




Initiative *for* Policy Dialogue

Based at Columbia University 

## *Working Paper Series*

# How Responsible is Socially Responsible Investment

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Insurance

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Special thanks to Michael Kerr (Australian Conservation Foundation), Walter Kahlenborn (German Sustainable Development Forum), Juan Yermo (OECD), Doug Wheat (SRI World Group), Felicity Wade (Ethical Investor, Australia), Tessa Tennant (ASrIA) and Mark Campanale (Henderson Global Investors) for their comments, and to Francois des Portes, Heiko Nitzschke (Columbia University) and Jean-Marc Salou (OECD) for their invaluable assistance in the collection of data.

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## HOW RESPONSIBLE IS SOCIALLY RESPONSIBLE INVESTMENT?

### 1. INTRODUCTION

This paper will examine the pros and cons of Socially Responsible Investment (SRI) practices. It will provide an overview of the issues at stake, highlighting the difficulties of definition, the reasons to conduct socially orientated investments, the factors which have made SRI a serious matter of relevance in the mainstream investment industry, the appropriateness of SRI regulations, the investment performance of SRI, and the suitability of SRI in Asia. Particular emphasis is placed in this paper on the issue of the responsibility aspect of SRI. Ironically, in the rush for companies and investors to, at the very least, appear to behave more responsibly, (termed the “rise of ethics by intimidation” by some<sup>1</sup>) few questions have actually been asked relating to the fundamentals on which SRI is based. In short, is socially responsible investment, as it is currently practiced, genuinely in the best interests of all – shareholders and wider stakeholders alike?

### 2. DEFINITION OF SOCIALLY RESPONSIBLE INVESTMENT

SRI is not to be confused with its near relative, economically targetted investments (ETI) which seek to infuse capital into underserved markets.<sup>2</sup> ETIs have infused funds into a country's infrastructure and include investments in low-income housing, projects that expand employment opportunities or improve public facilities. ETIs are therefore not driven by the financial returns of the investment and are sources of investment in schemes which would not ordinarily attract financial backing. As is discussed in Part 3.1.1 below, the importance placed on investment rates of return clearly distinguishes ETIs from the modern-day concept of socially responsible investment.

SRI may be considered to be investment where social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments.<sup>3</sup> It must however be

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1. Ethan B. Kapstein, “The Corporate Ethics Crusade”, *Foreign Affairs*, Vol. 80, No. 5. September/October 2001.
  2. Terence S. Davidson, "Economically Targetted Investments," *Employee Benefits Basics* (Second Quarter, 1995).
  3. As defined in the 1999 Amendment of the 1995 Pensions Act in the UK.

noted that a variety of definitions of the term SRI exist, and that the term has varied over time, with usage of the term SRI gradually replacing usage of the term "ethical investment". Investments which are considered to be socially irresponsible include those in companies with human rights violations, those which have poor employment practices, those which impair the local communities in which the companies operate and those with environmentally damaging practices.

Socially responsible investment has an inter-relationship with corporate responsibility, with investor pressure influencing the companies being invested in, and the pressures and trends experienced by companies influencing socially responsible investment practices. SRI can be considered to be a follow-up to the corporate governance movement. It advocates many of the same traits previously encouraged by proponents of corporate governance and corporate responsibility eg the importance of transparency and reporting, use of standards/codes of conduct and shareholder activism. In comparison with corporate governance, it can be said that SRI is still very much in its nascent phase, with as yet little standardisation regarding definition, components to be considered socially responsible/"ethical", or standardisation of index methods. Much can be learnt from the discussions, progress and difficulties encountered previously by those involved in corporate governance and corporate responsibility issues, in particular with regard to the arguments relating to the advantages and disadvantages of regulation *versus* the consent of free market forces, as will be seen in Part 3.1.2 below.

### **3. DOES SRI ACTUALLY DO GOOD?**

#### ***3.1 SRI IN THEORY***

##### *3.1.1 The purpose of SRI*

SRI is a continually evolving concept. The earliest form of ethically motivated investment as originally practiced by the Quakers was essentially an exercise in charity. This SRI aim remains the case with many Christian funds in operation today. SRI is most commonly associated with this aspect, based on altruistic motives.

In recent years however, both SRI and corporate responsibility have also been employed out of self-interest. Anti-globalisation and anti-capitalist opinions were repeatedly manifested at the World Trade Organisation talks in Seattle in 1999, at the riots in Prague in 2000 and at the G7 talks in Genoa in 2001. Most horrifically, anti-Western opinion took the form of the events of September 11 last year. Undoubtedly, globalisation has generated increased wealth. But its benefits have been unevenly spread. The wealth of the world's 225 richest individuals now equals that of 2.5 billion of the world's population. 20% of the world's population living in richer countries enjoyed a massive increase in wealth between 1960 and 1995 and the gap between the richest and poorest countries widened.<sup>4</sup> The same gap has also widened within the world's richest countries, with the United Kingdom and the United States – two of the world's leading economies – experiencing the shortest life expectancy amongst OECD countries. Regarding the extent of environmental degradation caused by human activity: the 2001 Delphi Report predicts the bankruptcy of the re-insurance branch due to climate change.

Many of today's problems - war and conflict, mass migration, the violation of human rights, international crime and terrorism, environmental degradation and rapid population growth - are rooted in under-development and poverty, both intra- and internationally. As such, it has been argued that greater use of SRI and corporate responsibility are key means of balancing the negative tide of opinion against the adverse effects of globalisation, as well as being central components in the sustainable development agenda.

As a result, SRI today has increasingly been driven by a variety of objectives, not all of them primarily based on altruistic motives. For some, SRI is considered to be both an exercise in charity and an investment in which investment rates of return play as important a role as the non-financial rewards of the investment. For others, SRI is in fact primarily driven by the financial rates of return for the investor, where the employment of SRI practices is seen to add value to the investment strategy. Referring to this performance-based approach, it has been said that: "many of the investments to which some have social, political or other non-financial objections are open to

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4. Rt Hon Clare Short MP, Secretary of State for International Development, "The Challenge for the UN in a globalising world", speech given at the Rockefeller Foundation, New York, 26 October 1999.

valid objections purely on investment grounds, such as fears for the stability of the country involved”.<sup>5</sup> These performance aspects of SRI are considered in further detail in Part 3.2.5 below.

### *3.1.2 The role of governments and companies in the 21<sup>st</sup> century*

Opponents of the concept of SRI fall into two inter-related categories: free market economists, and those who criticise the blurring of borders between the corporate and public sector. For the former, Milton Friedman’s oft-quoted statement holds sway: “There is only one social responsibility of business: to increase profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud”.<sup>6</sup> For such free-market economists, SRI and corporate responsibility interfere with the proper working of the market and the efficiency of the corporate sector. In response, proponents of corporate governance and corporate responsibility have previously put the same argument forward that the proponents of SRI argue today: SRI, corporate governance and corporate responsibility are in fact means to reduce risk. As was clear in the case of the 1989 Exxon Valdez oil spill and the 1996 reports of Nike’s apparent use of child labourers, there is a high price to be paid if SRI and corporate responsibility issues are ignored. Thus, for proponents of SRI and corporate responsibility, Henry Ford’s business vision appears far more appropriate for the 21<sup>st</sup> century: “No business will survive if not making a profit. But it will neither survive if it will just want to make a profit”.

The concern that the corporate sector should not be involved in traditional public sector spheres of responsibility follows on from the free market economist perspective. The suggestion that social issues are for governments does contain valid arguments. It would after all be inadvisable for the leaders of non-elected corporations to play too large a role in health care, education, social security etc. However, modern 21<sup>st</sup> century governments have taken on a partnership role with the private sector. In doing so, whilst governments have ceded some of their traditional monopolies of power, this can by no means be considered to be a complete cessation of power and the governments of today have remained very much the dominant actor in the partnership, thereby utilising some of the vast potential of such a public/private partnership.

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5. Rt Hon Sir Robert Megarry, “Investing in Pension Funds: the Mineworkers’ Case in Equities, Fiduciaries and Trusts”, ed Youdan, TG, Canda, Barswell, 1989.

6. Milton Friedman, “Capitalism and Freedom”, February 1963.

## **3.2 SRI IN PRACTICE**

### *3.2.1 The growing importance of SRI*

Four factors have contributed towards the growing importance of SRI. Firstly, public awareness of SRI issues has continued to grow, particularly within OECD countries. According to a MORI poll published in 2001, 46% of respondents in the UK consider socially responsible issues to be "very important". This represents an 18% increase since 1998. At a minimum, the increased pressure on pension fund trustees and fund managers has heightened their awareness of SRI. As will be examined in further detail in Part 3.2.4 below, this has been especially the case in the United Kingdom, France, Germany and Australia, where government-led initiatives have resulted in SRI disclosure requirements being included in recent legislation.

Related to the rise in public awareness is the size of SRI investments. According to a study published by the Social Investment Forum in 1999, SRI amounted to 15% of the total amount of global investments, totalling \$US2.2 trillion in 1999. To add to this, there has been a dramatic growth in the size of SRI funds, having doubled in size since the end of 1998. The US is by far the most dominant force in SRI, accounting for over 92% of the sector globally, with more than \$US2 trillion in assets. In 1999 one dollar in every eight under professional management in the US was invested in an SRI fund, up more than 80% only two years earlier.<sup>7</sup> Just as significantly, the rate of growth of SRI funds is three times that of traditional portfolio investments. In addition to the growth of SRI funds in terms of asset size, the number of retail SRI products on offer has also dramatically increased, with several major investment houses entering the market, including the world's largest pension fund, the Dutch pensions giant ABP, which announced in July 2001 that it had created two new SRI portfolios.

Thirdly, until recently, SRI was practiced only in Europe and North America and was largely a phenomenon of the retail pensions fund industry. In recent years however, SRI funds have entered the retail fund market in a variety of countries, including those in Asia. Japan's first SRI fund, the Nikko Eco-Fund, was launched in 1999. Since then, ten other SRI funds have been established in Japan and in September 2001 Japanese SRI funds had a total asset valuation of ¥130 billion.<sup>8</sup> In

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7. Geoffrey Heal, "Mastering Investment," *Financial Times*, 2 July 2001.

8. Nikko Asset Management Co. Ltd., "The Japanese Market for SRI", November 2001.

Hong Kong, the first SRI funds were launched last year. In Australia, it is estimated that A\$1 billion is currently invested in SRI funds<sup>9</sup>, representing 10% of the country's total pension savings. This amount is expected to increase in line with US and UK trends, to become a multi-billion dollar industry before 2005.<sup>10</sup> The SRI industry has also recently entered a new phase, and can increasingly be considered to have become a part of the mainstream pensions industry in a variety of OECD countries. An important factor in the move to the mainstream investment sector was the launch of the FTSE4Good index in the UK on July 31 2001. As the chief executive of the FTSE stated: "The creation of FTSE4Good means that socially responsible investment has now moved into the mainstream". FTSE4Good is the latest in a line of SRI rating indexes, following on from, *inter alia* the Domini 400 Social Index, launched in 1990, and the Dow Jones Sustainability Group Index, established in 1999.

Fourthly, recognition of the financial impact of reputational and liability risk has grown amongst mainstream investors as a result of high profile environmental and social issues, including the accusations of Shell's human rights abuses in Nigeria, the above-mentioned Exxon Valdez oil spill and Nike's apparent employment of child labourers. It seems likely that SRI will follow the same course as the corporate governance movement, receiving widespread recognition as a matter for serious consideration by mainstream investors around the world only as a result of negative events, as took place with corporate governance issues subsequent to the Asian financial crisis of 1997/1998.

### *3.2.2 Has SRI always been good in practice?*

Until recently, it has been taken for granted that SRI practices no doubt serve to benefit the interests of the wider global community, via the implementation of higher environmental, human rights, employment standards etc. However, few analyses have actually been conducted in which improvements in company practices as a result of SRI have in fact been proven to benefit the wider community. This can be considered to be a vitally important omission, bearing in mind the number of high-profile cases in which adverse publicity or SRI-related policies resulted in inappropriate company and investor responses.

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9. Allen Consulting Group 2000 Report.

10. Anne-Marie Dark, CEO of HESTA superannuation, quoted in *Sunday Age*, 14 May 2000.



In 1996, accusations of Nike's use of child labourers in Pakistan resulted in plant closures that severely affected the economic well-being of communities which had previously relied on the factories as a key employer. More generally, where plant closures have taken place in urban areas in response to claims of child labour practices, former employees have often been forced into illegal employment sectors, including the child sex industry.

In 2001, animal rights campaigners in the United Kingdom targeted Huntington Life Sciences plc, accusing the company of cruelty to animals. A key corporate governance issue that arose as a consequence of the often violent campaign, which directly targeted company directors personally, was the right of company directors to anonymity. Once again, adverse publicity and negative public opinion encouraged the investment and financial communities to respond by divestment, which would have resulted in widespread unemployment, would have set a precedent to divest from other such companies in similar situations and could have therefore affected the British economy. Fortunately, this scenario was narrowly averted after last minute financing was secured from overseas financial backers.

In 2000, questions were raised regarding the prudence exercised by the pension fund trustees of the California State Teachers' Retirement System (CalSTRS) to divest itself of tobacco stocks. Due to its anti-tobacco SRI policy as well as the threat of litigation for tobacco companies, the board of trustees had considered it to be in the best interests of its shareholders to divest its tobacco stocks in June 2001, in a matter of weeks. The decision to divest arguably cost pension scheme participants almost \$US110 million in lost investment returns.<sup>11</sup>

Since the high-profile, often inappropriate responses to apparent child labour activities in 1996, SRI and corporate responsibility practices have advanced, albeit in a vacuum of analysis and debate regarding norms and best practices in the implementation of SRI policies. Where plant closures had previously taken place in response to adverse publicity, companies affected by social responsibility campaigns have often implemented alternative responses, *inter alia* school/employment programmes for employees. However, this has often been the exception, with plant closures and divestment being the norm. Similarly, concern was raised by the decision to divest from Huntington Life Sciences and from tobacco stocks. In both cases, it was questionable

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11. Kathleen Connell: California State controller and member of the CalSTRS board of trustees, quoted in *The Sacramento Bee*, 9 January 2001.

whether divestment was in fact the best option for either shareholders or stakeholders in general. Further analysis needs to be conducted regarding the pros and cons of divestment. However, judging by the analyses that have been provided so far, it would appear that divestment in the above cases was the wrong choice to make. To avoid similar costly mistakes being committed in the future, it is imperative for the global debate over corporate and investor responsibility to focus on the rules of SRI engagement, in particular regarding best practice in cases of negative publicity, and thereby including further study of the advantages and disadvantages of divestment, for both shareholders and stakeholders alike.

Although SRI is most commonly associated with divestment, or negative screening, there are in fact other, until now lesser known, alternative approaches. Positive screening is another means of implementing SRI policies, which involves including only companies with superior social or environmental performance.

The third approach, engagement, involves improving a company's social, ethical or environmental behaviour via shareholder activism, *inter alia* dialogue, pressure, and voting. The engagement approach has also been a key approach in the sphere of corporate governance.

In recent years, the engagement approach has increasingly become the favoured mode employed by the SRI industry. It allows the flexibility of investment choice and the associated reduction in risk, whilst playing an influential role in the companies being invested in. This approach is particularly effective during periods of economic downturn, when "defensive" stocks, such as food and beverage, which remain relatively stable in an unstable economic environment, have traditionally been the choice of investors.

However, the dearth of analysis and lack of awareness regarding the advantages and disadvantages of screening *vis a vis* engagement has had an impact on SRI practices, which have progressed in fits and starts. Whilst increasing numbers of fund managers have begun to use the engagement approach to SRI, there have also been important exceptions to this trend. This was the case in November 2000 when the board members of the \$US170 billion California Public Employees Retirement Fund (CalPERS), the largest public pension fund in the United States, decided to follow a negative screening policy regarding developing countries with poor human rights records. This policy was enacted on 22 February this year, when the CalPERS board announced that it was going ahead with its divestment policy in Indonesia, Malaysia, the

Philippines and Thailand, thereby removing \$US300 million from its South East Asian equity portfolios. The California State Controller summarised the mood of many trustees deciding on SRI policies when she stated: “I’m concerned that we don’t know what we’re doing here”.<sup>12</sup> This state of affairs is of particular concern bearing in mind the continuing increase in interest in socially responsible investments amongst the general public, and the dramatic growth of SRI funds.

### *3.2.3 Room for improvement: SRI awareness, disclosure policies and evaluation processes*

Information is the key factor for pension fund regulatory and supervisory authorities to best protect the interests of pension plan participants. In order to ensure the optimum operation of SRI practices in the pension fund industry, authorities need to be aware of the decision-making processes of pension fund managers. With regard to SRI, questions that need to be addressed include: Are pension fund managers and trustees aware of SRI issues? Do fund managers employ specialist advisors on SRI issues where necessary? Are suitable SRI methods in place to assess a company's approach to the issues? Do formal feedback mechanisms/contacts exist between pension fund managers and rating agencies, organisations involved in SRI private initiatives and SRI indices? Lack of transparency and general disclosure deficiencies amongst the institutions involved in SRI activities (particularly pension fund managers, organisations responsible for SRI voluntary initiatives, SRI rating agencies and SRI indices) prevent informed evaluations being made within the industry.

Another area that has raised problems in evaluating SRI practices is the lack of standardisation of SRI norms and best practice. Wide acceptance of SRI norms is very dependant on the progress made to standardise corporate responsibility codes of conduct. At present a multitude of corporate responsibility codes exist, *inter alia* the the OECD Guidelines for Multinational Enterprises, SA8000, the UN Global Compact, the Caux Principles, the Global Sullivan Principles, the GRI etc. Clearly, reaching a consensus with such a wide variety of codes will be a matter of time. However, some progress on SRI norms has taken place in Europe in recent years with the establishment of Social Investment Fora in the UK, France, the Netherlands, Italy, and Germany. These fora aim to centralise information on SRI. In addition, the Sustainable Investment Research

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12. Kathleen Connell, quoted in the *San Francisco Chronicle*, 14 November 2000.

International Group (SIRI), established in August 2000, is composed of leading European and North American SRI rating agencies. It aims to standardise SRI rating methodologies amongst its member agencies and to publish data in comparable formats. The group plans to shortly expand its membership to Asian and South African rating agencies. However, further standardisation is required, both here and elsewhere eg in the varying criteria used by SRI indices in measuring companies included within their indices, and in methodologies employed by companies which conduct their own internal socially responsible audits.

#### *3.2.4 Positive developments: SRI legislation and guidelines for pension funds*

The United Kingdom was the first country in the world to initiate SRI legislation. As a result of the amendment to the 1995 Pensions Act, which came into force on 3 July 2000, SRI policy disclosure was tied for the first time to pension products.

The legislation requires pension fund trustees to state their policy in their statement of investment principles concerning:

"the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments".

The new legislation does not oblige trustees to adopt SRI policies but merely to state whether or not they adhere to any such policies. The effects of the SRI inclusion in the law have been manifold. Primarily, it has served to clarify the situation regarding the legality of SRI practices. Until the 1999 amendment, trustees around the world had dealt with SRI under the threat of breaching their fiduciary duty to shareholders. The clear message provided by the UK's SRI legislation is that investing in socially responsible investments is not in breach of their fiduciary duty. This will be discussed in further detail in Part 3.2.5 below. The second key effect of the SRI legislation is that many more financial institutions have begun to operate SRI funds in order to avoid the potentially embarrassing prospect of not having investment products that take social, environmental or ethical considerations into account. This development has provided consumers with a choice of SRI investments that had not existed previously. Thirdly, and of particular significance for the mainstream investor industry in the long-term, the legislation has brought the SRI issue to the fore, bringing SRI to the attention of company directors, fund managers and trustees, and compelling them to become aware of social, environmental and ethical concerns.

The inclusion of a SRI disclosure requirement in a fund's statement of investor principles was seen to be of critical importance both for shareholders and for the further advancement of SRI in practice. The arguments later put forward by proponents of SRI-related legislation in Australia apply equally to the SRI disclosure requirements in the UK and elsewhere: "The point of sale disclosure is the most critical period for disclosure. It is when consumers make the informed decision to purchase a particular product based on the information before them".<sup>13</sup> Moreover, making an informed decision at the point of sale is of key importance as "the consumer has no control over the day to day use of the money invested to generate the return."<sup>14</sup> Being able to compare the range of products on offer at this stage is therefore of particular importance, especially bearing in mind that consumers are seeking to generate a high return, bearing in mind that the investments carry a higher degree of risk than other investments such as savings accounts. It is important to note that in a variety of countries, including Australia, the funds to which pension contributions are paid are chosen by the employer. This is of note as interest for SRI funds has tended to stem from the general public/employees. This discrepancy may lead to conflicting positions with regard to the choice of fund made and may therefore be an issue of future concern.

Since the introduction of compulsory statements of investment principles in the UK similar legislation, based on disclosure of any SRI principles, has been passed in France, Germany and Australia. Belgium is the latest country to consider the inclusion of social, ethical and environmental aspects in its pensions legislation, with a Bill currently making its passage through parliament.

In France, an SRI-linked disclosure amendment to the Employees Savings Plans was issued in February 2001. Disclosure is optional for fund managers of Employees Savings Funds. The amendment states:

"if appropriate, the law details social, environmental or ethical concerns that the fund manager has to respect when buying or selling securities or while exercising rights that are related to securities

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13. Australian Conservation Foundation, *The Financial Services Reform Bill. Submission to the Parliamentary Joint Statutory Committee on Corporations and Securities*. Prepared by Michael Kerr.

14. *Ibid.*

ownership. The fund's annual report must fulfill the requirements under the conditions defined by the Commission for stock market operations."<sup>15</sup>

Based on the amendment to the pension reserve funds in France that was issued in June 2001, SRI-linked disclosure is mandatory for the executive boards of the reserve funds. The amendment states:

"The executive board ensures the fund's ruling and is responsible for its management. The board implements the investment policy directions and supervises their correct application. It regularly reports to the supervisory board and in this manner it describes the way the general investment policy directions of the funds have taken social, environmental and ethical concerns into account."<sup>16</sup>

With regard to occupational pension plans in Germany, the reforms passed on 11 May 2001 state that: "the pension fund shall provide written information regarding whether and how ethical, social and environmental considerations are taken into account regarding the use of the contributions received."<sup>17</sup>

The legislative wording is similar concerning personal pension plans: "...the provider shall also provide written information regarding whether and how ethical, social and environmental considerations are taken into account regarding the use of fees received".<sup>18</sup>

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15. "Le règlement précise, le cas échéant, les considérations sociales, environnementales ou éthiques que doit respecter la société de gestion dans l'achat ou la vente des titres, ainsi que dans l'exercice des droits qui leur sont attachés. Le rapport annuel du fonds rend compte de leur application, dans des conditions définies par la Commission des opérations de bourse". Projet de loi sur l'épargne salariale, 7 February 2001. Titre IV, Art. 21.

16. "Le directoire assure la direction de l'établissement et est responsable de sa gestion. Il met en oeuvre les orientations de la politique de placement. Il contrôle le respect de celles-ci. Il en rend compte régulièrement au conseil de surveillance et retrace notamment, à cet effet, la manière dont les orientations générales de la politique de placement du fonds ont pris en compte des considérations sociales, environnementales et éthiques." Projet de loi portant diverses dispositions d'ordre social, éducatif et culturel. 28 June 2001, Chapitre Vbis, Art. L.135-8.

17. "Der Pensionsfonds muss die Versorgungsberechtigten schriftlich darüber informieren, ob und wie er ethische, soziale und ökologische Belange bei der Verwendung der eingezahlten Beiträge berücksichtigt". Betriebliche Altersvorsorge: Art. 10, §115, #4, Änderung des Versicherungsaufsichtsgesetzes.

18. "... der Anbieter muss auch darüber schriftlich informieren, ob und wie er ethische, soziale und ökologische Belange bei der Verwendung der eingezahlten Altersvorsorgebeiträge berücksichtigt". Private Altersvorsorge: Art. 7, §1, #9, Gesetz über die Zertifizierung von Altersvorsorgeverträgen.

In Australia, the amendment to the Financial Services Reform Bill (FRSB) was passed on 23 August 2001. The regulations are due to come into effect on 11 March 2002. The amendment is in two parts. Firstly, it requires all financial services product disclosure statements to disclose:

"the extent to which labor standards, environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment".

Secondly, it states that: "ASIC [Australian Securities and Investment Commission] may develop guidelines that must be complied with where a product disclosure statement makes any claim that labour standards or environment, social or ethical considerations are taken into account in the selection, retention or realisation of the investment".

The Australian requirement is modelled on the United Kingdom legislation, but goes further in that it includes all financial products with an investment component, rather than only pension products. Although the legislation will apply immediately to all financial products from 11 March 2002 onwards, there is a transition period of up to two years before existing product statements need to comply. The legislation applies to fund managers. Financial products with an investment component are defined as pension products, managed investment products and investment life insurance products.<sup>19</sup> The inclusion of the reference to "labor standards" was the result of a further amendment introduced by the Labor Party in Australia.

No doubt, the fact that occupational pensions in Australia are compulsory for the large majority of the population played a key role in the pressure to include an SRI amendment. As a result of compulsory occupational pensions, the government had a larger responsibility to ensure that pension plan participants were provided with as much information as possible regarding their investments, and that as much choice of product was allowed for these compulsory investments.

As a result of the inclusion of guidelines in the Australian legislation, it is hoped that the ASIC will "direct financial institutions to clearly substantiate any statement they make when complying with the new ethical disclosure requirements".<sup>20</sup> In addition, the product disclosure statements should be clearly distinguishable, enabling consumers to distinguish between those who do not

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19. Australian Conservation Foundation, "The Financial Services Reform Bill. Submission to the Parliamentary Joint Statutory Committee on Corporations and Securities". Prepared by Michael Kerr.

20. Michael Kerr, legal advisor to the Australian Conservation Foundation, quoted in *The Australian Financial Review*, 28 August 2001.

take socially responsible investment issues into account, those who do to some extent and those who do to a great extent. In short, SRI-related product disclosure statements should not be allowed to be vague or misleading, as was often the case in the UK following the SRI amendment, and led to what has become known as corporate “green wash”.

In the UK, the Association of British Insurers (ABI) recently took a lead role in the SRI agenda, by issuing new investment guidelines that seek to improve company disclosure of their approaches to social responsibility issues.<sup>21</sup> The guidelines follow publication of ABI research that concluded in favour of increased company involvement in social responsibility issues. The guidelines are non-binding and encourage companies to confirm in their annual report that they have assessed the risks of failing to respond appropriately to social, ethical and environmental matters, and that management practices are in place in order to assess these risks and enhance the value of the company.

In Belgium, the Bill on occupational pensions which is to be decided shortly, states: "The pension scheme or the person designated by the collective agreement of the pension settlement, prepares a report each year on the management of the pension fund liabilities. This report is given to the organiser, who delivers it to the affiliates upon simple request.

The report must include the following information:

- 1). the means of financing pension fund liabilities and the structural modifications to the financing;
- 2). the short and long-term investment strategy and to what extent social, ethical and environmental aspects are taken into account"<sup>22</sup>.

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21. Association of British Insurers, "Investing in Social Responsibility. Risks and Opportunities". Research Report, 2001.

22. "L'organisme de pension ou la personne désignée dans la convention collective de travail ou le règlement de pension, rédige chaque année un rapport sur la gestion de l'engagement de pension. Ce rapport est mis à la disposition de l'organisateur, qui le communique sur simple demande aux affiliés.

Le rapport doit contenir des information sur les éléments suivants:

1° le mode de financement de l'engagement de pension et les modifications structurelles de ce financement;



The European Commission has also been active in promoting further developments in SRI, including it as part of its recently published Green Paper as a "launch pad for debate" on the subject.<sup>23</sup> The overall aim of the Green Paper is to examine how the European Union can promote corporate responsibility, both within the 15 member states and internationally. As decided at the European Council meeting in Stockholm in March 2001, greater SRI co-ordination and standardisation within the EU will be an important component of the planned creation of a dynamic and efficient European Securities Market by the end of 2003.

These disclosure-based legislation on SRI principles differ from the United States, where legislation relating to SRI is markedly absent.

There has been a great deal of debate in SRI and corporate responsibility circles concerning the advantages and disadvantages of a voluntary *versus* regulatory approach to these issues. The conclusion that can be drawn from these debates seems very much to be that progress can best be achieved via a combination of the two approaches. The comments made by the UK government with regard to corporate responsibility apply equally to the SRI debate: "Intervention may be helpful to support productivity and competitiveness, to ensure that the market mechanisms that drive corporate responsibility's development work effectively, or to register key policy concerns. But public authorities should recognise the power of the independence of this voluntary approach. Private sector initiatives can go further and faster in setting standards and encouraging innovation than is possible for Governments, given the ongoing development of this area".<sup>24</sup> Judging from the wording used in all SRI legislation until now, this combination of the two approaches has been put into practice, encouraging the private sector to build on the legislative initiatives.

### 3.2.5 *The investment performance of SRI funds*

Traditionally, the prime duty of pension fund trustees, that of managing pension fund assets in the best interests of the beneficiary, has been interpreted in its narrowest sense i.e the maximisation of

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2° la stratégie d'investissement à long et à court terme et la mesure dans laquelle sont pris en compte les aspects social, éthique et environnemental". Projet de loi relative aux pensions complémentaires. Art. 42, Chapitre 8: Transparence.

23. European Commission, "Promoting a European Framework for Corporate Social Responsibility", Green Paper, July 2001.

24. "UK Government Response to European Commission Green Paper on Corporate Social Responsibility", 2001.

the beneficiary's financial gains, for a given risk assumed. As stated in Part 3.2.4 above, recent SRI legislation which has been passed in Europe and Australia has served to underline the legal interpretation that a trustee's paramount duty is to act in the best [financial] interests of plan members. In doing so, the legislation implicitly state that SRI practices do not contravene this prime duty.<sup>25</sup>

The facts concerning the performance of SRI funds give further reason to allay fears that SRI practices may not be in the best interests of the beneficiary. Despite the controversy concerning SRI and fiduciary responsibility, past performance of SRI funds indicates that beneficiaries of SRI funds need not necessarily assume lower financial rates of return than beneficiaries of traditionally invested funds. In fact, a variety of studies seem to indicate that SRI funds have either offered returns as good as those in traditional funds or have even outperformed them. In the US, the Dow Jones Sustainability Index provided annualised returns of 17% compared with 13% for the Dow Jones Global Index between 1994 and 1999.<sup>26</sup> The Dow Jones Sustainability Index also outperformed Standard & Poor's 500 by approximately 15% throughout the 1990s.<sup>27</sup> The SRI-based Goodmoney Industrial Average has consistently outperformed the Dow Jones Industrial Average since 1977.<sup>28</sup> As one of the leading analysts of the links between finance and environmental and social issues states: "there seems to be little evidence of systematically lower returns resulting from the application of a sensible selective equity SRI approach. Furthermore, these sorts of SRI policy do not appear to involve particularly increased downside risk. There does not seem to be an increase in total risk from adopting an SRI policy".<sup>29</sup>

Most importantly, despite the predictions of SRI critics, who had expected a sharp decline in the performance of SRI funds (which had previously invested heavily in technology stock), SRI fund

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25. This view was already endorsed in the UK in 1993 by the Pensions Law Review Committee (the Goode Committee): "As trustees they are perfectly entitled to have a policy on ethical investment and to pursue that policy, so long as they treat the interest of the beneficiaries as paramount and the investment policy is consistent with the standards of care and prudence required by law. This means that trustees are free to avoid certain kinds of investments as long as they make equally advantageous investments elsewhere [...]. What trustees are not entitled to do is to subordinate the interests of beneficiaries to ethical or social demands and thereby deprive the beneficiaries of investment income or opportunities they would otherwise have enjoyed".

26. Mark Mansley, "Socially Responsible Investment. A Guide for Pension Funds and Institutional Investors", 2000.

27. Geoffrey Heal, "Mastering Investment," *Financial Times*, 2 July 2001.

28. Geoffrey Heal, *ibid.*

29. Mark Mansley, *ibid.*

performance has continued to track that of traditional funds since the global market downturn became evident in 2000. According to percentile rankings just released by Weisenberger,<sup>30</sup> SRI mutual funds in 2001 achieved financial performance on par with traditional funds. For 2001, the Domini 400 Social Index (DSI 400) benchmark tracked closely to the S&P 500, coming in close to two-tenths of one percent lower for the twelve month period.<sup>31</sup> The latest financial data provided by SocialFunds.com states that SRI had even outperformed traditional funds: in the US, where the performance of equities was particularly volatile in 2001, “60% of SRI mutual funds outperformed traditional funds in their respective categories”.<sup>32</sup>

A variety of reasons may have attributed to the continuing performance of SRI funds. The balance of academic analyses that have been conducted on SRI investment performance suggest that companies with good environmental, ethical and social performance are reliable predictors of good corporate governance performance and in turn good overall performance.

Moreover, it is interesting to note that interest in SRI has not abated despite the global economic downturn. SRI world equity funds experienced an influx of \$US44 million, a 5.4% increase over start-of-year assets. In contrast, non-SRI world equity funds experienced a 3.1% decrease compared to start-of-year assets, with a total divestment of \$US13.7 billion.<sup>33</sup> According to a MORI survey, half of the respondents believe that socially responsible issues are more important in an economic slowdown than in prosperous times.<sup>34</sup> Following the events of 11 September, pressure for better investment policies, particularly in emerging/developing countries, and sustainable development more generally has been increased further.

### *3.2.6 Is SRI appropriate for Asian and other non-Western regions?*

Critics of the spread of SRI to Asia and other non-Western regions have based their arguments on three main points: the imposition of Western ideals on the non-Western world, the relevance of

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30. Weisenberger monthly data, quoted in “Top Five Social Investing News Stories of 2001”, SocialFunds.com, 8 January 2002.

31. The Domini Social Index 400 lost 12.07% during 2001, while the S&P 500 fell 11.88% during the same period.

32. SocialFunds.com, “Top Five Social Investing News Stories of 2001”, SocialFunds.com, 8 January 2002.

33. Lipper Inc., 2001 database.

34. MORI Annual Study on Corporate Social Responsibility, 2001.

such luxuries as SRI in emerging/developing countries, and the feasibility of putting SRI into practice in regions where there is little legal, political or general will, or even awareness, of SRI issues.

Each of these points has its merits. With regard to the first of the three claims: SRI has its origins in the Western world; the earliest forms of ethically motivated investments were guided by Anglo-Saxon, Christian morals; until very recently, SRI was practiced solely in North America and Europe. Clearly, as a result of these influences, the values that have so far guided SRI have been dominated by Western ideals and culture. However, that is not to say that these views should continue to dominate the SRI agenda in the future. Issues that may be particularly pertinent to specific regions can only add to the reasons to adopt SRI practices. In Asia, where there is a history of micro-credit, this aspect of SRI may receive greater attention than in other regions. Energy efficiency and ecological awareness is a higher priority in Japan and Korea than in many Western countries. As such, these issues, rather than emphasis on individual human rights and individual employee rights would seem to be more appropriate to Asia than elsewhere. At the same time though, there are also several inalienable values that are common to all regions of the world eg companies should not needlessly damage the natural environment or exploit child labour, directly or indirectly. These should not be ignored in the drive to form region-specific SRI values. Moreover, in countries that have signed multi-lateral conventions, the adoption of SRI practices around the world can only serve to further global progress on human rights, environmental protection and working conditions.

Those who argue that SRI is irrelevant to the needs of Asian countries state that higher priority must be given to create jobs and political stability rather than minimising ecological damage or protecting workers' rights. However, the creation of jobs and political stability are the very objectives that SRI aims to achieve. A clear conclusion from a study completed by Shell<sup>35</sup> recently is that redesigning production processes to reduce or eliminate ecological wastage can often lead to surprising gains in competitiveness, thereby having an effect on jobs and in turn political stability. The reduction of poverty and social tensions is a major focus of SRI policies. The "democratisation of capital" and the expansion of micro and community lending initiatives are examples of SRI-related movements that are having a significant positive impact on

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35. Shell, "People, planet and profits – the Shell Report", April 2001.

disadvantaged people around the world. Similarly, it can be argued that SRI facilitates dialogue between corporations, the financial industry, governments and community groups, thereby allowing alternative corporate and policy thinking that recognises the importance of the quality as well as the quantity of economic growth. This shift towards “quality growth” can contribute to economic advance that is equitable, prosperous and sustainable.

Finally, in response to the argument that there has been and there is currently little interest in SRI issues in Asia: one need only consider the development of SRI in North America and Europe until now. For many years, SRI was considered to be a “soft” idealistic fringe of mainstream investment, much as it is in Asia today. As was seen in Part 3.2.1 above however, SRI is increasingly being practiced in Asia. Awareness of environmental issues has also increased significantly in China, where pollution in major cities has affected the health of these populations. The rapid economic advance of Asian developing countries in particular has led to an increase in numbers of affluent and educated people, the sophistication of the market and an increase in the numbers of investors in the region. As such, the potential for SRI growth in the Asian investment industry generally is high, particularly in Hong Kong, China; Taiwan; China and Singapore. Moreover, the same key drivers for SRI that have been encountered previously apply to SRI in Asia: SRI can be a key means in which to positively adjust the imbalance of wealth amongst populations, both inter- as well as intra-nationally. Once again, adoption of SRI need not be based primarily out of altruistic motives, but rather out of self-interest. No doubt, it is merely a matter of time before interest in SRI issues increases across the region, just as happened previously with regard to SRI in the developed world, and with corporate governance issues in the post-Asian financial crisis era. In the words of Arthur Schopenhauer: “There are three steps in the revelation of any truth: in the first it is ridiculed; in the second resisted; in the third it is considered self-evident”.

#### **4. CONCLUSION**

As was seen above, SRI in theory is a win-win situation for both shareholders and stakeholders alike. The concept of SRI in the 21<sup>st</sup> century is no longer merely driven by altruism alone. As long-term investors, pension funds are an appropriate vehicle for promoting sustainable development and socially responsible investment. Given the continuing growth in interest in SRI issues around the world, it is in the best interests of pension plan beneficiaries that specialists in

the pensions field study this form of non-traditional investment in further detail, with particular analysis and expert discussion placed on SRI rules of engagement, norms and best practices, in order to provide the best means of ensuring that socially responsible investment practices remain true to their name, being responsible to both investors and the community at large.