criteria, whether implicitly or explicitly. This is now considered a ‘normal’ form of risk management. After all, the pension fund cannot afford to invest in a company our country that might bring them into discredit, nor can they explain such an investment to their customers.

VBDO has chosen not to accept the use of solely negative criteria by the pension funds to define sustainable investments.

The next step for pension funds usually involves the best-in-class approach. Thereafter the pension funds can choose to enter into dialogue with companies (referred to as engagement) and, in doing so, stimulate them to invest in a sustainable manner. Both of these last methods qualify as sustainable investment.

See Table 3 below.

The degree of engagement has dropped slightly from 2001 to 2002 as a result of the decreasing value of portfolios. The best-in-class method has remained about the same (€611 million compared to €607 million). About 1% of the pension funds’ assets included in the study are invested in a sustainable manner by using one of these two methods.

Table 3: Methods and Volume of Socially Responsible Investments by Dutch Pension Funds (In € Billion)

<table>
<thead>
<tr>
<th>Method</th>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engagement</td>
<td>2.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Best-in-class</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>TOTAL</td>
<td>3.1</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Source: VBDO analysis
Insurance Companies

At the end of 2002, assets invested by insurance companies came to €297 billion. Little is known at this time about SRI investments for this group.

There are a number of sustainable insurance products available on the Dutch market. These are associated with capital and life insurance, both of which serve to supplement pensions or to be combined with mortgages. The premium can be invested in one or more sustainable investment funds, depending on the provider.

A Code of Conduct was presented at the general members’ meeting of the Dutch Association of Insurers in June 2002. The next implementation phase will involve the formal acceptance by all association members. Over time, the endorsement of the code will, in fact, become a condition for membership in the association. The code’s purpose is to create a framework in which insurers give substance to their aim to have their company function according to corporate sustainability.

The Code of Conduct is based on four chapters:

- Chapter 1 explains the reasons for corporate social responsibility. It explains that there is more to business than just profit.
- Chapter 2 discusses the involvement of the stakeholders in the development, recommendation, sales, and management of insurance products. These include current and potential insurance consumers, victims, NGOs, governmental authorities, capital providers, employees, and fellow insurance companies.
- Chapter 3 is the core of the Code of Conduct, where the basic values and rules of behaviour are summed up. The five basic values are reliability, professionalism, solidarity, social responsibility, and transparency. Every value is furnished with substance in the form of rules of behaviour. Where sustainable investment is concerned, two rules of behaviour apply to the insurers:
  - Rule of Behaviour M.g (Social Responsibility) “In our role as institutional investor, we will invest the money we receive soundly and with an eye on yield, always including our sense of social responsibility.”
  - Rule of Behaviour T.d (Transparency) “We are striving to create investment criteria that are transparent for insurance consumers, shareholders, members, and the general public.”
- Chapter 4 focuses on living up to the code, monitoring, and a complaints procedure.

By endorsing the code, insurers take it upon themselves to give real substance to the business policy. At the start of 2004, insurers will provide a public report twice a year (at the very minimum) on the activities they have developed within the framework of the code of conduct.

VBDO applauds the creation of this code of conduct. It can serve as a starting point to make insurance companies more sustainable and transparent. Of course, we have yet to see how the code will work in actual practice. Furthermore, a number of rules of behaviour — for instance, those concerning socially responsible investment — must be made more concrete before any conclusions can be drawn concerning the insurers’ investment policies.

Charitable Organisations

As far as the ethical aspects of their investment policies are concerned, charities rarely render an account of their actions while, in fact, their investment strategy could well be in direct conflict with the organisation’s aims. Theoretically, an organisation raising funds to protect the environment could invest in a company that causes negative environmental impact. In other words, insight into the investment policy of charitable organisations is very desirable.

The Association of Fund Raising Organisations (VFI) supports the collective interests of its members. It represents more than 80% of the charity sector measured based on income from their own fund raising activities. In their code of conduct, the VFI indicates the standards and values its members must live up to in their activities. In the code of conduct, responsibility to the donors, volunteers, fellow
organisations, and the society as a whole are of chief importance.

Charitable causes associated with the VFI are required to render as complete an account as possible concerning their asset and investment policy and, according to the VFI, this does in fact take place. Nevertheless, in the spring of 2002, the VFI set up an independent Advisory Commission for Asset Standardization in Charitable Causes under the leadership of Mr. Cor Herkströter. The committee has provided recommendations about criteria and standards that can serve to set asset policies for charitable causes.

The Herkströter Commission made its recommendations known in June 2003. Concerning the investment of reserves, the commission concludes that, "Accumulated reserves may be invested, though depreciation must be avoided. In other words, risk-bearing investments should be avoided." Specific recommendations concerning sustainable or socially responsible investment of reserves were not addressed.

In response to the Herkströter Commission's recommendation, the VFI will draw up guidelines concerning its members' capital policy in the autumn of 2003.

V. Future Trends

We believe SRI will become mainstream in the Netherlands, similarly to how negative screening has become inherent to pension funds. All investors will have to incorporate non-financial criteria in their selection process, if only for risk management purposes. Sustainable companies will 'live' longer and will also perform well financially in the long term. Therefore, these companies are more profitable and safer investments.

In the next five to ten years, gradually more investors will start to implement SRI policies. Engagement will be of growing importance in their SRI investment process, which will also be fed by public attention to corporate governance issues (shareholder engagement). Based on our research, we believe that negative screening in general will gradually lose its importance for SRI as it will become common practice among most institutional investors. The next question would be whether a certain level of negative screening could be regarded as SRI.

Upcoming Research

This year, the Dutch research concentrated on SRI by pension funds. In the coming years, more attention will be given to other institutional investors, such as insurance companies and charities. VBDO will try to collect quantitative data on the SRI policies and practices by both institutional and retail investors, to determine the actual size of the Dutch SRI market. Research will also be carried out on a variety of subjects such as: insight into which SRI methods are used and why, new developments in SRI methods (i.e. practices of engagement), ways to stimulate groups of institutional investors to incorporate SRI in their investment process, etc.

Acknowledgements

This research has been carried out by the VBDO, the Dutch Association of Investors for Sustainable Development (Vereniging van Beleggers voor Duurzame Ontwikkeling). The research has been sponsored by the Triodos Bank, which is one of the members of the VBDO.

References

Germany
Austria
Switzerland

The total size of the institutional SRI market is over €3 billion in Germany and in Switzerland. It is likely below €1 billion in Austria.

The institutional SRI investment market is more developed in Switzerland than in Germany or Austria.

In all three countries (Germany, Austria, and Switzerland) the most important institutional SRI investors are pension funds.

The institutional SRI market relies mainly on screening and, to a lesser extent, on engagement.
I. SRI in Germany, Austria and Switzerland

Historical Background

Germany

SRI initiatives in Germany evolved in the 1970s from the ecological and peace movements. Alternative forms of economy and trade were discussed and tested. The concrete outcome of these movements was the foundation of the alternative bank GLS Gemeinschaftsbank (1974). Starting in 1989, the BfG ÖkoRent (now SEB ÖkoRent) was offered to the public as the first investment fund with SRI criteria. From 1991 onwards, the Renewable Energy Act facilitated the installation of wind power stations. Tax advantages endorsed the application of closed funds as a financing instrument and led to a broad perception of renewable energy as an investment sector.

In the late 1990s, SRI in general experienced a considerable increase in prosperity. The shares of green companies, life insurance with SRI criteria and, above all, green investment funds became more and more popular. At the moment, more than sixty SRI institutional funds are on offer for private investors in Germany.

Austria

Sustainable investment is a relatively new issue in Austria. Until the 1980s, very little action took place. A highlight in early sustainable finance activity is the Kommunalkredit Austria agency that provides subsidy credits to public entities in order to achieve substantial improvement on environmental matters. Loans are paid through the placement of environmental bonds among private and institutional investors. The first Austrian private sustainable investments in the 1980s were hydroelectric power plants, which were built with financial support from investors involved in the operating company. At the same time, biomass based local heat supplies emerged, funded through citizen participation schemes. Since the 1990s investment in green shares is promoted by a special Austrian publication.

Since the mid-1990s, life insurance products with sustainable components have been available in Austria. Today, assets can be invested in green investment funds, shares, bonds, projects and saving deposits. The number of SRI investment funds available to Austrian private investors has increased to thirty-two, of which eleven are of Austrian origin.

Switzerland

Swiss banks were among the first financial institutions to include the issue of sustainability in their business policy. Initially this consisted of environmental credit risk assessment. Another incentive for sustainable finance activities emerged from traditionally strong citizen involvement in Switzerland, which led to the foundation of two alternative banks. In 1990, Credit Suisse started its Eco Efficiency fund (now Global Sustainability Fund), followed by Bank Sarasin’s OekoSar in 1994 and UBS’s Eco Performance in 1997. In addition to these environment-focused funds, an ethical fund, the Prime Value, has been available since 1995. The development in the field of sustainable investment funds was accompanied by the formation of a number of research agencies dedicated to ecological and ethical matters, of which Centre Info (1990) was the first. In 1997, the Ethos foundation started offering its investment services to pension trusts. A big step towards a broader perception of sustainable investing was made with the creation of the Dow Jones Sustainability Index in 1998. SAM Sustainability Group and Dow Jones Indexes formed the index in order to focus investments on those companies whose sustainability performance beats most competitors within the respective sector. In Switzerland, about thirty investment funds with SRI background are available. Twenty of these are Swiss funds; most of them invest in shares of big companies with exceptional environmental or social performance.
SRI Policies and Definitions

Traditionally, SRI has a strong linkage to environmental issues.

There is no generally agreed term for the concept of SRI in the German speaking countries. Rather there are more than five different terms, which are used to describe the concept of SRI. The specific meaning of these terms varies according to the user. Traditionally, SRI has a strong linkage to environmental issues. This holds true particularly for Germany, but also for Switzerland and Austria. A clear indication for that fact is the common use of “Grünes Geld” (green money) as one term to express the concept of SRI or the use of Öko-Fonds (ecological funds) as equivalent for SRI funds.

Over recent years however the dominance of environmental issues has decreased. The wide acceptance of the sustainability concept in German speaking countries has led to a broadening of SRI concepts. Socially responsible investment in Germany, Austria and Switzerland now integrates a diversity of criteria: ethical, ecological, eco-efficient, cultural and environment-technological.

While the concept of SRI in the German speaking countries has moved closer to the concept in other continental European countries and Anglo-Saxon countries, there is still a divide. CSR or community investments are not yet as influential in shaping the SRI market as they are elsewhere.

Market Structure

While the SRI market in Germany was originally governed by smaller specialised financial service providers, there are several large, and more mainstream financial service providers now active in the market as well. The same holds true for Switzerland and Austria.

Specialised research services evaluate companies’ environmental and social performance. These are Fifega in Austria, imug, oekom research, and scoris (sirigroup) in Germany, and Centre Info, Ecos, Inrate, and SAM in Switzerland.

Available Products

In Germany, there are special funds (Spezialfonds), which are established exclusively for institutional investors. Spezialfonds are investment funds pursuant to the Investment Company Act. Mutual (public) funds and segregated accounts are also a possibility for the institutional investors to invest in. Several Spezialfonds exist for SRI institutional investors. Also, there are some public mutual funds targeting mainly institutional investors.

Laws and Legislation

Germany

From January 2002 on, certified private pension schemes and some occupational pension schemes “must inform the members in writing, whether and in what form ethical, social, or ecological aspects are taken into consideration when investing the paid-in contributions” (§1 Article 1 (9) AltZertG). This disclosure regulation has been based upon the British example. It applies however only to a small segment of the pension fund market. Within this segment it has had a distinctive impact. The rest of the pension funds market has seen some new SRI initiatives inspired by the new regulation, but no major shift.

In February 2002 the official “German Corporate Governance Code” was published. Companies have to confirm their compliance with the code at least annually, or explain deviations. The code summarises key statutory requirements on the governance of listed companies. It also provides recommendations taking account of nationally and internationally recognised standards. It contains “should suggestions”, which give individual companies ideas for good and responsible corporate governance.

1 Reister products.
**Austria**

As in Germany, a major pension reform has taken place over the last few years. The introduction of a disclosure regulation has been an issue in the discussion towards that reform as well. However, the idea was not integrated into the new system. Still, most of the new pension funds, which have been set up as a consequence of the new law, will apply SRI criteria.

**Switzerland**

Swiss discussions on the pension system have also been affected by the introduction of disclosure regulations in other countries. However, the proposal to integrate such an obligation into the legislation for pension funds did not receive majority. As a compromise, the Swiss legislation foresees only a reporting obligation on the use of voting rights - an obligation, which is not restricted to SRI issues.

### II. Financial Market Context

Legislation applying to other kinds of institutional investors and obliging them to use SRI disclosure does not exist in Germany, Austria or Switzerland.

An institutional investor is an entity with large amounts to invest such as pension funds, relief funds, churches and religious institutions, foundations, endowment funds, charities, investment banks, and insurance companies, although there is no established definition in German speaking countries. The most important SRI institutional investors are pension funds, thereafter churches and religious organisations, and finally foundations and NGOs. Also, SRI investment by insurers has some significance.

#### Example: Pension Funds

In Germany, there are about 154 pension funds with €72.3 billion AUM.²

In Austria, there are twelve company pension funds and seven interplant pension funds with €8.3 billion AUM.³

In Switzerland there are around 3600 pension funds. Eighty-three of them are organised in a holding company, called Ethos. These asset foundations manage approximately 900 million Swiss francs, taking into account ethical, environmental and social aspects.⁴

The other important players on the financial market are the fund managers. The biggest ones are in (IPE Ranking 2002):

**Germany**

Allianz Dresdner Asset Management (€1 048 billion), Deutsche Asset Management (€726 billion), Deka (€122 billion).

**Austria**

Erste-Sparinvest (€16.2 billion), Capital Invest (€15 billion), UNIQA Finanzservice (€14 billion) and Raiffeisen (€13.8 billion).

**Switzerland**

UBS Global Asset Management (€384 billion), Credit Suisse Asset Management (€269 billion), Swiss Re (€105 billion).

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² Yearbook BaFin 2002.
⁴ www.ethisches-investment.de
The table below shows the ten leading asset managers in Germany as of June 30 2003.

**Table 1: AUM of institutional funds of the top ten Fund Managers in Germany**

<table>
<thead>
<tr>
<th>Fund Manager</th>
<th>AUM (€Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>dbi</td>
<td>66</td>
</tr>
<tr>
<td>DEKA</td>
<td>45</td>
</tr>
<tr>
<td>Deka AM</td>
<td>41</td>
</tr>
<tr>
<td>Activest Investmentgesellschaft Universal Investment</td>
<td>32</td>
</tr>
<tr>
<td>Union Investment Institutional</td>
<td>30</td>
</tr>
<tr>
<td>MEAG AG</td>
<td>28</td>
</tr>
<tr>
<td>COMZ EV</td>
<td>27</td>
</tr>
<tr>
<td>West AM</td>
<td>22</td>
</tr>
<tr>
<td>K/LAM</td>
<td>20</td>
</tr>
<tr>
<td>DAV-KAG</td>
<td>14</td>
</tr>
</tbody>
</table>

*Source: BVI, Bundesverband Investment und Asset Management e.V., June 30 2003*

**SRI Market Context**

In German speaking countries the market for socially responsible investment is growing steadily. There are some strong movements visible among the institutional investors, such as pension funds, foundations and churches.

In Germany, Austria and Switzerland there are about eighty mutual funds which take into account ethical, social, ecological and sustainable (SRI) criteria. In addition to pension funds and mixed funds (Mischfonds) there are equity funds with different SRI specific strategic positioning on the market.

See also www.nachhaltiges-investment.org

A study conducted on behalf of the “Gruenes Geld” (Green Money, 2001) show calculated that in 2000, approximately €1.06 billion (€ 319 million in 1999) were invested in SRI funds by investors in Germany, Austria and Switzerland. In the same year, green companies could acquire €332 million (€146 million in 1999) by issuing shares. The total volume of SRI funds offered in Germany, Austria and Switzerland was €2.92 billion in 2000, which represents a 0.4% share of total investment fund volume.

Furthermore, investors may contract life insurance contracts with SRI criteria (eight insurance companies have relevant offers) or participate in projects as entrepreneurs, in the renewable energy sector for example. The total volume of wind power projects surpasses €1.2 billion.

In Austria, twenty-two asset managers managed 1,837 investment funds with total AUMs of €102.7 billion as of 2002. The total AUM grew by €3.98 billion (4.03%). By the end of 2002 €70 billion were invested in mutual (public) funds and €32.71 billion in Spezialfonds. €217 million had been invested in ethical-environmental funds by the end of 2002.

In Germany, the total number of mutual (public) funds and Spezialfonds did not change dramatically compared to 2002. In 2002 2,419 funds existed with AUMs of €382.1 billion. As of June 30 2003 the total number grew to 2,452 with AUMs of €416.8 billion. The total number of institutional funds (Spezialfonds) in Germany as of June 30 2003 stood at 5,219 (5,347 in 2002) with AUMs at €505.3 billion (€480.3 billion in 2002) whereby 4,798 with AUMs of €474.2 billion are controlled by German institutions.²

### III. Methodology

Data for the German speaking institutional SRI market was collected using the Eurosif questionnaire. To gather relevant information the supply-side investors, or asset managers, were contacted. In

² Source BVI Bundesverband Investment und Asset Management e.V.
Germany, almost all asset management companies are members of the Federal Association Investment and Asset Management (BVI, Bundesverband Investment und Asset Management e.V.). Making a small pre-selection, excluding the real estate asset managers, and adding relevant members of the German Sustainable Investment Forum, sixty-three asset managers were contacted by phone and email. Seven of them gave indications on their SRI investment. Thirteen do not manage institutional portfolios or do not invest in SRI. Together the twenty respondents constitute a feedback rate of about 30%. In terms of SRI investment they certainly represent more than the market size. Firstly, because asset managers investing in SRI are more likely to answer the questionnaire than the others. Secondly, several of the respondents represent the large players in the market and are well known for their SRI involvement.

In Austria and Switzerland, sixteen asset managers each were contacted by phone and email. In Austria, five asset managers answered (two of which have SRI holdings for institutional investors), in Switzerland four responded (all of which have SRI institutional investments).

IV. Findings & Interpretation

Research

- Germany: the smaller asset management companies tend to use external research agencies to evaluate the products and companies; those working for big companies do have in-house research but use rating agencies as well.
- Austria: mainly use external research and rating agencies.
- Switzerland: most of the asset managers have in-house research teams.

Criteria

- Germany: mainly negative and positive criteria are used. Negative screening was introduced at the end of the 1990s and one to two years later positive screening was being applied. Engagement is a very new kind of involvement (2001-2002).
- Austria: mainly negative and positive criteria are used.
- Switzerland: screening (positive/negative) is used as much as engagement. The degree of exclusion that can constitute negative screening varies across fund managers. The most usual is: 5% share of turnover or 5% of the return. All of the known positive screen criteria are being used by the fund managers, applied by a best-in-class approach. The most common forms of supply side engagement activity that fund managers undertake are dialogue, shareholder voting for some of the products and collaborative initiatives mainly in the area of drugs. Engagement was introduced over time from 1997 to 1999, and positive and negative screening a few years earlier.

Scope of SRI Criteria

SRI criteria are used for stock, corporate bonds and public debt.

Reasons for Involvement

The reasons for involvement are mostly customer demand-driven. Some of the asset managers are trying to distinguish themselves by specialising in sustainability (SRI) products. Another reason is the fact that sustainability criteria can influence the financial development and risk of a company and respectively the company’s stock.
Size of the Market

In Germany, the total volume of the assets (retail and institutional) managed by the seven fund managers totalled €1,460 billion. €7.7 billion were socially responsible investments. The volume of institutional AUMs totalled €125.3 billion at the end of 2002. Assets invested in socially responsible funds by institutional investors came to €1.37 billion, which is 1% of the German institutional market.

In Austria, the overall market for socially responsible investments is relatively small. The AUMs of the two fund managers totalled €6.7 billion and only €109.1 million are socially responsible investments. €80 million were invested in socially responsible funds by the institutional investors.

In Switzerland, the total volume of assets managed by the four fund managers came to €142.8 billion, €2.15 billion of it are socially responsible investments. The volume of institutional AUMs totalled €1.34 billion at the end of 2002. Assets invested in socially responsible funds by institutional investors came to €1.25 billion, which is almost 2% of the institutional market in Switzerland.

Based on these answers, one can estimate that the total size of the SRI institutional market in Germany is likely to be above €3 billion. The same holds true for the Swiss market, while the Austrian market is still much smaller in size, and does not exceed €1 billion.

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€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-Chanoinesses de Saint-Augustin Convent in Paris and managed by La Financière Meeschaert,
• Plural 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’Epargne, 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 billion. 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.

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 Epargne 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’Epargne mutual bank and CDC that jump-started...
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.

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, layoffs & 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 Plans 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

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 Réseves 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

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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)

<table>
<thead>
<tr>
<th>Insurance Companies</th>
<th>Third Party Asset Management</th>
<th>Pension Funds*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>UCITS</td>
<td>Discretionary Mandats</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>895</td>
<td>860</td>
</tr>
</tbody>
</table>

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.

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)

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

* 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 (CDR’s) such as Agirc and Arrco were set up by

§ 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)

<table>
<thead>
<tr>
<th>Negative Screening</th>
<th>Positive Screening</th>
<th>Engagement</th>
<th>Negative &amp; Positive Screening</th>
<th>Negative Screening &amp; Engagement</th>
<th>Positive Screening &amp; Engagement</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUMs 400</td>
<td>1326</td>
<td>0</td>
<td>46</td>
<td>0</td>
<td>68</td>
<td>228</td>
<td>2068</td>
</tr>
</tbody>
</table>

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)

<table>
<thead>
<tr>
<th>Source: FIR analysis</th>
</tr>
</thead>
</table>

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, Ethys), 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, ODE\(^6\)) - 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.

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.

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.

Acknowledgements

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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.

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).
SRI for institutional investors in Italy is €240 million, or 0.06% of the total of a global institutional market of €436 billion.

Unlike other countries, the SRI retail market is more developed than the institutional.

Insurance companies, Catholic churches and banking foundations make up the main SRI institutional investors.

There are few tailor made products for socially responsible institutional investors in Italy, mainly based on portfolio screening. Engagement is not practiced at all.

The overall SRI for institutional investors is still negligible, but the growth of interest and attention to the CSR debate, combined with imminent legislation reforms will lead to an expected increase in SRI practice; especially for pension funds and banking foundations.
I. SRI in Italy

Historical Background of SRI Market

Historically speaking, the Italian financial industry has a strong tradition of social responsibility. The Casse di Risparmio (savings banks), the Banche Popolari (credit societies), and the Banche di Credito Cooperativo (cooperative credit banks) have been offering financial support to local communities, small businesses and families, as well as disadvantaged sections of society for decades. They did not belong to any private corporation, but rather to local communities (through municipalities or regional governments, in the case of Casse di Risparmio, or groups of farmers and craftsmen in the case of Banche di Credito Cooperativo) and the profit was re-invested or distributed locally.

Today, the concept of social responsibility in the financial sector is approached from two different angles: one side representing the ethical banks and, the other side representing traditional financial institutions that are currently developing CSR and SRI strategies.

The SRI movement first grew and developed as people objected to campaigns regarding military expenses and financial support for racial regimes in South Africa. Based on this, during the 1980s, a number of Mutual Cooperative Banks were created in northern Italy. Their aim was to offer a new way to collect and use private money in order to support projects created by cooperatives and NGOs, which could not be backed by traditional financial loans. This experience led to the creation of Banca Etica, which offers micro-credit and finance for marginal economies.

The current SRI movement has been stimulated by the need to reinforce the relationship of confidence between banks and their stakeholders. The Italian financial industry was State-owned until the end of the 1980s. After the privatisation of this sector (which is still in process), banks faced a new challenge, which was becoming competitive in an open market and acting as profitable companies. Once the banks satisfied the expectation of shareholders, they started to pay attention to other stakeholders. While the former nature of semi-public bodies could imply a certain regard to public interests, as private companies, they have to justify a commitment to social responsibility.

Responsible asset management was the first area where social engagement could be practiced. In 1997, Sanpaolo IMI launched the “ethical line”, which includes four SRI retail products. Later, other major banks, as well as some smaller ones, started socially responsible funds. Today, about twenty investment products are available, with different degrees of credibility. Considering SRI funds in the narrowest sense, the assets under management for Italian retail funds is about €1 200 million.

The SRI Market Today

The Italian SRI market is mostly concentrated in the retail sector. This is due to two different factors:

- The small size of traditional institutional investors (particularly, pension funds).
- The lack of awareness and sensitivity for social issues.

The supply side:

- Asset managers: all the largest Italian financial banks are active in the sector of ethical finance, mainly with retail mutual funds. Regarding the overall retail and institutional assets under management, Sanpaolo I mi is the pioneer in SRI and still the most important with €960 million AUMs. They are followed by Nextra, Banca Intesa’s asset manager, with €60 million AUMs, and Pioneer, Unicredito Italiano’s asset manager with €13 million.
- The products: there are thirty-nine retail mutual funds available, out of which twenty-two are managed by Italian financial institutions. Total AUMs of pure Italian funds is some €1.2 billion, and three financial instruments for institutional investors corresponds to an overall
asset management of €56 million. All of them apply a consistent framework of positive and negative screening criteria. The number is higher if we consider the funds which donate part of their commission rates to charities.

See the “Available Products” section in this country report for more information about known assets.

- Accepted as SRI: the most used criteria in the qualification of financial instruments are negative and positive screening while examples of engagement in the form of shareholder activism are very rare.

The demand side:

- SRI retail investors: for retail customers, according to the most recent survey there is evidence that Italian consumers have an increased interest in CSR issues. In particular, great attention has been paid to environmental damages and exploitation of workers. Out of a significant sample, 60% of respondents were said to have used negative (33%) or positive (25%) screening when buying goods and services. In terms of negative screening, tobacco, biotechnology, oil, chemicals and financial services are perceived as being the most “irresponsible” sectors.

- SRI institutional investors: there is no reliable information concerning institutional investors’ attitude towards SRI. The only available survey, by Mefop and the FFS (Forum per la Finanza Sostenibile / Forum for Sustainable Finance) on a sample of pension fund directors, show that according to 50% of those questioned, “SRI will notably grow” and for 14% SRI “will become mainstream for the whole industry”. This research suggests that there is a strong interest in SRI. In principle, the pension fund community do not see relevant legal obstacles to the introduction of SRI criteria into the investment policies, but there might be organisational constraints, mainly due to the unclear definition of SRI criteria.

### Laws and Legislation

The legislative framework is currently unfavourable to SRI activities. There are no specific rules that create incentives for SRI, or for any other socially responsible financial product. There is no comprehensive regulation on SRI in place, although several bill proposals have been drafted both by Members of Parliament and by the Government. The FFS has proposed an amendment to the pension system reform bill in order to introduce a UK-style disclosure regulation.

Rating agencies: Avanzi SRI Research, a member of the SiRi Group, is the oldest environmental and social rating agency in Italy. E.Capital Partners is the largest national SRI index provider.

### II. Financial Market Context

#### Institutional Investors

In Italy, there is not a unique and official definition for institutional investors. For example, the Bank of Italy considers insurance companies, pension funds, mutual funds, SICAVs and portfolio management services to be institutional investors. On the other hand, CONSOB (Commissione Nazionale per le Società e la borsa / the Italian equivalent of the Securities and Exchange Commission) includes closed investment funds, venture capital companies, and commercial and investment banks as institutional investors. As a result, each survey defines its own group of institutional investors based on the subject under investigation.

In this particular report we include the following as institutional investors:

**Banks**

There are 814 banks under Italian law. Direct deposits represent €1 064 billion. The level of concentration is medium with the first five players sharing 45% of the market. As regards to their
portfolio management, there are different approaches. Some manage their own portfolio directly; others give it to investment companies, which are often owned by the same financial group.

The portfolio make up follows two main criteria: short duration and low risk. As a result, these assets are invested mainly in short-term government bonds; the choice of the issuing country is subjected to the regulatory solvency ratios imposed by the Bank of Italy. For these reasons, portfolio management as practised today is not compatible with SRI.

Insurance Companies

There are more than 200 insurance companies under Italian law, which are divided into life and non-life insurance sectors. Collected premiums reach €88 billion. The level of concentration is medium with the first five players sharing approximately 35% of the market. As regards to their portfolio management, about 60% of the companies directly manage their own financial portfolio. This approach turns out to be more popular among big companies, where the size of portfolios makes it economically efficient; however, there are also significant exceptions, represented by major insurance companies that are shifting the asset management to their group investment company.

The composition of their portfolio follows two main criteria: low credit risk and short duration for non-life insurance companies, and low credit risk and higher duration for life insurance companies. The choice of the issuing country subjected to the regulatory solvency ratios imposed by the competent authority, which is ISVAP (Istituto per la Vigilanza sulle Assicurazioni Private e di Interesse Collettivo / Institute for monitoring private insurance and collective interests).

Pension Funds

The “first pillar”, or public system of compulsory contribution, is represented by funds reserved for the public as well as private employees and special funds for self employed professionals (€13 billion). We do not consider these assets, which are managed in a pay-as-you-go system, because their asset allocation strategy is largely pre-determined by law and no element of social responsibility is used.

The “second pillar” instruments adopt a pay-as-you-earn system, and can be divided into three categories: occupational pension funds, open pension funds and company pension schemes.

- The occupational pension funds were established with the 1993 reform. These are reserved to either private or state-owned company employees on a sectorial base.
- The open pension funds are accessible by self employed workers, or groups of workers whose sector has not established an occupational pension fund.
- The company pension schemes existed before the 1993 reform.

The “second pillar” instruments total €25 billion.

The “third pillar”, or individual pension schemes, is virtually negligible.

In sum, the funds we consider manage a total amount of €43 billion.

There is evidence of SRI practice for only one occupational pension fund (Previambiente, the pension scheme of environmental public services providers, with €9 million AUM) and for one open pension fund (Unipol Insieme €0.1 million).

Foundations

There are 2,919 general-purpose foundations in Italy. These can be defined as non-profit organisations with one single source of income that comes from the financial management of their own assets. Consistent information regarding the asset management strategies, if any, is not available. Even if these organisations’ missions should be clear about their task to pursue public benefit purposes, there is no evidence of SRI practices. However, given the small average size of these foundations’ portfolio, their management is likely to be very traditional and oriented towards low risk strategies.
The banking foundations represent the most interesting sub-class in the Italian financial market. There exist eighty-nine of these organisations, which were established by law in 1990 as a first step in the privatisation of the so far publicly owned banks. The level of concentration is medium with the first eighteen foundations holding 76% of the total assets. Today, most of them still have significant shares in primary banks even if they will have to diversify their portfolio and reduce their financial participation in the capital of the banks. Investment strategies have been very conservative so far, also because the legislative framework regarding governance and goals was not clear (several cases have been discussed by the Supreme Court).

Banking foundations can pursue their “socially responsible” purposes directly, such as through grant making activity, or indirectly, by using their influence as major investors. Although their statutory mandate is clearly oriented towards social responsibility also in the asset management, there is little evidence of SRI practices. Only one of them, namely Fondazione Cariplo, has invested in an institutional fund (GEO) managed on an SRI basis (AUM €380 million).

Churches

The universe of religious organisations is very complex and far from being transparent. In principle, there are four main actors: the Vatican City, the Holy See, the IOR (Istituto per le Opere Religiose / Institute for Religious Works) and the Holy Orders. Although all of them act mainly in Italy, they can hardly be considered Italian, provided that international law and agreement with the Italian State preserve the sovereignty of the church, whose bodies are not under Italian jurisdiction.

The Vatican is, in fact, an independent State, with almost 5,000 residents. It is formally separated from the Holy See, and it has an autonomous administration. In 2001 the Vatican produced a profit of €14 million.

The Holy See is at the heart of ecclesiastic life. It has its own balance sheet that showed a deficit of €15 million in 2001. The Holy See is organised into seven different administrations, the most important of which is APSA (Amministrazione del Patrimonio della Sede Apostolica / Administration of the Patrimony of the Apostolic See), managing most of the activities of the Roman Church. It takes on the costs of the staff, manages the purchasing and maintenance of the properties and, through its “Special Section”, manages all the financial assets of the Holy See, which we estimate to be more or less €6 billion. In terms of SRI, ethical screening of investment is done on the basis of negative criteria (excluding weapons, tobacco and pornography).

With regards to the IOR, the bank of the Vatican City State, after the scandal with the Banco Ambrosiano in the 1980s, it is now officially in charge of managing the money of the residents in the Vatican City State. Its balance sheet is secret and the Italian institutions do not control the movements of incoming and outgoing money because the IOR is not under Italian regulation. No information is available with regards to its investment criteria.

The Holy Orders is a very fragmented and almost impenetrable world. We succeeded in collecting some information by only questioning the supply side, or the asset managers, but only in aggregated format.

Institutional Market Size

Overall, the assets available for portfolio management of institutional investors amounts to €436 billion. In terms of SRI, the overall share is €240 million, which corresponds to 0.06% of the total market.

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1 The Casse di Risparmio (savings banks) used to be local or regional non-profit financial institutions, established as public entities, whose boards of directors were appointed by local governments (city or provincial councils, according to statutes). Their original purpose was to provide credit to small businesses and local economies; the surplus was given back to the communities in the form of donations and support to common interest projects. With the 1990 reform, the two functions (financial activity and grant making) were separated: the banks were transformed into incorporated companies and the new established foundations got their shares.
Available Products

In principle, most Italian asset managers are capable of managing typical SRI financial products, as well as designing customised ones. The problem seems to be the lack of demand. Today there is only one tailor-made financial instrument: a unit trust devoted to ethical investing of the Multi-manager GEO Fund. Currently, only one banking foundation is investing in it (Cariplo Foundation, AUM €38 million as of September 1, 2003). It is also worth mentioning SRI ETF Beta1, managed by Nextra sgr (Banca Intesa), launched in January 2003. This fund is designed mainly for institutional investors - especially foundations and religious organisations - but it did not experience the desired success (AUM €19 million as of September 9, 2003). Another important financial instrument is Gestietica, which is portfolio management based on economic efficiency and ethical criteria, designed by Capitalia launched in January 2002 and explicitly created for charities and foundations. (AUM not known)

In addition, some institutional investors actually invest in retail SRI mutual funds. For instance, the only open SRI pension fund invests in retail funds that are managed by Sanpaolo Imi.

Several insurance companies launched unit or index policies linked to SRI indexes or ethically compiled portfolios.

Table 1: SRI linked products for insurance companies (in € million)

<table>
<thead>
<tr>
<th>Company</th>
<th>Products</th>
<th>AUM</th>
</tr>
</thead>
<tbody>
<tr>
<td>BdS – Romavita</td>
<td>Futuroverde</td>
<td>10U</td>
</tr>
<tr>
<td>CariFirenze – Centrovita</td>
<td>Index Ethical World</td>
<td>10</td>
</tr>
<tr>
<td>Meia Aurora</td>
<td>Unietic</td>
<td>8.7</td>
</tr>
<tr>
<td>Duomo Maeci</td>
<td>Sceltissima Index Etica</td>
<td>5</td>
</tr>
<tr>
<td>Venetobanca – Claris</td>
<td>Forza Etica</td>
<td>&lt; 1</td>
</tr>
<tr>
<td>Poste Vita</td>
<td>Ideale</td>
<td>Not known</td>
</tr>
</tbody>
</table>

Source: FFS analysis

III. Methodology

Scope of Research

This study does not take into consideration universities and NGOs, because in Italy they are not wealthy organisations. We also excluded the religious organisations that are not under Italian law (The Holy See, Vatican City State) and that do not disclose any information. In this respect, even if we have analysed them and provided some figures earlier, we do not count them for the amount of total asset/total SRI assets. This is the first attempt in Italy, except for pension funds, to investigate the world of SRI for institutional investors.

See the References section at the end of this country report for more details.

Approach

Thanks to the cooperation of Assogestioni, the Italian Association of Asset Managers, we were able to send a questionnaire to all of their members (both Italian members and foreigners operating in Italy) and gather figures regarding SRI mandates given by institutional investors, as earlier defined. We started from the assumption that most of these investors do not directly manage their portfolios, but usually prefer to use professionals for this purpose. The return rate was 27% of the sample, corresponding to 78% of the overall asset management market in Italy. In addition, we have carried out direct interviews with the most important asset managers in order to collect qualitative information on their approach to institutional customers, especially banks, insurers and charities.
Assumptions

The estimate of the institutional market size is based on annual reports issued by trade associations (i.e. ANIA (Associazione Nazionale Imprese di Assicurazione / Insurance Companies Association), ABI (Associazione Bancaria Italiana / Italian Bankers Association), ACRI (Associazione Casse di Risparmio Italiane / Association of Italian Banking Foundations) for banking foundations or other official documents issued by regulatory agencies (COVIP – Commissione di Vigilanza sui Fondi Pensione / Pension Funds Control Authority) providing aggregate figures taken from financial statements. Moreover, where needed, we carried out some direct interviews with representatives of these institutions.

Biases and Issues Encountered

The biases in these data are mostly related to figures about overall financial assets of institutional investors. In particular, figures about religious organisations can be illegitimate and incomplete because of the strong confidentiality around information about the Church’s assets. With regards to general-purpose foundations (i.e. the non-banking foundations), because of the fragmentation and the little transparency of the sector, we did not find reliable and comprehensive figures regarding their overall financial assets. Moreover, one of the answers to the questionnaire provided only the aggregate amount of SRI for institutional investors without splitting it into the different classes. This is referred to as the “Other” group in the table in the “Findings & Interpretation” section.

IV. Findings & Interpretation

Table 2: SRI Practices in Italy (in € Billion)

<table>
<thead>
<tr>
<th></th>
<th>Negative screening</th>
<th>Positive screening</th>
<th>Negative &amp; Positive screening</th>
<th>Engagement</th>
<th>Not known</th>
<th>Total assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occupational Pensions</td>
<td></td>
<td></td>
<td>0.02</td>
<td>0.04</td>
<td>0.04</td>
<td>43.21</td>
</tr>
<tr>
<td>Foundation</td>
<td>0.01</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>20.02</td>
</tr>
<tr>
<td>Churches</td>
<td></td>
<td>0.12</td>
<td></td>
<td></td>
<td></td>
<td>256.00</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>117.00</td>
</tr>
<tr>
<td>Other</td>
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<td>0.01</td>
<td>0.18</td>
<td>0.04</td>
<td></td>
<td>436.23</td>
</tr>
</tbody>
</table>

Source: FFS analysis

Interpretation of Results

The big players on the institutional side: the market for SRI institutional investors is far from being mature. In principle, religious organisations, pension funds and banking foundations are the big players. However, in reality, only single organisations within these categories have played a role so far; thus we can hardly speak of a widespread interest in SRI.

Type of screening taking place most often: the most used criteria in the qualification of financial instruments are negative and positive screening while examples of engagement, apart from occasional dialogue, are very rare.
IV. Future Trends

The debate on CSR in the financial sector has grown in importance over the last few months, with the launch of various SRI products onto the market by mainstream financial institutions. More of these types of products are expected to appear. Surveys about customers’ willingness to embrace these products show an encouraging trend.

Factors that might slow down this process seem to be:

- the definition of legislative framework for banking foundations,
- the reform of the pension system that allows the growth of second and third pillar instruments.

Acknowledgements

Assogestioni is thankfully acknowledged for the helpful support in gathering data.

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€0.08 billion are invested in the institutional SRI market in Spain.

Institutional investors are still marginal in Spanish SRI, with one category of such investors creating the demand for the market (NGOs).

Although most existing products are designed for the retail market, there are many initiatives that show that institutional investors are beginning to invest or are looking for products that match their needs.

CSR is now the main issue, although the first ethical funds on the market were sharing funds.

Our analysis demonstrates that measures and initiatives that were taken in Spain last year to encourage SRI must continue to be reinforced by different sectors in politics and society as a whole.
I. SRI in Spain

Definition of SRI in Spain

In Spain, a considerable number of the funds known as socially responsible investment funds are also sharing funds. A fund is a “socially responsible investment fund” when it screens the companies for inclusion in its portfolio using criteria based on social responsibility. However, “social investment funds” allocate part of their management fees for donation to various social bodies (charities, NGOs, co-ops, communities, etc.) but do not use any mechanisms for filtering or screening its portfolio. In the latter case, the funds in question designate beneficiaries, usually Non-Governmental Organisations (NGOs), to receive the relevant part of their fees. There are also a few pure sharing funds that do not use social responsibility criteria.

The most common methodology applied to Spanish funds, and funds of Spanish origin, is negative screening, with some reference to positive screening. In Spain the most popular screening criteria for ethical funds are environmental (positive screening), which is used by 92% of funds; and arms (negative screening), which is used by 75% of funds. The best-in-class approach is rarely used.

History

The earliest SRI funds to appear in Spain were ethical investment funds. These first funds on the market were basically social funds that subjected their portfolios to negative screening. Three exclusively sharing funds were also issued, with no SRI screening.

The origins of these first SRI funds were diverse and they experienced parallel but different developments:

- In the late 1990s, the NGO Intermon Oxfam, which first learned about SRI funds in the United Kingdom, felt it had to seek an SRI option for its investments, particularly funds designated to actions involving development cooperation in the form of surplus liquidity. At the time, Spain only had one environmental fund, Arco Iris, a mutual fund belonging to Ahorro Corporación. Intermon Oxfam negotiated with several fund managers to create an SRI fund that would reflect their values. Eventually the Spanish fund manager AB Asesores, currently part of the Morgan Stanley group, accepted the commission and bought out the mutual fund, Fundo Ético. Research on Spanish companies is carried out by the Ethical Research Committee, and for non-Spanish companies by the parallel institution EIRIS (Ethical Investment Research Service).
- Renta 4 followed the same path when they launched their mutual fund Renta 4 Ecofondo, based on environmental criteria. Co-founders of the fund were the Fundación Ecología y Desarrollo, applying the company research methodology of the international network, the Siri Group.

A few months later, about eight SRI funds and three exclusively sharing funds entered the market. By then, two SRI funds issued by foreign managers had also registered.

At the time, target clients for these funds were institutional investors with a specifically social profile, for example NGOs and religious bodies, but also private investors who wanted their investments to reflect their beliefs.

Early in 1999, the CNMV (Comisión Nacional del Mercado de Valores / Spanish Securities and Investments Board), the public body responsible for regulating the national stock market, asked the financial sector for clarification on the funds they were calling ethical, environmental and social. This initiative for self-regulation was taken up by INVERCO (Asociación de Instituciones de Inversión Colectiva y Fondos de Pensiones / Association of Institutions of Collective Investment and Pension Funds), who constituted an “Ethics Committee” made up of five members.

After nine months of deliberation, the committee drew up a “Circular sobre utilización por las Instituciones de Inversiones Colectivas (IIC) de las denominaciones “ético”, “ecológico” o cualquier
It seems that the greatest stimulus for SRI in Spain is currently coming from foreign institutional investors

Apart from these initiatives, it seems that the greatest stimulus for SRI in Spain is currently coming from foreign institutional investors. They count social responsibility practices as good indicators of quality in management and corporate governance. Spanish companies under great pressure from these institutional investors are taking steps to join SRI funds. In addition, given media interest in market indexes like the DJSI and FTSE, companies in the IBEX 35 are showing increasing interest in appearing in these indexes as a way of enhancing their reputations.

This phenomenon is also beginning to influence Spanish institutional investors, particularly pension funds (reinforcing pressure from trade unions on their Monitoring Committees) and insurance companies.

Description of Available Products

From 1999 to 2002, thirteen ethical and/or sharing funds were set up in Spain. These were two funds from the Santander Central Hispano group, recently merged to create a single fund, and others from fund managers (BNP, Morgan Stanley Dean Witter, Ahorro Corporación, Bankpyme, la Caixa, Caja Madrid, Caixa Catalunya, Rent a, Deutch Bank, Monte de Piedad y Caja de Ahorros de Huelva y Sevilla, Ahorro Corporación, BBVA). Two foreign funds (UBS and Crédit Suisse) were also registered.

Between late 2002 and early 2003 the scenario changed substantially with the creation of two new Spanish products (SIMCAV Banco Urquijo and Albufera Verde Bankpyme), and ten new foreign funds that were registered (by Pictet Funds, Dexia, Axa IM, Pioneer, ABN Amro IF, ING IM and Mellon Global Investment).

Various measures and initiatives are currently reinforcing the concept of Corporate Social Responsibility (CSR):

- The concept of corporate governance of listed companies is highly developed in Spain, thanks above all to the work of the Aldama Commission. The Aldama Commission is a government-led committee of experts created to pronounce on and regulate the current situation, whose work puts Spain among the leaders in Europe on the issue.
- In Spain, business ethics is frequently included as a subject in academic programmes. This has long proved a stimulus for organising conferences and meetings, and for the creation of associations like EBEN (European Business Ethics Network).
- The Spanish tradition of social action, highly developed through a series of private foundations and companies that return profits to social or environmental causes, is a first step towards CSR. However, this also has a negative effect in that it distances social and environmental concerns from core company management, and thus giving them a marginal status.
- Evaluation of environmental risks is a very active field in Spain. There is a plethora of initiatives by consultants and academics, in most cases applied to company management.
- Sustainable development is the field where corporate management has made most progress and where specific management strategies are most frequently applied.

Over the last two years, the concept of corporate social responsibility has assumed a high profile in the most forward-looking business and political forums. A few organisations have seized the initiative in encouraging this development.

Source: AENOR Standard No. UNE 165001
SRI Legislation

The Spanish presidency of the European Commission (first six months of 2002) completely ignored commitments already made in the field of sustainability. Likewise, the presence of the Spanish Government at the World Summit in Johannesburg was largely symbolic.

However, Spain has an array of instruments for corporate governance that follow the lines established by the EC (the Winter Report): the white book, the Aldama Committee, and the Olivencia code. More recently, these issues have also begun to be debated at national level under various policy initiatives:

- The motion of 4 February 2003, urging the Government to take the necessary measures to introduce an obligation to inform that is directed at mutual investment institutions and pension funds about their use of ethical or social responsibility and environmental criteria in the selection of its investments. Presented in the Senate by the parliamentary Group of the Catalan party, Convergencia i Unió.
- Ministry of Employment and Social Affairs: A Technical Committee of Experts has been created with the remit of preparing a report on corporate social responsibility. The group met for the first time in July 2003.

II. SRI Market Context

In Spain, ethical investment is still a marginal and under-developed sector as regards to both results and management practices. From the appearance in the late 1990s of the first Spanish ethical funds, ethical investment has shown a slight tendency to increase, but has still not reached the high levels attained in other European countries. After two uneventful years, last year brought some important additions to the market in socially responsible investment funds in Spain. However, these changes were not initiated by the internal market, being mainly due to the commercialisation in Spain of ethical investment funds registered and managed in other European countries. European managers of socially responsible investment funds could see opportunities for commercialisation of these funds in the Spanish market. Only one ethical SIMCAV (open-ended investment company) was created by a Spanish fund manager.

By 2002, there were twenty-five ethical investment funds being commercialised in Spain, fourteen of which were managed in Spain. The eleven remaining ethical funds were based and managed in other European countries. However, in spite of this growth in the number of funds, the economic data on this situation does not seem so bright. Investment in ethical funds in Spain in 2002 at over €79 million (volume of capital) decreased by 9.8% from the previous year (€87 million). Comparing this with the market for group investment institutions in Spain, investment funds in Spain for the same period (2001-2002) registered an annual decrease in capital of 11.71%, affected above all by the depressed state of the financial market. We can therefore say that the percentage of capital reduction of ethical funds was lower than in the rest of the market, due above all to the incorporation of new funds.

Apart from this, the number of participants also went down, from 5,556 in 2001 to 5,242 in 2002. In this case, the reduction in volume of participants was 5.65%, while the average reduction in participants for mutual funds in general on the Spanish market was 8.19%. However, this more positive data on ethical funds was also influenced by the appearance of new ethical funds. Here too, an analysis of the situation shows the relatively limited presence of Spanish companies in business indexes like the Dow Jones, FTSE 4 Good, etc., with most Spanish funds not exceeding 3% of the total equities portfolio.

Be that as it may, the situation of SRI, still in its infancy in Spain, is not only defined by investment statistics alone. A series of recent initiatives by institutional investors is a sure sign that the market is about to take off.
Role of Institutional Investors

In Spain, the appearance and subsequent development of SRI really began to gather speed in the late 1990s. This firmed up with the entry in 1999 of the first ethical investment funds for small investors and some community banking projects. We are looking at a very young movement, still in its very early stages of development.

It should also be said that socially responsible investments have not appeared as a response to a clear demand from Spanish society. On the contrary, they are due to the initiative of minority individuals and groups familiar with the movement in Europe who considered it vital to initiate this type of activity in Spain. In addition, the promotion of SRI has entered Spain in the wake of corporate social responsibility, which has played its part in spreading the idea that companies in Spain should better understand the workings of SRI.

There have been other important changes during the movement’s five years of existence:

- First and foremost, raising awareness of ethical banking and socially responsible investments among members of Spanish society, the majority of whom knew nothing about this movement,
- Secondly, the consolidation of projects aimed at developing methodologies of work.

In Spain, SRI is already a well-known concept in some business circles. However, the most problematic aspect still to be addressed is how to turn this concept into concrete projects. In order for this to happen, portfolio screening techniques need to be applied and people need to have access to proper research on management behaviour.

Players on the Institutional Side

Today, the institutional market is still an emerging and marginal market in terms of volume of assets invested. However we are beginning to see progressive changes in the attitudes of some institutions that will most certainly turn into concrete projects in the coming months.

SRI is having a substantial impact on certain types of institutions, such as companies, NGOs, foundations, pension funds etc. In some cases, their boards of directors are even now discussing the need to give consistency to their shares by linking investments to SRI projects. Important debates are going on in some corporate pension funds, in many NGOs and foundations and also in some religious orders, as detailed below.

NGOs

NGOs have been the social actors most involved in promoting the SRI movement in Spain, mainly by participating in the creation and development of SRI investment funds for individual investors (retail). There is also a group of NGOs with a significant volume of capital invested albeit temporarily, who have adopted SRI policies and are currently engaged in further internal debate on the sector. Some of these NGOs active in cooperation for development in the fourth world, and in human rights have already adopted SRI policies. We can therefore say that this sector is leading current deliberations in Spain on SRI.

However, there is one group of NGOs whose role in this field is restricted to that of beneficiaries of socially responsible investment funds, enabling them to receive management fees. This group is therefore encouraging the consolidation of sharing (social) funds.

 Churches and Religious Orders

The church and religious orders form the social sector expected to be the most closely involved in SRI projects. In fact, some of the socially responsible investment funds that came onto the market in 1999
were specifically launched with the understanding that churches and religious orders would invest in them. Another factor would appear to be the serious financial scandals in which some church institutions have recently been implicated. But up to now, few changes in their behaviour have been observed.

Nevertheless, it would be wrong to say that there has been no change. Certain religious orders are now adopting a more proactive role and starting to adopt SRI policies. The current status is the use of SRI criteria for screening portfolios. The investment volume of this group could become very substantial.

**Pension Funds**

Spanish pension funds are familiar with movements in favour of SRI in other countries, as can be seen from specialist magazines and international conferences. Moreover, Monitoring Committees of Occupational Pension Plans include representatives of trade unions (Unión General de Trabajadores and particularly Comisiones Obreras), actively involved in working towards raising awareness about social and environmental criteria in investment.

Also significant is the fact that CSR policies being defined by large companies are increasingly global and all-inclusive, and some pioneering firms even include the companies in which their pension funds are invested within their “stakeholder” relationships.

All this makes it clear that in the near future, pension funds will be the institutional investors with most clout in Spanish SRI. This is shown by the objectives that some have set for themselves in 2003, such as Pension Plan Study Days for Telefónica employees. Among their eight most current and relevant issues for pension plan management, Telefónica have created one session putting forward SRI as the new alternative. Some economic data that will serve to illustrate this situation:

- 2002: Investment by occupational pension funds (aggregate and declared) in a mutual fund. Amount: €1.5 million (compared with the accumulated amount of around €30 billion in Spanish pension funds).

**Insurance Companies**

As has happened in other countries, managers of insurance companies are also considering the option of investing using sustainability criteria. Their concern is prompted by the increasingly high costs deriving from natural disasters that are seen to be the consequence of climate change, and by legislative advances in environmental responsibility (the European “Let the polluter pay” debate). They are also involved in the general debate on CSR. Several of these initiatives were created in 2003, which leads us to believe that this type of investor will continue to follow in the footsteps of pension funds.

**III. Findings and Interpretation**

**Future Development in the Institutional Market**

The institutional market was sparked off by the demand of one class of investors (NGOs), which was met by the managers of Spanish funds. New demands from traditional institutional investors (pension funds and insurance companies), will probably also start a reaction from national managers.

Socially responsible investment is the best illustration, should one be needed, of the importance of bringing CSR policies into corporate management. SRI began to gather force as a social argument
when social groups decided to use their financial resources to fight against specific business behaviours and activities. Although this focus is still important today, in the late 1990s and above all from the year 2000 on, a significant change of trend began to take shape. Traditional investors started to consider that the practices established for issues including CSR, sustainability, corporate governance etc. are good indicators of quality in management and governance in any company.

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Laura Albareda
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II. Case Studies
UK Case Study

The Joseph Rowntree Charitable Trust

As of the end of December 2002, the Joseph Rowntree Charitable Trust (JRCT) had assets of £113m, 98% held in equities. According to its website, JRCT operates an ethical investment policy, aiming to ensure that, as far as possible, the Trust’s income is earned in ways which are compatible with the Trust’s Quaker roots and its grant making policies.

In particular, JRCT aims to invest in companies:

- Whose products or services are of benefit to humankind with minimal harmful impacts and with an emphasis on meeting basic needs rather than luxuries.
- Whose profits in the long term grow at least in line with the economies in which they operate.

JRCT excludes companies materially involved in armaments; the brewing/distilling/trading of alcohol as a main activity; gambling; tobacco manufacture and/or retailing as a major activity or other activities that are felt to harm society more than they benefit it. As well as sectoral exclusions, the trust has regard to the way companies conduct their businesses, including: employment conditions; equal opportunities; environmental impact and attitude to the communities in which they operate.

Current policies date from 1975, when the trust first diversified out of Rowntree shares. Although the investment policy has subsequently been refined, the core principles remain essentially the same. Research on potential investee companies is provided by EIRIS (which JRCT helped found), which divides up companies into ‘yes’, ‘no’ or ‘check’ categories. JRCT arrives at its own view of those in the ‘check’ class, often in alliance with its fund managers.

According to Roger Morton, one of the JRCT trustees and Chair of the JRCT Investment Committee, this process currently excludes about a third of the FTSE All-Share. Until recently, the exclusions came closer to half of the index, but then JRCT started to look at the very big sectors that were emerging within the FTSE and in which it had low representation to see if it could add ‘best in sector’ companies back to its portfolio. It felt it was able to do so without compromising its policies, partly because of improvements which had been taking place in companies’ behaviour.

In its engagement activities, JRCT supports the occasional shareholder resolution (i.e. the Worldwide Fund for Nature resolution on BP), but in general prefers to act on its own; ‘if we are concerned we see the companies ourselves’, says Morton. ‘We have found it surprisingly easy to get to senior people in companies when we want to; the name may help’, he adds.

Since the late 1990s, about 90% of JRCT’s assets have been managed by two external fund managers (Hendersons and RC Brown). Contact with these consists of regular informal communications plus two meetings a year with each manager. ‘The managers run an intelligent eye over what comes from EIRIS and if they spot a mistake, they say so, but it’s not formally part of their duty to us. The fee we pay them reflects that - we pay a standard fee,’ says Morton.

Fund managers are formally reviewed every three years, but Morton believes that many current managers have limited capacity on SRI. ‘The problem with fund managers is distinguishing between those who see squeezing good performance out of a restricted universe as a professional challenge and a matter of pride, and those who approach it as providing a permanent alibi for poor performance. The latter group tends to end up with poor performance for that very reason, but some of them are still picking up charity business!’

Morton, who has been involved with JRCT since it first developed its ethical policy, expresses himself ‘entirely happy with the financial consequences of our investment policy. We have performance figures since 1978, and from them until 2002, our UK equity performance is bang in line with the FTSE All Share. It’s been slightly more volatile, but relative returns have been fine.’

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1 This article was originally produced in the Just Pensions report “Do UK Charities Invest Responsibly.” Just Pensions reports are available at www.justpensions.org.
Dutch Case Study

PGGM

The pension fund provides former and current employees in the healthcare and social work sector with a comprehensive and broad-ranging pension package at as low a price as possible. This is achieved by investing employer and employee contributions so that the investments generate optimum returns at acceptable levels of risk. The fund spreads its investments – both in the Netherlands and in the rest of the world – over equities, fixed-interest securities, real estate, private equity and commodities. PGGM's total pension capital is around €45 billion. This capital comprises pension contributions and investment returns and is used to pay pensions, both now and in the future.

Sustainable Investment Policy

PGGM is fully aware of the fact that it has social as well as financial responsibilities. This awareness is reflected primarily in its continuing commitment to provide good, low-cost pensions, but sustainability is also an important factor in investment decisions.

PGGM increasingly assesses investment opportunities not only in terms of the expected financial return, but also from the social and environmental perspective. PGGM takes the view that high shareholder value can only be achieved if the interests of all the stakeholders in an organisation are taken into account. Businesses which acknowledge their responsibilities in relation to human rights, the environment and social policy are generally managed by people who are quick to recognise and respond to changes in society. The evidence indicates that the best-performing businesses are those which promote sustainable development, for example through environmental innovation.

Sylvia van Waveren (Manager Corporate Governance & Sustainable Investments): “The reason for SRI by PGGM is not ideological, nor meant for image-building. PGGM believes that in the long run, SRI will lead to higher profits. This is the most important reason why SRI is practised by PGGM.”

Within the framework of its sustainable investment policy, PGGM translates its social responsibility into concrete investment decisions by weighting companies on the basis of their environmental, human rights and social track record. This adds value to investments over the longer term and PGGM believes it will help to achieve a structurally higher return. Sustainable investment policy therefore also brings financial benefits, and PGGM’s commitment to providing good, affordable pensions goes hand-in-hand with its efforts to promote a sustainable society.

Sylvia van Waveren: “PGGM’s SRI policy is unique among Dutch institutional investors because it has the largest SRI portfolio. In August 2003, PGGM started a new SRI portfolio in the United States of 120 million US dollars. Furthermore, PGGM is the only Dutch pension fund that has an engagement policy that has been put into practice. The largest challenge in SRI is to establish that all the portfolio managers are aware of the importance of SRI and will act accordingly.”

PGGM’s sustainable investment policy is based on three principles:

1. Exclusion: rejecting investments that meet two negative criteria, such as involvement in arms production or trading or human rights violations.
2. Best-in-class: investments are ranked on the basis of positive criteria relating to sustainability. Companies rated as ‘best-in-class’ qualify for overweighting in PGGM’s equity portfolio.
3. Engagement: entering into active dialogue with companies with the aim of encouraging sustainable business practices.

Exclusion

PGGM will not invest directly in a country if it systematically violates the three fundamental human rights (freedom of association, freedom of speech and freedom of the press). It will not, for example, invest in countries upon which a boycott or extensive economic sanctions have been imposed by the international community, the United Nations, the International Labour Organisation (ILO) or the European Community on grounds of human rights violations. Similarly, PGGM will not invest in companies which generate over half of their turnover from arms production or trading.

Best-in-class

A positive approach to sustainable investment has emerged in recent years, in many cases using ‘best-in-class’ or ‘best in sector’ as criteria.
This pragmatic approach involves evaluating the companies with the highest market capitalisation in each sector in terms of compliance with various sustainability-related criteria. Companies scoring above average on these aspects qualify for inclusion in PGGM’s pool of potential investments, from which the financial analysts and fund managers make the final selection in the normal way. PGGM has appointed a number of fund managers to manage pilot portfolios of sustainable European equities in recent years. The challenge for these portfolio managers is to outperform the FTSE index, despite having their choice of investments restricted by sustainability screening. In the long term, investments based on sustainability criteria are expected to outperform those based on traditional performance measures.

**Engagement**

Engagement, the third principle underlying PGGM’s sustainable investment policy, is applied to the European equity portfolio. Through its Responsible Engagement Overlay (reo®) programme, UK asset manager ISIS Asset Management engages with companies in which PGGM invests, cooperating closely with them to establish active and positive policies on human rights, the environment and social-responsibility issues. Added value is generated by actively seeking to influence company policy.

Sylvia van Waveren: “The engagement policy of PGGM is executed by ISIS Asset Management. Mandated by PGGM and other (foreign) institutional investors, ISIS has a dialogue with companies. When visiting the companies, ISIS tries to establish if the companies act according to their business policies and will also try to stimulate companies to take more action on CSR issues. The effectiveness of the engagement policy cannot yet be proven. PGGM would like to quantify the effect in extra profits gained, but that is not yet possible.”

**Increasing the Return**

Sylvia van Waveren: “PGGM would like to see some proof that SRI is more profitable than traditional investing policies. At the moment, PGGM has three years of experience with SRI. This is too short of a period to determine if SRI is actually more profitable. Some developments indicate that this is the case; others show the opposite. At the end of 2003, the SRI policy of PGGM will be evaluated for the first time. After that the PGGM board of directors will decide if the SRI activities will continue.”
Spanish Case Study

Analysis of the part played by Non-Governmental Organisations (NGOs) in the structure and development of socially responsible investment funds in Spain

Written by Laura Albareda Vivó, Institute for the Individual, Corporations and Society (IPES), ESADE

Most socially responsible investment funds aimed at individual investors (retail funds) registered in Spain were created between 1999 and 2000. Now in Spain, socially responsible (ethical and environmental) investment funds can also act as sharing funds. However, the two concepts are different and must be clearly defined. An investment fund becomes socially responsible when it pre-screens the companies it admits to its portfolio by using criteria based on social responsibility. A sharing investment fund, on the other hand, is a fund that contributes part of its management fees to social organisations, but has no mechanisms for screening or pre-screening its portfolio. In the second instance, the funds designate beneficiaries, usually Non-Governmental Organisations (NGOs), to receive part of these fees.

Of the twenty-five socially responsible investment funds registered in Spain, only eleven are sharing funds and as such have charity beneficiaries.¹ There is in addition one social fund that has created its own mechanism through the direct funding of social projects instead of designating organisations as beneficiaries.² In total, these eleven investment funds - all of which are managed in Spain - have sixty-three beneficiary organisations, most of them charities. Some of these receive benefits from more than one fund, and one is even included in four different funds.

This case study arose from research carried out by ESADE’s Institute for the Individual, Corporations and Society (IPES). It was published in its annual publication Observatorio de los fondos de Inversión Éticos, Ecológicos y Solidarios en España - Año 2002 (Observatory on Ethical, Environmental and Sharing Investment funds in Spain, 2002). The object of the research was to analyse the part played by NGOs in the structure and development of socially responsible investment funds in Spain. For the purposes of the study, one questionnaire was sent to all fund managing institutions and another to all beneficiary organisations.

Of the sixty-two questionnaires sent to the beneficiaries, fifty elicited a reply. Since some of these organisations were beneficiaries of more than one investment fund, this was reduced to thirty-nine separate beneficiaries. The questionnaires sent to the eleven fund managers with beneficiary organisations resulted in nine replies.

Results

1. In 1999, when the majority of these socially responsible investment funds were being created, most Spanish funds were launched on the market by fund managers who made use of a model developed by a few pioneer institutions. These origins may explain why even today, beneficiary organisations assume the somewhat passive role of funding recipients rather than participating in the funds as active owners or investors.

2. However, of the beneficiaries surveyed all considered it important to join such funds. They felt that by so doing they would encourage SRI in Spain, and hoped that the funds would serve to educate and positively influence society on the issues of SRI. They also felt it was important that their approach to financial matters should, if possible, reflect the values that they publicly uphold as social organisations. Conversely, what had least influence on beneficiaries was the idea of these investment funds as a new form of funding.

3. Only half the beneficiaries took any active part in creating and defining the investment policy or principles of their investment funds.

4. There was some uncertainty among beneficiaries about how company behaviour could be investigated. For example, 20% of ethical or environmental investment fund beneficiaries claimed not to know that pre-screening of companies featured in the investable stocks catalogue entailed the management institution’s investigating company behaviour.

5. 87% of beneficiaries considered that fund managers should tell companies of portfolio exclusions. In practice, this is not done since no techniques for engagement in this area have yet been developed.

6. The relationship most frequently established between the beneficiary organisation and the ethical, environmental or sharing investment fund managers was that of donor-recipient, the funding involved being the part of the management fees due to the beneficiaries. This is only to be expected, since it largely reflects the stance adopted by beneficiary organisations when they first began to participate in such funds. Furthermore, in this respect the perceptions of beneficiaries and their managing institutions coincided.

7. The second most common relationship was the participation of some beneficiaries in the fund’s independent monitoring committee.

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¹ Eight of these sharing funds are also ethical or environmental, and three are exclusively sharing funds and so do not conduct any pre-screening of their portfolio.
² This fund has been excluded from analysis in the present study due to its lack of beneficiary organisations.
8. Some other relationships entailed beneficiaries publicising the investment fund among their members, or participating in the development of socially responsible investment policy or principles.

9. Most beneficiaries did not provide information to managing institutions, nor did they oversee the catalogue of investable stocks.

10. All the fund managers claimed that during their three years of operations there had been no disagreements with their beneficiaries.

11. Seven managing institutions considered that beneficiaries should promote the investment funds among their members. However, when it came to promotion by the managers themselves, none directly promoted the investment fund to members of their beneficiary organisations.

12. As already indicated in the introduction, it would be logical to assume that social sector organisations - which themselves stand for specific social values based on justice, fairness, peace, etc. - would view SRI as a way of reflecting their core social values in their approach to funding. However, even social organisations that were beneficiaries of socially responsible investment funds were unlikely to invest their own capital in such funds. Only six beneficiaries indicated in their replies that they held part of their capital in socially responsible investment funds. And of these, only four claimed to have assigned more than 10% of their invested capital to these funds. However, two other beneficiaries replied that they had invested 100% of their capital in socially responsible investment funds. It would seem that beneficiary organisations in Spain do not appreciate the potential of SRI in the creation of socially responsible value. Their most common role in the structure of socially responsible investment funds is still that of mere beneficiary: in other words, they confine themselves to simply receiving their due share of the management fees.

15. When asked to rank the importance of several factors for the immediate future evolution of socially responsible investment funds in Spain, both beneficiaries and fund managers were in agreement. They considered the most important issue to be the development of legal regulations to support SRI, as had occurred in other European countries.

16. Beneficiaries also highlighted the importance of tax regulations that favoured socially responsible investment funds, and felt that fund managers should adopt appropriate means for the development and promotion of their funds. Finally, beneficiaries gave lower priority to the setting up of a forum in Spain to bring together all agents involved in SRI.

17. The managing institutions considered it important for not only beneficiaries but also the social sector as a whole to take part in socially responsible investment funds.

We trust this information will contribute substantial arguments for bringing the Spanish SRI market in line with the European markets in this sector.