

# Committing to responsible investment

**Within the broad category of SRI, what areas have investors focused on and are there any areas that have been neglected?**

**Sami Gotrane and Christine Lacoste:** Over the past few years, the Socially Responsible Investment (SRI) market in Europe has increased a remarkable 102% between the end of 2005 and the end of 2007.<sup>1</sup>

All types of SRI attract interest. In particular, ethical exclusion funds have been growing the fastest, representing the largest assets under management today. This includes both the 263% growth for simple exclusion strategies and the 115% growth for multiple exclusion strategies (more than two negative criteria) over the past two years.<sup>1</sup>

This growth trend can be explained by historical factors: the ethical exclusion funds were after all the first SRI products on the market. Also, recent government regulations in some countries (e.g. Belgium) contributed to this structural trend.

Additionally, SRI growth has been driven by investors' increased interest in newer SRI products, such as themed funds (e.g. water, climate change) and "best in class" funds (no sector exclusion), which focus on selecting companies with the best environmental, social and governance (ESG) practices in their sector.

Natixis Asset Management (NAM) covers a wide range of SRI management styles – theme, integrated SRI (the new "best in class"), and ethical. We manage 40 open-end funds dedicated to SRI. The leader in France,<sup>2</sup> NAM is today a top SRI European asset manager with €4.6bn under management as of 30 June 2008.

**How do you see SRI evolving in the next couple of years?**

**Steven Falci:** I believe SRI will continue to evolve, with a new generation of mainstream investors who identify more with the labels sustainable investing or responsible investing, integrating Environmental, Social and Governance (ESG) factors into their portfolios based on the criteria of investment materiality. The broad acceptance of the United Nation Principles for Responsible Investment (PRI) is one large indicator that the market for sustainable investment is growing. More than 400 asset owners and investment managers with US\$15trn in assets have made a commitment to the PRI, and a scan of the list reveals that the majority of signatories are mainstream investors.

While I believe many are still grappling with exactly how they will integrate ESG, two major factors point to sustainable investing gaining more prominence over the coming years. First, one of the major lessons of the credit crisis is that myopic focus on short term profits or returns can lead business managers and investors to ignore material risks. Sustainable investment's horizon is grounded in the long term as is the nature of value and risk embedded in ESG variables.

A proper refocus on a longer term horizon for equity investors I believe will lead investors to a closer focus on material ESG factors. Secondly, while the credit crisis moved to the fore, long term sustainability challenges remained in the background, but their implications are more critical than ever.

For example, climate change remains the most significant challenge to our global society, with countries and regions setting aggressive targets to reduce carbon emissions to combat global warming. How companies manage risks and opportunities related to operating in a carbon

*Global Pensions* asks a panel of experts to discuss the finer points of Socially Responsible Investment (SRI) and explain how it varies from sustainable investment



constrained world will have a material impact on their long term value.

**Sami Gotrane and Christine Lacoste:** We see a growing number of investors wanting to integrate extra-financial criteria in the valuation of assets for many reasons. For example, significant moves in populations, urbanisation, climatic patterns, and employee and consumer attitudes are some of the leading themes of the century. Citizens and NGOs are paying more attention to the sustainability of each business model. The consensus is now clear and strong: corporations and sovereigns need to improve their practices.

In terms of SRI styles, we believe the market is shifting. It was originally based on a subjective view, focused on the exclusion of some sectors. Now we see it aimed at improving corporate behaviour in terms of sustainability through financial investments. However, due to the broad diversity of investors' needs, we strongly believe the various SRI styles will subsist and further develop.

Portfolio managers themselves are growing conscious of the importance of integrating extra-financial criteria to the traditional financial analysis in order to better value assets. The final outcome could even be that most SRI analysis will be part of the mainstream view.

**How does sustainable investment differ from SRI and what are the benefits for pension funds?**

**Sami Gotrane and Christine Lacoste:** Sustainable investment can be characterised as long term investing in companies that conduct their business in such a way as to cause the least amount of harm to their

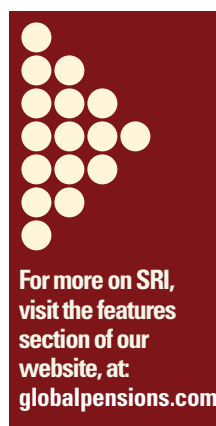
global environment by minimising negative externalities. Consequently, sustainable investment often derives from a subjective point of view, thus inducing sector bias.

SRI consists in investing, in the mid to long term, in companies that meet some standards of ESG responsibility. This approach is probably less ambitious than Sustainability, but easier to implement and more manageable in terms of performance.

For the vast majority of pension funds, the SRI or Sustainability focus is built on the idea that a corporation's long term risks on ESG issues need to be addressed and could have a significantly positive impact on a company's long term performance. These investors are convinced that exclusion or a focus on short term financial criteria are not efficient ways to generate a good and less volatile level of return on assets.

Indeed, many investment choices based solely on short term financial views would not be considered appropriate for public pension funds given their risk-reward profile and the needs of the funds' shareholders. Inclusion of SRI-based investment choices thus presents some unique challenges given the nature of fiduciary responsibility of pension fund trustees.

**Steven Falci:** Sustainable investing is an integrated investment discipline that is designed to achieve strong investment performance while also helping to address society's most pressing issues. It explicitly recognises that certain ESG factors that traditional SRI has viewed primarily through an ethical lens can have material impact on company prospects – i.e. how it manages opportunities and risks arising



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from operating in a carbon constrained world, how it manages its workforce and the governance structures in place to assure accountability and sound management practices – and integrates them into an investment process in a way that is cognisant of their various impacts across companies, industries and sectors. While it is aligned with traditional SRI's human and environmental concerns, sustainable investing is explicitly looking to employ an integrated, forward looking investment discipline to earn more consistent long term returns, more comprehensively identify sources of risk and create a "win-win" situation between societal impact and investment performance.

For pension funds whose investment horizon is defined by the long term nature of their liabilities, the explicit long term nature of ESG variables, properly integrated into an investment discipline, has the potential to provide more comprehensive management of risk and enhance long term returns.

**How much of a role should sustainable investment play in pension fund portfolios?**

**Steven Falci:** Given pension funds long term time horizon, sustainable investment's focus on the long term value creation impacted by ESG factors provides the potential for pension funds to enhance returns and manage risk.

For example, returns can be enhanced by investing in sustainable thematic portfolios that are positioned to invest in companies that are providing solutions to our greatest sustainability challenges. Water solutions, renewable energy and clean tech all have strong long term investment rationales. Economic and population growth in the developing world has created severe stress on the availability of clean water, and that along with the need to replace aged water infrastructure in developed countries points to the need for more than \$1trn in capital expenditures to provide adequate drinking water across the globe over the next 25 years. Similarly, the need to meet aggressive emission reduction targets to address the challenges of climate change points to the need to

significantly increase the deployment of renewables within the energy mix as well as employing more energy efficient technologies in both homes and businesses. This will also require significant investment, and companies with leading technologies will be positioned to deliver strong returns. While the themes have strong long term investment rationales, pension fund managers should focus on identifying specialist managers in these areas who have the necessary experience and focus on the sectors, technologies and stocks that are best positioned to benefit from the overall theme of water, climate change or renewable energy.

**Sami Gotrane and Christine Lacoste:** We strongly believe sustainable investments should play an increasingly large role. There is a growing number of institutional investors who wish to invest their assets with a sustainable approach, driven by national and international regulations and guidelines, such as corporate governance legislation, the Loi de Nouvelles Regulation Economique in France, or the UN PRI.

Moreover, there is a growing number of pension funds who have a firm belief in the impact of sustainability issues on long term investments because they have liabilities for a number of decades to come, as employees paying contributions today expect pension benefits when they retire. And, while pension fund managers also have responsibility for the short to mid term, this intrinsic long term nature of pension investments makes managers increasingly sensitive to the need of maintaining a sustainable environment far into the future.

<sup>1</sup> Source: Eurosif European SRI Survey, 2008

<sup>2</sup> Source: Novethic, quarterly indicator as of 30/6/2008

**Disclosure Statement:** The opinion and analyses in this article reflect the subjective judgments and assumptions of the authors at the time this article was written and do not constitute an offer of services, nor an offer or recommendation to purchase or sell shares in any security. Natixis Asset Management, a subsidiary of Natixis Global Asset Management, is a French asset manager authorized by the Autorité des Marchés Financiers (Code 1200009, Agreement No. GP90009).



**Steven Falci**

Steven joined KBC Asset Management in the newly created position of vice president – sustainable investment in May 2008. Prior to this, Steve was senior vice president, chief investment officer, equities, with the Calvert Group, where he oversaw the equity and asset allocation portfolios for the largest family of socially responsible mutual funds in the US. Before joining the Calvert Group, Steve was senior vice president, senior portfolio manager and principal at Mellon Equity Associates.



**Sami Gotrane**

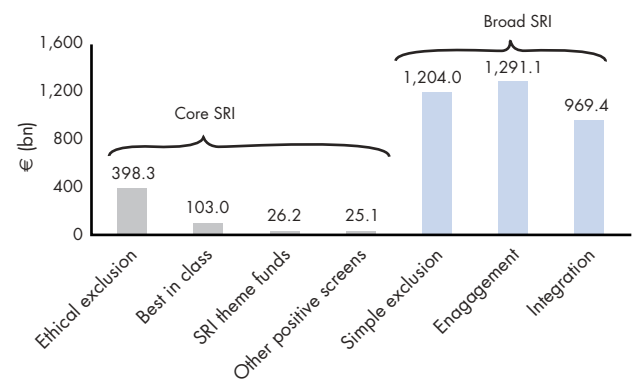
Sami is head of extra financial and credit research at Natixis Asset Management. He joined Natixis Asset Management in February 2005 as head of credit research. He began his career in 1988 as a financial analyst reporting to the secretary general of the Banque de France's Banking Commission. In 1997, working for Paribas Capital Markets in London, he set up the first credit research team in a Continental European bank, before becoming HSBC Asset Management's Global Head of Credit in 2000.



**Christine Lacoste**

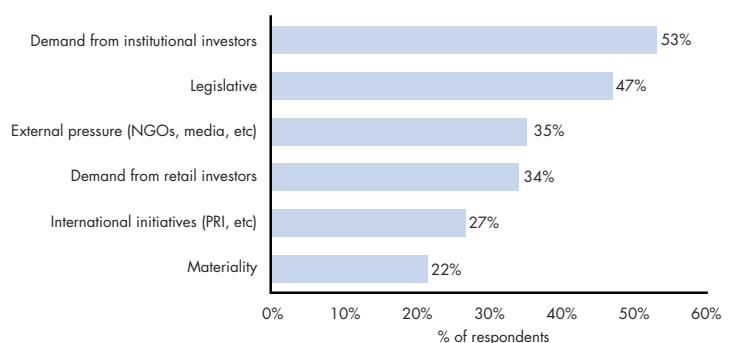
Christine is head of marketing at Natixis Asset Management (Natixis AM). She began her career in 1989, as a corporate account manager for the Crédit Agricole group. In 1995, she became a local authority project manager, working for Caisse Nationale du Crédit Agricole (now CA-SA). In 1999, she joined the sales teams in the Crédit Agricole AM network to establish and develop a range of investment funds at sales departments. From 2001 to 2004, she was responsible for products targeted at institutional investors.

**Chart 1: SRI strategies applied in Europe**



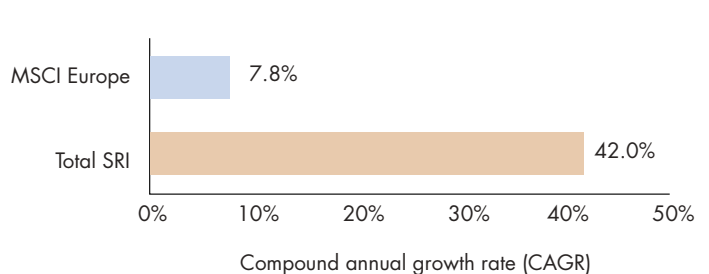
Source: Eurosif European SRI survey 2008

**Chart 2: Key drivers for SRI demand in the next three years**



Source: Eurosif European SRI survey 2008

**Chart 3: Growth of the SRI and overall markets 2005-07**



Source: Eurosif European SRI survey 2008