

PENSION PROGRAMME

Socially Responsible Investment



2004-2005

Member Affiliates

ABP, The Netherlands
Amnesty International, UK
AXA Investment Managers, France
Calvert, USA
CIC Crédit Mutuel AM, France
CoreRatings, UK
Det Norske Veritas (DNV), Norway
Dexia Asset Management, Belgium
Economistas sin Fronteras, Spain
ESADE, Spain
Ethical Investment Research Service (EIRIS), UK
Ethix SRI Advisors AB, Sweden
Ethos, Switzerland
Fédération des Experts Comptables Européens (FEE), Belgium
Fidelity, UK
FTSE, UK
Fundaciòn Ecología y Desarrollo (ECODES), Spain
Henderson Global Investors, UK
HSBC, International
I.DE.AM., France
Insight Investment, UK
ISIS Asset Management, UK
Jupiter Asset Management, UK
Kinder, Lydenberg, Domini & Co., USA
Nextra (Grupo Intesa), Italy
Oikocredit, The Netherlands
Pioneer Investments, Italy
SAM, Switzerland
Bank Sarasin, Switzerland
Standard Life Investments, UK
Trade Union Advisory Committee (TUAC), International
Triodos Bank, The Netherlands
UBS AG, Switzerland
Universiteit Nyenrode (EIBE), The Netherlands
Vigeo, France
WestLB, Germany
WWF, UK



National SIFs

Belsif, Belgium
Forum Nachhaltige Geldanlagen, Germany
Forum per la Finanza Sostenibile, Italy
Forum pour l'Investissement Responsable, France
Swesif, Sweden
UK Social Investment Forum, UK
VBDO (Vereniging van Beleggers voor Duurzame Ontwikkeling), The Netherlands

| | |
|----|---|
| 04 | Foreword |
| 05 | What is the purpose of this toolkit? |
| 07 | I BACKGROUND |
| 08 | What is SRI? |
| 09 | Why do it? |
| 12 | What is the legal framework around it? |
| 17 | II STRATEGIES |
| 18 | What strategies are available? |
| 27 | What are emerging trends in SRI? |
| 29 | III GETTING STARTED |
| 30 | What should I ask asset managers about SRI? |
| 31 | What do I do about conflicts of interest? |
| 32 | How to integrate CG/SEE into Investment Principles? |
| 33 | What are other trustees doing? |
| 36 | Glossary |
| 37 | References |
| 39 | Credits |



Matt Christensen
Eurosif
Executive Director

Eurosif is proud to present the first European toolkit designed to help interested pension fund trustees and other readers understand how to make Socially Responsible Investment (SRI) an integrated part of institutional fund portfolios.

Based on research conducted in ten European countries during 2004, this toolkit aims to present the reader with a framework to better understand fiduciary risk, decision making criteria and potential strategies that can be utilised. SRI continues to be an area with diverse interpretations but I am confident that this toolkit can help pension fund trustees improve the means and ways to integrate SRI into the long-term management of their funds.

Thanks to the way it has been designed, this user-friendly toolkit allows readers to focus on the content areas most pertinent to them. The tools inside are meant to be put into practice in real life situations. I encourage readers to think of this document in that light. It is for you to extract what is most important in helping you to solve the key SRI issues you are facing.

Eurosif looks forward to your comments,



Matt Christensen
October 2004

Dominique Bé
European Commission
Employment & Social Affairs Directorate General

We are pleased to support Eurosif in its research and publication of this inaugural European toolkit for pension fund trustees.

This excellent guide provides more clarity and greater understanding for all interested parties about how to better implement SRI practices. The toolkit will serve not only the pension fund community but also the mainstream financial service providers interested in better understanding the evolving debate on SRI taking place across Europe.

Regards,
Dominique Bé

Thanks to the Pension Programme
Advisory Board

Eurosif wishes to acknowledge the active support and direction provided by the Pension Programme Advisory Board, a group of dedicated professionals from the SRI and Corporate Governance fields, in the conception of this toolkit.

Our heartfelt thanks go to:

Rob Bauer, ABP Investments & Maastricht University
Dominique Biedermann, Ethos Investment Foundation
Reg Green, ICEM, Henderson Global Investors Advisory Committee, FTSE4Good Expert Committee
Harry Hummels, Universiteit Nyenrode & ING Bank
Stefano Pighini, ENEL, FOPEN
Helen Wildsmith, UKSIF, Just Pensions

(All acting in personal capacity)

What is the purpose of this toolkit?

Eurosif's pension toolkit aims at helping trustees better understand and integrate Socially Responsible Investment (SRI) into their pension fund's strategy.

With increasingly unpredictable markets and a trend shifting from Defined Benefits plans to Defined Contributions plans, European pension fund trustees are under increasing pressure to understand and manage the many risks that companies face. Simultaneously, there is a growing tendency to take into account non-financial aspects of company management, both for their financial and non-financial consequences: material risk, values, and sustainable development. These factors are more and more enshrined in national and trans-national legislations; hence Eurosif's wish to directly pursue the growing interest in SRI in creating this European toolkit.

What questions does this toolkit answer?

Pension fund trustees, as well as other institutional investors, often approach SRI with a number of questions:

I - BACKGROUND

- 1 What is SRI?
- 2 Why do it?
- 3 What is the legal framework around it?

II - STRATEGIES

- 4 What strategies are available?
- 5 What are emerging trends in SRI?

III - GETTING STARTED

- 6 What should I ask asset managers about SRI?
- 7 What do I do about conflicts of interest?
- 8 How to integrate CG/SEE issues into Investment Principles?
- 9 What are other trustees doing?

This toolkit looks at answers and ways to address these questions, and seeks to help readers become more familiar with the issues at stake in the world of SRI.

Who is it for?

This toolkit is aimed largely for pension fund trustees. It will however be of great interest to anyone involved with pension funds, institutional investment, asset management, or those who are curious about SRI in general.

How to use it?

The toolkit combines background information with **Explainers** on specific topics, **Case Studies** on best-practice examples and useful **Tools** for trustees. It also contains a **Glossary** that explains commonly used terms and **References** for further reading.

SYMBOLS USED IN THIS DOCUMENT:



See also symbol: please go to another chapter or section in the document for more information.



Reference symbol: please see reference list at the end of the document for more information.

Readers are not expected to use this document from start to finish. Rather, it has been designed so that specific areas of interest can be read independently of other sections.

What are the expected benefits?

In reading this toolkit, trustees will:

- Understand more about SRI,
- Be familiar with issues, players, strategies and ongoing initiatives,
- Know what actions to take to start involving other trustees and their plan in SRI,
- Know where to look for further guidance.



I . BACKGROUND

What is SRI?



SRI traditionally combines investors' financial objectives with their concerns about social, environmental and ethical (SEE) issues. SRI is an evolving movement, whose most recent development is based on a growing awareness by the population, investors, companies and governments of the impact of SEE risks on long-term issues ranging from sustainable development to long-term corporate performance.

The reasons why investors decide to invest 'responsibly' may vary from one investor to the next. Where the emphasis is placed on ethics, one's approach may be described as value-based, whereas when the primary focus is set on financial return, the usual terminology is shareholder value-based. In most cases, investors find their motivation is a mix of both, and there are a number of means employed to act on information related to SEE risks.

Nevertheless, Eurosif believes that today's trustees must also think of SRI as incorporating corporate governance (CG). Indeed, as mainstream institutional investors' interest in SRI has been increasing¹ so too have questions about how it relates to corporate governance. It is necessary to explain the links between SRI and corporate governance. They relate in two ways:

- CG is a part of SRI.
- CG also works as an enabler of SRI policy.

Explainer:

What is corporate governance again ?

The media have raised the public's awareness of CG in the past few years due to scandals in the US and Europe. As a reminder, corporate governance covers the accountability and control mechanisms that govern the relationships among shareholders, management and stakeholders of a company. In essence, it's about creating an accountable process rather than about setting goals and standards, thus helping to prevent major crises. Among other things, it defines:

- Board composition,
- Board remuneration,
- Shareholders' rights to information,
- Shareholders' rights to submit resolutions at Annual General Meetings (AGMs),
- Shareholders' voting rights (such as one share-one vote-one dividend principle),
- Control mechanisms (including risk management).

What are the commonalities between SRI and CG issues ?

SRI has traditionally focused on stakeholders and respect for their rights. Shareholders are key stakeholders and corporate governance is intrinsically the vehicle of respect for their rights and interests. Advocates of good corporate governance, including SRI practitioners, wish to see greater accountability from the side of corporate management in order to ensure the long-term well being of the company and of its stakeholders.

How does good CG enable SRI policy?

Corporate governance allows active shareholders to voice concerns that deal with non-financial aspects of corporate life through engagement and voting strategies. Examples include:

- Disclosure requirements that enable shareholders to ask for information and thus help ground a dialogue with companies on facts rather than assumptions,
- The right to file shareholders' resolutions at AGMs in the case of continuing disagreements between shareholders and management, thus allowing shareholders to give an ultimate warning before a vote is cast. Presently, this issue is one of the weak points of European legislations, as usually only large shareholders are entitled to file resolutions,
- The defining of shareholder rights on voting. Currently, shareholders are not always granted voting rights commensurate with their share holdings. Many advocates would like to see a rule of "one share - one vote - one dividend" enforced.



See also information on Engagement and Voting in Chapter 4 "What Strategies are Available?"

In concluding this section, trustees will increasingly face non-financial risks that are material. These material, CG/SEE risks will require the trustee to be engaged and informed on SRI matters in order to decide appropriate actions for a pension.

1. The Eurosif 2003 study on Institutional Investors and SRI sized the market at up to € 336 billion.

This chapter aims to improve the understanding on a main issue: Trustees will first and foremost want to know whether SRI may add value to their plan, that is, whether it is compatible with their fiduciary duty. In other words, how may considering non-financial aspects of a company respect the management of financial assets in favour of a plan's beneficiaries?

Eurosif contends that if the reader accepts the business case for SRI, then the fiduciary case will follow. Further, although in the short-term the business case for SRI may not always be evident, when looking at SRI from the perspective of a long-term investor, the arguments for incorporating SRI into a pension plan become more apparent. We will start with the business case first.

FROM THE BUSINESS CASE...

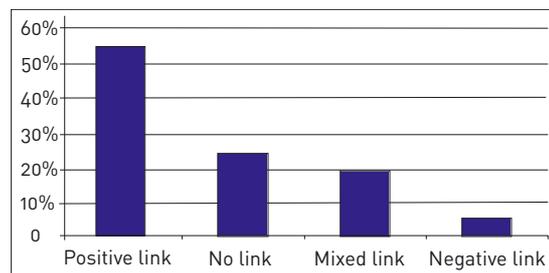
At present, Eurosif sees the evidence on SRI fund performance as positive or neutral. Here's why:

- **On company performance:** The definition of Corporate Social Responsibility² (CSR) remains a point of contention. Noted economist Milton Friedman argued as early as 1962 that companies should be left to maximise their profits and stock performance³ and leave it to shareholders to determine whether their money was being earned in acceptable ways. However, SRI is inherently a long-term approach to investing, sometimes at odds with the short-term vision prevalent on financial markets, and it is possible to argue that CSR policies will impact company value in the long run through improvement of reputation, reduced risk, better use of resources and new market opportunities.

- **On SRI screened fund performance:** To this day, no business case perfectly justifies SRI as a whole. SRI's history is too recent and a number of contradicting studies have been published. Nevertheless, one comprehensive study, Margolis & Walsh (2001), synthesized 80 studies on SRI portfolios, producing some interesting findings on SRI. More than 50% of the studies indicated a positive link between CSR practice by companies and SRI fund performance. Only 5% of these

studies showed a negative link. The remainder, however, failed to evidence the link between relative performance and the funds' SRI approach. Thus, the conclusions testify largely to a neutral or positive link.

Chart: Margolis & Walsh 2001 SRI fund performance study results



Source: Vigeo

- **Positive case examples:** Recent studies indicate that when a certain aspect of CG/SEE issues becomes quantifiable, taking into account those aspects in investment decision-making brings positive results. **Three cases below**, on reputational risk, eco-efficiency and corporate governance are provided as examples:

1) Reputational risk

Companies and investors increasingly acknowledge reputational risk. Some of its key aspects are:

- Government's decisions to grant operating licenses,
- Consumer decisions to buy products,
- Job-seekers' decisions to apply at a company,
- Impact of a CG/SEE event on share price.

As an illustration, the last aspect is demonstrated in a 1997 study by the University of Pittsburgh of stock market reaction to 27 incidents of socially irresponsible and illegal behaviour, involving lawsuits, fines and product recalls. This study found that such companies suffered very significant losses in shareholder wealth, which were not subsequently recovered.⁴

2. CSR addresses corporate practice, as opposed to SRI, which addresses financial investment practice.

3. Within the limits of law and of ethical custom, Friedman added. He thought law should define the social responsibilities of corporations.

4. Source: Just Pensions Guide for Trustees, May 2001.

2) Environment and Eco-efficiency

Corporate environmental issues are frequent objects of social and regulatory pressure. They are also associated with management skill. A very recent study by Derwall, Günster, Bauer & Koedijk (2004)⁵ tackles the impact of eco-efficiency on stock performance.⁶ By using eco-efficiency scores established by a rating agency, the authors created two equity portfolios. It turned out that the portfolio containing companies with high eco-efficiency scores provided substantially higher average returns than its low-ranking counterpart over the period of 1995-2003, even after transaction costs. The results of this study have been publicly endorsed by mainstream Asset Managers such as the CIO of Global State Street Advisors.⁷

3) Corporate Governance

Stock market research supports the claim that good corporate governance impacts the share price. In a recent study, Professor Metrick, Paul Gompers, and Joy Ishii of Harvard University graded the level of shareholder rights of 1,500 US companies on a scale of 1 to 24. The higher the score, the less say shareholders had. Companies with the strongest shareholder rights had a governance score less than 5 and were part of the “democracy portfolio,” while those with the weakest rights—those with a score greater than 14—were part of the “dictatorship portfolio.” The democratic firms significantly outperformed their autocratic peers. According to the study, an investment of \$1 in the democracy portfolio on September 1, 1990, would have grown to \$7.07 by December 31, 1999, or 23.3% annually. Companies in the dictatorship portfolio, in contrast, would have only been worth \$3.39 in December 1999, a growth of 14% annually.⁸

...ON TO THE FIDUCIARY CASE

The business case suggests that the link between SRI and fund performance is positive or neutral. Thus, a fiduciary case for SRI becomes easier to justify. Simply put, the fiduciary duty is the duty of an institutional investor to carry out investment decisions in the primary or sole interest of its beneficiaries – though an exact definition and/or interpretation may vary slightly.

In fact, since no law in Europe clearly and explicitly defines the relationship between fiduciary duty⁹ and CG/SEE, it is left up to the interpretation of practitioners, academics and local culture. It must be said that there is a larger consensus around the fiduciary case for good corporate governance, while other SEE issues are still perceived with uncertainty by many parts of the investment community.

Indeed, there are different and opposing views on how fiduciary duty allows CG/SEE criteria to be integrated into the investment process:

- The traditional mainstream view is that it is not permitted. This however is becoming less frequent.
- The leading British view is that fiduciary duty allows engagement strategies,¹⁰ but not extensive screening, as screening reduces investment universes and thus reduces diversification, diversification being key to the prudent man rule.
- Another common view in Britain, as advocated by the Trade Union Congress (TUC) and leading asset managers, is that voting rights are part of the asset of owning a share, and that the exercise of these rights is a fiduciary duty.
- The leading continental European view is that using the best-in-class approach is actually good for pension funds because it allows investors to eliminate risk factors and accumulate profit potential through a more thorough portfolio analysis that integrates CG/SEE risks and opportunities.



See also Chapter 4 “What Strategies are Available?”

The key argument in Europe is a debate around how screening reduces the potential for diversification and how it could thus be incompatible with fiduciary duty. Screening advocates reply that the

5. See www.epn-magazine.com

6. The Eco-Efficiency Premium Puzzle, Derwall, Günster, Bauer & Koedijk, May 2004.

7. Eurosif would like to acknowledge the participation of Rob Bauer in conceiving this business case.

8. Quoted from www.nyse.com

9. Except in the UK, where a court in the 1980's ruled against a mining sector's pension fund's applying screens to its investment process.

10. See “Is it legal?” chapter of the Just Pensions Guide for Trustees, May 2001.

reduction of investment universe is quite common under other circumstances (For example, when funds only invest in companies of a certain size: small caps, mid-caps, and large caps).

These views however are likely to evolve as legislation, experience and research in these markets increase and become more specific over time, and practices spread to new countries.

In conclusion:

- We have displayed strong elements suggesting that there is a business case for SRI profitability through positive or neutral evidence on stock market performance of SRI funds,
- If you accept the business case, then there is a fiduciary case for the long-term investor,
- How that fiduciary case is translated into practice depends on your country's acceptance of screening and/or engagement and voting strategies,
- We will show later that regardless of these current acceptance levels, each strategy may be best adapted to address a specific type of issue.

**Explainer:
Recent developments in economic theory support fiduciary case for SRI**

The Universal Investor Theory is a macro-economic approach with conclusions that support responsible investing. Jim Hawley and Andrew Williams of Saint Mary's college in California developed this concept. The authors define the universal owner as "a large fiduciary institution, which by virtue of its size or its asset allocation strategy owns a cross-section of publicly trade equities".

The Universal Owner (UO), of which a pension fund is the standard example, holds its shares for the long term. Additionally, its return is not defined by the return of each of its assets, but by the economy as a whole.

One major implication is that whenever a UO evaluates a firm, it should take into account how this firm's activity affects the overall performance of the economy, through its impact on environment, education, commitment to research, policy-making, etc, since all of these factors will eventually affect the investor's performance.¹¹

Practically, this indicates that if an industry is consistently imposing negative externalities on other industries, it is affecting the Universal Owner's entire portfolio. Thus, a UO's fiduciary duty would require it to address that industry's problem as it affects the UO's other holdings. This entirely new approach is gaining ground in investment circles and should be the object of important attention in coming years.

11. More on the Universal Owner at www.fidcap.org

What is the legal framework around it?

SRI regulations in Europe regarding the pension systems

Currently, five countries in Europe have specific SRI regulations in place that cover their pension systems: Belgium, France, Germany, Sweden and the United Kingdom.¹² Two more countries are on their way to introduce such regulations (Italy and Spain), while another two countries have debated about introducing them, but decided against it (Switzerland and Austria). The existing regulations vary in a number of ways, e.g. the pillar of the pension system which is concerned, the way the regulations are implemented and their success.

Regulation content can be divided into two types: transparency rules and investment rules. The pilot scheme of the first type has been the British SRI disclosure regulation for pension funds. Almost all of the other existing regulations follow this approach and in fact have been inspired by the British example. The most outstanding example of the second type is the Swedish regulation for its AP-funds. The regulation has found few successors, although it came into force at about the same time as the British regulation and it has been rather successful as well.

In this chapter we briefly present the regulations in the various countries and discuss the impact they have had on the pensions market and the application of SRI in their respective countries.

United Kingdom

British SRI-disclosure regulation came into force on July 3rd, 2000. This regulation was pushed both by the desire to enhance consumer protection and the intention to clarify the legality of SRI-oriented pensions investment policies. The regulation covers both private and public occupational pension schemes and stakeholder pensions schemes (part of the third pillar of the British pension system).

The regulation states:

“(other matters on which trustees must state their policy in their statement of investment principles) are (a) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments; and (b) their policy (if any) in relation to the exercise of the rights

(including voting rights) attached to investments.” (Statutory Instrument 1999 No. 1849; Amendment Regulations 1999)

Both the transparency effect and the enforcement of the regulation are rather weak. Members of the pension funds receive the statement of investment only upon request and the information does not have to be provided before customers sign a contract. Also, recent research revealed that about half of the pensions funds do not comply with the law, since their statement of investment does not contain particular information on SRI. Finally, those statements of investment which contain information on SRI are often rather vague.

The impact of the regulation has been very weak with respect to stakeholder pensions. Only eleven stakeholder pension schemes now provide a screened SRI option. Given the fact that there has been little promotion of the new regulation, public awareness and public interest in the issue have been weak and consequently demand of SRI and other stakeholder pension schemes has been low. Pension funds have been far more open to the new regulation. While there have only been a few mandates for screened portfolios (with a total of several hundred million euros), a number of pension funds have now started an engagement policy. 15% of all pensions funds (representing 51% of all members of pension schemes and accounting for several hundred billion euros) already apply an engagement policy (which in most cases includes SRI issues). An as-of-yet unresolved issue however is the quality of the engagement processes applied. In order to improve the engagement activities and to provide more transparency in this area, Eurosif together with twelve fund managers have developed the “Transparency Guidelines for Engagement and Voting in Institutional Investment”.

 See also the Engagement section in Chapter 4 “What Strategies are Available?”

Germany

Germany has introduced transparency regulations based on the British model for certain segments of the second and third pillar of its pension system. The regulation was driven by the desire to steer private investment into sustainable investment

12. Norway being an exceptional case, see Norway section in this chapter.



opportunities and by the request for enhanced consumer protection. The regulation was part of a general overhaul of the German pension system. With respect to the second pillar, the regulation which came into force the 1st of August 2001 introduced pensions funds (Pensionsfonds) as a new element of the pension system. These pension funds have to report annually to their members on the application of SRI policies. As in the British case, the funds are not obliged to invest in SRI, but they have to report if they do so or not and what activities they undertake.

In the case of private pensions the law applies to a new government subsidised private pension scheme (Riester-Rente). The law uses the same wording as in the case of pension funds. However, the financial authorities implemented it differently. Private pension schemes do not have to report if they already state in the contractual agreements with their customers that they will not take into account any social, environmental, or ethical considerations.

There are no rules as to how the reporting will have to take place. Customers or members usually will know only after signing the contract about the SRI policies of their fund or scheme. Authorities sporadically control the application of the regulation. However, failure to comply has little consequences.

The regulation has had quite an impact on the new market of pension funds. Almost 25% of the pensions funds (Pensionsfonds) apply an SRI-policy for parts of their equity portfolio or the total of it. Only screening is used; there is no engagement policy. The total SRI investment is likely to be in the tens of millions of euros or the lower range of hundreds of millions euros. This is a consequence of the fact that Pensionsfonds have only been introduced with the pension system reform and that they have had little success. Other types of company pensions schemes continue to prevail in the second pillar of the German pension system.

With respect to the private pension schemes to which the regulation applies (Riester-Rente), the general market itself has developed far better with millions of contracts already signed. However, less than 1% of the products apply SRI. Actually, many

schemes have used the option to state in the contract that they will not apply SRI principles. The regulation has thus created the only worldwide market of legally based Non-SRI products. Due to contractual reasons, a modification of the law (which is likely to come soon) will not change this fact anymore.

France

Two laws concerning SRI and pension systems have been introduced, one shortly after the other in France in 2001. Both have been inspired by the British example. Consumer protection as well as the desire to strengthen SRI-investments were the main reasons for the legislation.

In a law from February 2001 the French Parliament relates SRI issues to Employee Saving Plans. The French Employee Saving Plans are partly a substitute for voluntary company pensions schemes. The new legislation has changed many features of these plans and introduced at the same time an obligation that the fund's internal rules specify (if need be) the social, environmental or ethical considerations the fund management company must take into account. Also, the regulation requires that the fund's annual report make known how these considerations have been taken into account. The second law voted in 2001 requires the executive board of the Fonds de Réserve des Retraites (Retirement Reserve Fund, FRR) to report to the supervisory board on the investment policy guidelines and how these take into account social, environmental and ethical issues. The Retirement Reserve Fund has a total volume of about €16 billion and has been set up to support the first pillar of the French pension system.

The legislation has been successful with respect to the Pension Reserve Fund. In a step-by-step approach the fund is enlarging its SRI investment policies. SRI voting policies are applied now. Also, at the end of 2004, the Pension Reserve Fund will set up a special SRI niche fund, and the mandates for all European equities will require the fund managers to establish an SRI investment policy. The SRI regulation concerning the Employee Saving Plans has been less successful, though it was heavily supported by the French trade unions.

Belgium

The Belgian disclosure regulation came into force the 1st of January 2004. The regulation covers exclusively the second pillar, e.g. company pension schemes. As the French and the German case, the law has been inspired by the British model. The main reasoning behind the law was the wish to strengthen a sustainable development of the Belgium economy and to enlarge SRI investments. The law requires the pension funds to write in their annual reports in how far social, environmental and ethical issues are taken into account in the investment strategy. The annual report is distributed to the organisers of the pension fund, but not to its members. Members can obtain a copy only upon request.

There are no specific control mechanisms or special sanctions attached to the SRI regulation. Rather the usual rules concerning the annual report cover this information requirement. Also, there are no specific reporting guidelines. First reporting will be done only in 2005 (for the year 2004). Therefore, it is still too early to judge the market impact of the regulation. So far, almost no pension fund has changed its investment policy, but widespread interest by pension funds in the issue is reported.

Sweden

Sweden introduced SRI-related investment legislation on its approximately €65 billion Swedish National Pension Funds (AP Fund) system on January 1, 2001. This legislation covers the buffer funds, AP:1, AP:2, AP:3 and AP:4, as well as the premium reserve fund, AP:7. These funds "must take ethical and environmental considerations into account without relinquishing the overall goal of a high return on capital."

The AP Funds have adapted different strategies to meet their SRI legislative obligations-one size does not fit all in Sweden. AP:1 has implemented a norms-based approach. An engagement strategy is applied; exclusion is used as a last resort. While historically focusing on traditional CG issues, AP:2 has expanded its CG policy. It also uses a best-in-class approach on €76 million of its assets. AP:3 has also incorporated SRI issues into its CG policy.

While this policy covers all of its assets, it emphasises its engagement with Swedish corporations. That is, with companies that AP:3 can best assert its influence as a large, respected Swedish investor. AP:4, the least active AP Fund, uses a CG approach. AP:7, one of the pioneers in norms-based screening, has a policy similar to AP:1's policy.

Interestingly, the legislation has led to a SRI "competition" among the AP Funds and this, in turn, has been a driver in promoting SRI among other institutional investors. While AP:7 introduced a highly visible norms-based SRI policy in 2001, its activities have been overshadowed, to some degree, by AP:1 and AP:3's SRI advancements. Recently, attention has been placed on AP:2's decision to compliment its corporate governance strategy with a best-in-class approach.

Italy

In the end of July 2004 the Italian pension reform bill was approved by the Camera dei Deputati (Lower House), after the "green light" from the Senate, and has now become law. The new piece of legislation includes a UK-style disclosure regulation for all second and third pillar pension funds. The amendment requires pension funds to report both in the annual report and in a more comprehensive way in the information sheets sent to their members if and in which way they apply SEE considerations to the investment policy and in exercising the rights as holder of their securities.

Given the complexity of this reform, the Parliament has adopted the so-called "delegation procedure", which means that the bill gives a framework and contains general principles, but the specific rules will be set by the government with a decree to be issued within one year. To this purpose, a working group will be established within the Ministry, which will present its results to the Parliament and the Senate. Proposals on the wording of the decree with respect to the ethical disclosure regulation do not exist yet.



Spain

In 2003, the Spanish Senate has recommended to the Spanish Parliament a new legislation regarding SRI and pension funds. Due to the new composition of the Spanish Parliament after the elections in March 2004, the chances are good that the proposal will be taken forward.

So far, the proposal foresees a disclosure regulation for all pension funds; it would thus cover both company pension schemes as well as private pension funds. The proposal does not specify precisely how the reporting should be done by the pension funds. It also does not contain any further information on how the regulation should be implemented by the financial authorities.

Austria

In the course of a reform of the pension system, which took effect on July 1st, 2002, a discussion developed in Austria concerning the introduction of a SRI disclosure regulation for a new type of pension fund (Mitarbeitervorsorgekassen). Due to a short time frame and political opposition the regulation was not integrated into the law. However, the discussion on the regulation has given the issue of SRI and pensions much more prominence in Austria. Seven out of the nine new pension funds have declared that they will implement SRI policies on a voluntary basis.

Switzerland

In Switzerland as in Austria, the proposal to introduce an SRI disclosure regulation into a reform law concerning the pension system failed. Nevertheless, a reporting obligation on pension funds' voting policies¹³ was introduced in 2002. This new rule led many previously passive pension funds to exercise their voting rights. The obligation, however, does not comprise explicitly an obligation to report on SEE issues concerning the voting policy.

Norway

The Norwegian Government Petroleum Fund was established in 1990 and had €103 billion in assets under management at the end of 2003. This Fund acts as a buffer for stabilising fluctuating petroleum revenues. While currently not a pension fund per se, its long-term investment strategy closely resembles those used by pension funds. As a consequence, its SRI related activities serve as a catalyst for other large institutional investors, like pension funds, both in Norway and abroad.

In 2001, a small portion of the Petroleum Fund's assets were placed in an environmental fund. In the following year, the Graver Committee was assembled to propose SRI investment guidelines for the entire Fund. The Graver Committee's guidelines have been endorsed by the Parliament and are contained in Norway's Revised National Budget 2004.

The Fund's SRI guidelines invoke a combined strategy. Corporate governance will be used to promote long-term financial returns, under the hypothesis that long-term returns will be enhanced by a portfolio consisting of companies that demonstrate respect for universally accepted norms of ethical behaviour. Negative screening will be used to exclude companies that produce weapons whose normal use violate fundamental humanitarian principles. Finally, the Fund will exclude companies that are deemed to present an unacceptable level of risk of contributing to violations of fundamental humanitarian principles, gross human rights violations, gross corruption or severe environmental degradation. The Fund's segregated environmental fund will be discontinued after the new guidelines have been implemented.

13. This must be understood as an obligation to specify how one votes, and not as an obligation to vote.

Conclusion

The SRI regulations regarding the pension schemes in various European countries have been very similar in their wording. The impact they have had on the market however has been very different. As an example, in the UK, the SRI disclosure regulation has largely introduced SRI engagement policies and thus succeeded in building the bridge between the small SRI market and the mainstream market. However, in Germany the regulation has created a substantial market of legally bound “Non-SRI Products”.

Apart from the German case, overall the regulations have brought a substantial push to SRI, and it looks like the momentum will continue. Along with Italy and Spain, new countries are likely to follow the example of the existing ones. Also, the success of the disclosure regulations in several countries might well lead to an enlargement to further compartments of the pension systems. There is a good chance, that what we have seen so far with respect to SRI regulations for pension systems are only the first initiatives in a longer chain of campaigns to follow. It should be noted, however, that regulation is not necessarily the only way to promote SRI. The Netherlands for example does not have specific laws, but that has not stopped Dutch pension funds from becoming active on the SRI front.





II . STRATEGIES

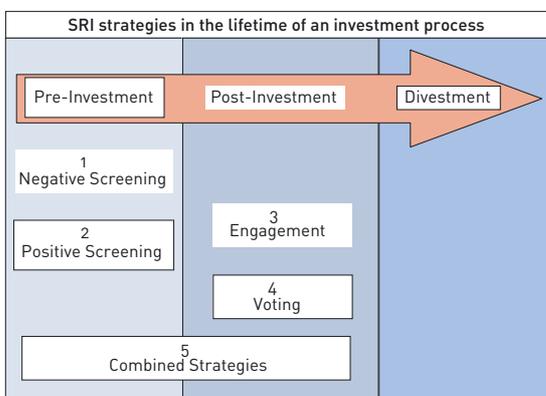
What strategies are available ?



This section presents the various strategies available to the investor who would like to practice Socially Responsible Investment. As a reflection of the diversity of SRI approaches and strategies in Europe, Eurosif does not discriminate in favour or against any such strategy, such as screening or engagement approaches. This toolkit aims at presenting an impartial, balanced view of the benefits and limits associated with any strategy.

Trustees will want to consider SRI as part of their overall fund management strategy, but also as an investment option to offer beneficiaries in the case of Defined Contributions plans.

While they are presented individually, it is important to note that these strategies are not mutually exclusive. Rather it could be said that they are complementary as they seek to address CG/SEE issues at different moments in the life of an investment. Screenings are pre-investment actions, while engagement and voting take place when the investor already owns stocks.



Source: Eurosif

The key question for a trustee is: what strategy is most likely to succeed in attaining the goals decided upon by the investor?

NEGATIVE SCREENING

What is it?

Negative screening is also sometimes called exclusion. It consists of barring investment in certain companies, economic sectors, or even countries for CG/SEE related reasons.

Negative screening was at the root of the SRI movement when religious investors in the US and the UK started excluding investments in so-called "sin stocks", such as gambling and alcohol. It was again in the spotlight when CalPers, California Public Employee's Retirement System, actively campaigned and barred investment in companies with South African activities in the early 1980's to protest against apartheid. A tool at the end of this section lists common exclusion screens.

Norms-based screening is often grouped together with negative screening since exclusion can be used at the end of the analysis process. The norms-based approach involves monitoring corporate complicity with internationally accepted norms, such as the UN's Global Compact, Millennium Development Goals, ILO Core Conventions, and OECD Guidelines for Multinational Enterprises.

Why use negative screening?

Funds employ negative screening in order to:

- Eliminate a very specific risk from one's portfolio,
- Make an ethical statement,
- Communicate in an effective way with members and the general public on ethics,
- Uphold their investment policy.

Negative screening, especially extensive screening, can increase risk because it can alter sector and geographic allocations within an investment universe. This could in turn affect a portfolio's performance relative to its benchmark index. Nevertheless, pension funds using norms-based screening report insignificant changes in risk levels.

How do you do it?

Pension plans first identify the areas in which negative screening should be applied. Then they determine the level of tolerance to these areas. These screens must then simply be communicated to asset managers.

There is one major technical difficulty to address when looking at negative screening: many companies may not have their entire business, but only a share of it, in the sector that one wishes to exclude.

For tobacco screening, a classic example would be large retailers that sell cigarettes. In this situation, the key issue is for the investor to decide where to draw the line. That share of turnover can again be measured in terms of risk. Rating agencies and SRI analysts may provide this assessment as a service.

Who does it?

Negative screening has historically been popular among some pension funds, particularly in the Netherlands, where Eurosif found that €184 billion (or about 42% of total Dutch pension assets) are managed with some form of negative screens.¹⁴ Again, it is also a common practice for charities and churches. Norms-based screening is increasingly being used as a minimum criteria in investment processes, especially in Scandinavia. It has been estimated that the total amount of assets under norms-based screening management is around €100 billion.

| Tool: Common negative screens used by institutional investors like churches, charities and some pension funds | | |
|--|---|--|
| Armaments and nuclear weapons | Animal exploitation (e.g. fur industry, factory farming) | Animal testing (e.g. pharmaceutical and cosmetic industry) |
| Alcohol manufacture and promotion | Activities, processes or products that have a major impact on climate change (e.g. automobile, oil and gas industry, road building, etc.) | Genetic engineering |
| Manufacture and promotion of hazardous substances such as pesticides, chlorine-containing chemicals (e.g. PVC) | Manufacture and promotion of ozone-depleting substances | Tobacco manufacture and promotion |
| Environmentally damaging practices | Nuclear energy | Oppressive regimes |
| Poor employment practices | Gambling | Pornography |

Source: *Observatoire de la Finance, Responsible Investment in Europe, online executive summary.*

POSITIVE SCREENING

What is it?

Positive screening is the selection, within a given investment universe, of stocks of companies that perform best against a defined set of sustainability or CG/SEE criteria.

The most popular form of positive screening is called 'best-in-class', where stocks are selected within each sector of a given index, thereby retaining sector balance within the investment universe. A slightly less popular form is pioneer screening, where funds specialise in the best-performing companies against a specific criterion, such as management of natural resources. Moving away from equity to fixed income, funds applying positive screens to bonds are gradually becoming available as well.

While it is a good strategy to tackle all aspects of CG/SEE, positive screening is rarely used in direct connection with corporate governance. If this is the issue that you are concerned with, you should look at engagement or voting as strategies of choice. Positive screening is usually based on the triple bottom-line. This means ensuring that companies perform well on social, environmental and economic factors. To understand what criteria are used to rate companies, see the tool at the end of this chapter.

Why use positive screening?

In continental Europe, positive screening is viewed as an excellent SRI strategy. Due to its systematic approach in covering a large number of companies and clarity of practice, it is often considered a more accountable strategy than engagement.

However, as is the case for negative screening, some investors believe that positive screening reduces investment diversification and therefore goes against the limits imposed by fiduciary duty. While this must be discussed with lawyers taking into account a country's or plan's peculiarities, it must be said that this assertion is just as true on other common funds such as large caps funds, mid-caps, etc. Best-in-class selection, specifically, addresses this criticism by maintaining sector balance.

The following explainer goes into further detail.

14. Source: Socially Responsible Investment among European Institutional Investors 2003, Eurosif.

Explainer: How best-in-class performs compared to benchmark indexes:

Studies¹⁵ show that the size of the investment universe is key in determining how best-in-class may impact performance against a benchmark. In practice, the larger the original investment universe, the less likely there will be a visible impact on the fund performance as related to the benchmark.

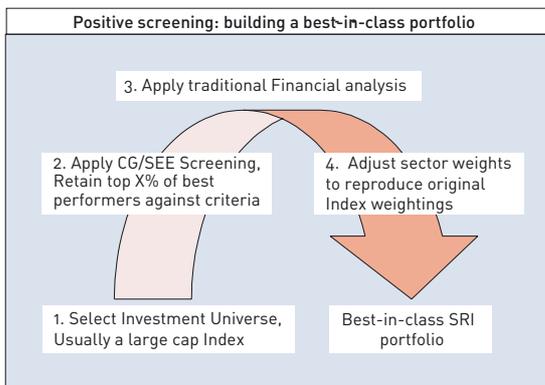
On smaller universes, like on smaller countries' stock market indexes, the presence of heavy-weighting stocks (companies with larger-than-average caps) presents a certain danger for positive screening. As these stocks' performance are key in determining the evolution of the overall index, inclusion or exclusion of these large companies represents a significant risk.

On common larger benchmarks though, such as the S&P 500 or MSCI 650, this risk effectively disappears. Thus, when based on large universes, best-in-class portfolios become acceptable investment vehicles in terms of risk.

How do you do it?

Pension Funds may buy into existing funds managed with positive screens. They can also buy into funds that track an SRI index. Additionally, they may ask their managers to apply the screens of their choice.

As a common example of positive screening, the following chart illustrates the creation of a best-in-class portfolio as a 4-step program:



Source: Eurosif

Who does it?

Some pension funds or other institutional pension investors in continental Europe run "test" positive

screening portfolios on a small share of their assets. Some examples include ABP and PGGM in the Netherlands, the FRR and soon ARCO/AGIRC in France. Best-in-class funds and other positive screening portfolios are widely available from asset managers everywhere.

Case study: A best-in-class test portfolio at ABP

ABP is Europe's largest pension fund and is actively committed to sustainable investment. Its SRI best-in-class portfolio is worth about € 150 million and serves as an experience for future activities in the area. ABP's active attitude in this area was rewarded in 2003 with the IPE Award for the best European pension fund in terms of SRI.

Its in-house fund manager uses out-house rating on environmental, social, and strategic governance issues for companies and sectors. The portfolio is based on the MSCI World Index. Companies that can be included for potential investment are selected through the CG/SEE ratings.

Traditional fund management techniques then bring the portfolio to its final composition. The portfolio is balanced to maintain sector weights that correspond to the benchmark index (though ABP retains the right to deviate from this methodology for specific stocks when serious risk issues are involved).

Significantly, at the present time ABP does not mix sustainable criteria with corporate governance criteria, in order to be able to assess each of those criteria's impact on performance individually.

Source: ABP Investments

Tool: Issues and criteria used in positive screening

For trustees considering positive screening, this table indicates issues and criteria used in rating companies. Note that this approach is not 'One-size-fits-all', as companies must be rated according to the key issues within their sector.

| Domain | Issues |
|-----------------|---|
| Human Resources | Integration of human resources issues into corporate strategy, Promotion of labour relations, Encouraging employee participation, Career development, Training and development, Quality of remuneration systems, Improvement of health and safety conditions, Respect and management of working hrs. |

15. See "International Evidence on Ethical Mutual Fund Performance and Investment Style", by Bauer, Koedijk and Otten, November 2002.

| Domain | Issues |
|-------------------------|---|
| Environment | Environmental strategy and eco-design, Pollution prevention and control (soil, accident), Development of "green" products and services, Protection of biodiversity, Protection of water resources, Minimising environmental impacts from energy use, Management of atmospheric emissions, Waste management, Management of local pollution, Management of environmental impacts from transportation, Management of environmental impacts from the use and disposal of products/services. |
| Customers and Suppliers | Product safety, Information to customers, Responsible Contractual Agreement, Sustainable Relationships with suppliers, Integration of environmental criteria in the purchasing process, Integration of social criteria in the purchasing process, Prevention of corruption, Prevention of anti-competitive practices. |
| Human Rights | Respect for human rights standards and prevention of violations, Respect for freedom of association and the right to collective bargaining, Elimination of child labour and abolition of forced labour, Non-discrimination. |
| Community Involvement | Promotion of social and economic development, Societal impacts of company's products and services, Contribution to general interest causes. |
| Corporate Governance | Board of Directors, Audit & Internal Controls, Shareholders' rights, Directors & Key Executives, remuneration. |

Source: Vigeo

ENGAGEMENT

What is it?

Engagement can be defined as "influencing corporate policy by virtue of the position as investor and the associated rights."¹⁶

There are three levels of engagement:

- Cultivating general dialogue,
- Taking a proactive stance: "we would like this specific issue to change for the following reason",
- Reactive dialogue: what to do in case of a problem to ensure it does not happen again.

Essentially, engagement differs from screening in that it does not affect the selection of stock, as the strategy takes place after a stock is purchased. With an engagement approach, every company in the investment universe can be purchased. After purchase, an asset manager will create dialogue teams that will engage with the company on specific, selected issues – usually a few per annum.

Explainer: When to engage?

The British Institutional Shareholders Committee (ISC, whose members are ABI, AITC, IMA, and NAPF) produced a Statement of Principles on Shareholder Activism, in which it states that investors should engage companies when they have concerns about:

- The company's strategy,
- The company's operational performance,
- The company's acquisition/disposal strategy,
- Independent directors failing to hold executive management properly to account,
- Internal controls failing,
- Inadequate succession planning,
- An unjustifiable failure to comply with the Combined Code (UK CG code),
- Inappropriate remuneration levels,
- The company's approach to CSR.

Why use engagement?

First and foremost, for many practitioners, engagement solves the fiduciary duty issue by keeping all investment possibilities open.

Traditionally, engagement focuses on corporate governance, and is in fact the strategy of choice when it comes to this issue. A newer and more recent dimension to engagement is the activist stance taken by a number of SRI investors to push forward the issues that matter to them.

Another significant aspect is the diversity of means

16. From "Corporate Shareholder Engagement", Hummels, Willeboordse, Timmer, 2004, Universiteit Nyenrode.

that are available to the engaging investor, from writing letters directed at senior management, to filing resolutions at AGMs to voting, and, ultimately, divestment. Filing resolutions is considered a good way to warn management that the investor strongly disagrees with some of the company's policies.

A downside is that the focus of engagement is intrinsically limited by human factors such as size of engagement teams and time allotment, thus potentially covering less ground than positive screening strategies.

In addition, many asset managers are reluctant to quantify the result of their engagement activities, thus making assessment of the policies more difficult.

How do you do it?

Shareholders such as pension funds have a variety of methods, both public and private, to exert influence:

Private methods

- Raising questions or discussion of social issues in routine meetings between institutional investors and company management.
- Writing to company management about issues of concern.
- Arranging special meetings to discuss such matters.
- Writing to other shareholders to express concerns.
- Joining with other like-minded investors to undertake some or all of the above.
- Informing other investors on the dialogue as to build up pressure.

More public mechanisms

- Attendance at annual general meetings to ask questions.
- Proposing shareholder resolutions.
- Exercising voting rights, e.g. on the adoption of the report and accounts or the re-election of directors.
- Calling an extraordinary general meeting.
- Issuing press briefings.

Source: "Just Pensions, A Guide for Trustees and Fund Managers", May 2001

Who does it?

Engagement has become a common practice in the UK, where £84 billion of pension assets are managed through engagement mandates.¹⁷ Its practice is also on the rise in continental Europe.

Specialised asset managers have dedicated SRI (or SRI/CG) teams. They engage on behalf of their customers and supply the resources to address key issues. It is also possible, and more and more frequent, for pension funds to separate engagement from fund management by issuing specific mandates to specialised asset managers. The most advanced specialists report regularly through their websites or dedicated material on the advancement of their engagement activities, including raised issues and outcomes.

In 2004, Eurosif issued the "Transparency Guidelines for Engagement and Voting in Institutional Investment". Currently in a pilot phase until 2005, the Guidelines aim to clarify the practice of asset managers and improve understanding of the market's practices by mandates. Eurosif urges trustees to see if their asset managers will be reporting in line with the guidelines.

Tool: How to engage?

- Trustees should identify which issues, sectors or companies they wish to engage upon within a policy document,
- Decide whether to engage themselves or use external services (as advisors of the fund or as external engagers mandated by the fund),
- Set up the required resources or mandates necessary to engagement,
- Check that reporting about the engagement process is in line with the pension's policy.

Case study: Engagement in practice

USS Ltd is the occupational pension fund for the UK Universities and with nearly 200,000 members and assets of approximately £19.5 billion, is of the largest pension funds in the UK and Europe.

USS's Directors - what other funds call trustees - decided to adopt a policy on RI (responsible investment) in 1999, and appointed a team of three specialists to address the issues.

17. Source: Socially Responsible Investment among European Institutional Investors 2003 Report, Eurosif.

USS's Directors believe that companies which manage corporate responsibility well, and which have good standards of corporate governance, will – all else being equal – prove to be better long term investments, not least because of better risk management. USS also believes that corporate ability to manage these issues well is an indicator of good management and as such is an indicator of likely superior performance over the long-term. The fund also believes that it is in the fund's interests to encourage companies that perform poorly on these issues to improve their performance, as this too is likely to add value to the fund over the long-term.

In the operation of this engagement strategy, USS focuses on specific issues and sectors rather than trying to engage with all the companies in which the fund invests. For example, the fund has focussed on the Oil and Gas sector, and its management of climate change as a risk issue. Engagement is multifaceted, and not just relating to proxy voting at AGMs.

As an example, and because of perceived risks associated with its policies on climate change, USS decided to engage with company X, a major oil company. The engagement, over a three-year period, included:

- Face to face meetings between RI team members, internal fund managers and the company
- Collaborative meetings between the company and a group of investors concerned with the position the company had taken on a number of extra financial issues, including its repose to climate change risk and opportunities.
- Production of a company specific report on the risks faced by the company as a result of its management of the issue, a copy of which was sent to and debated with the company.
- Voting at the AGM, followed up with an indication to the company on how the fund voted.

What has this engagement achieved? It is not possible to attribute change by a company to actions by one stakeholder, especially in a situation where many others are involved. What is clear is that the company took this joint engagement project very seriously and since then, there has been a shift in the way the company has responded to the issues under discussion and its communication with shareholders and other stakeholders. In terms of process outcomes, this initiative also involved large UK and UK offices of large global investors in a project focused on a non-UK listed company and on issues which are material but not traditional corporate governance issues, and this has been a significant development.

Source: USS

VOTING

What is it?

Every year at companies' AGMs, shareholders are given the opportunity to vote on a number of issues. Today, given the many scandals such as Parmalat and others, voting is not just an opportunity, but it is also increasingly being considered a duty for owners to cast their views on a company's decisions and future perspectives. Indeed, the ability for an investor to vote is inherently part of corporate governance issues.

Explainer: Why is Voting separate from Engagement in this toolkit?

Voting is inherently part of an engagement process, yet in most cases, ALL shareholders are systematically asked to cast their ballot on issues regardless of their engagement activity. A regulatory trend in making votes compulsory in many countries accentuates this phenomenon. In light of this, Eurosif decided to consider Voting a strategy of its own.

Because of the lower importance granted to voting in the past, most shareholders tended to vote along with management, or, more to the point, let their asset managers decide whether to vote and what vote to cast. However, this is beginning to change, as shareholders understand the importance and relevance of voting more and more.

Voting today is mostly applied to corporate governance, as local regulations limit the type of items that can pass as resolutions. As a result, when no SEE resolution can be submitted, history shows that shareholder activist groups opposing a company's CSR performance have voted against listed companies' mandatory shareholder approval of accounts and reports as a form of protest.

It must also be said that institutional investors are increasingly investing beyond their domestic borders. Voting thus becomes de facto a cross-border issue. But in this perspective, investors willing to vote abroad will have to be aware that local cultures, regulations and codes on corporate governance differ. Voting policies cannot be one-size-fits-all.

Why vote?

As we stated earlier, voting is one of the central means by which shareholders can influence companies in which they have holdings. This strategy can be quite effective, both as a result of the vote's immediate impact on a corporation, as well as through the strong media coverage of cases where conflicts between shareholders and companies led to votes against management.

Voting is often non-binding, but is an excellent means to communicate a shareholder's positions to management. Voting records may only describe part of the relationship between the company and shareowners, but it is an important part and one that is quantifiable and cannot be hidden behind vague policy statements.

Ultimately, voting has every reason to become more than a box-ticking exercise. It is an opportunity for concerned investors to get together with other shareholders in order to pursue the goals that they have in common and ensure that their views are represented in the most official way.

On the negative side, voting alone (without engagement) lacks the activist side of other strategies. It may succeed in accompanying change, however it is unlikely to bring this change about by itself.

 Further reference on the subject is available to Dutch readers: *Maatschappelijk verantwoord ondernemen door financiële organisaties, VBDO May 2003.*

How do you do it?

The key aspect of voting is that a pension fund should have a Voting Policy. A standard example is provided in this chapter as a Case Study, as it effectively takes a global approach to cover all issues subjectable to vote. Trustees should look to develop their plan's Voting Policy. On the corporate governance side, there are many existing guidelines that may be used as a source:

- The Combined Code, ABI Guidelines, NAPF in the UK,
- Tabaksblat commission report in the Netherlands,

- Rapport Bouton in France,
- SWX Code in Switzerland,
- OECD Guidelines,
- ICGN's Global Share Voting Principles,
- Etc.

Beyond the policies themselves, numerous voting advisory services have been set up in order to help investors navigate through the ocean of resolutions that are submitted at AGMs all over the world every year.

In practice, pension funds and other institutional investors may retain direct use of their voting rights, or rely on the asset manager to do so. Practices vary from country to country and mandate to mandate. As an example, in the UK, most asset managers use voting rights, whereas in the Netherlands they usually are not part of the mandate. Managers throughout Europe are increasing their capacity to tackle voting issues through the creation of corporate governance teams, or SRI teams.

There is not necessarily a "right way" to vote. For example, many fund managers inform a company that they will vote against an item before an AGM in order to encourage senior executives to change their behaviour. If the company promises to improve, the investor may decide to revise their voting position. And because opposing management may sometimes be a contentious issue due to the complicated issues of confidence that permeate the relationship between shareholder and company management, investors often use abstention as an alternative to voting when opposing a resolution.

Who does it?

Due to increasing pressure, voting is becoming more frequent - with a more or less activist approach. Recent data suggest that in 2002, little more than half of the shares in the biggest 350 companies were voted in the UK (one of the highest rates in Europe).

Votes against management were rare.¹⁸

18. Source: The Economist, Oct 31st 2002.



Trustees should be aware that unions are increasingly active on the voting front. In the UK, the TUC has started carrying out a small number of shareholder campaigns each year, mostly on executive remuneration so far. The TUC uses its internal Member Trustee Network to advise trustees of certain policy positions and encourage them to instruct their fund manager of that position and related voting opportunities.

Case study:
Hermes' "International Corporate Governance Principles": Guidelines for voting as primary way for shareholders to participate in the stewardship of companies abroad.

Hermes based its principles on those of the International Corporate Governance Network (ICGN), which were derived from the OECD's Principles on Corporate Governance (May 1999). They are meant to guide Hermes' voting decisions and apply to investments outside the UK. Hermes acknowledges that proxy voting is the primary way for shareholders to assume their responsibilities as owners outside their home market.

Key principles highlighted are:

1. Corporate objective: the overriding objective of the corporation is to optimise shareholder return.
2. Communications and reporting: accurate reporting by companies.
3. Voting rights: one vote per share and a duty to vote for fiduciary investors.
4. Corporate boards: accountability of the board of directors to shareholders and appointment of independent directors, among other things.
5. Corporate remuneration policies: in line with the interests of shareholders.
6. Strategic focus: shareholder approval for major strategic shifts.
7. Operating performance: optimisation over time.
8. Shareholder returns: optimisation over time.
9. Corporate citizenship: respect of applicable laws and co-operation with stakeholders.
10. CG implementation: application of local corporate governance codes.

Source: Hermes web site - www.hermes.co.uk

Tool: Establishing and implementing proxy voting guidelines

- Develop proxy voting guidelines that clearly identify voting criteria, and provide voting instructions regarding CG/SEE issues (see Hermes example).
- If the pension plan does not itself, obtain the services of a proxy voting service and ensure that the plan's Statement of Investment Principles and Guidelines are applied in voting proxies.

Source: SHARE, *Implementing Socially Responsible Investment Policies and Practices in your Pension Plan*

COMBINING STRATEGIES

As we have shown throughout the Strategies Chapter, certain strategies may be more effective than others in tackling specific issues. In practice, applying a combination of strategies may enable an investor to reap the benefits of SRI's possibilities and ensure that its assets are protected in an efficient manner, for example:

- Negative screening is applied to sectors that the investor in no way wishes to support,
- Positive screening is applied to ensure that the investor's views are represented over all of its investments,
- Engagement is applied to tackle specific issues and create a working relationship with the investee company that enables collaboration on and tracking of the evolution of those issues.

Classic examples of combined strategies include:

- Funds tracking sustainable indexes, which apply a combination of positive and negative screening in order to create their investment portfolios. Such fund products are quite popular with institutional investors. Examples include FTSE4Good and DJSI.
- Another example is where investors create a best-in-class portfolio for SEE issues and track and improve corporate governance matters through an engagement approach. The following case study illustrates this approach in greater detail.



Case study: ETHOS Fund - Combining strategies to maximise effectiveness.

The Ethos Foundation was set up by local Swiss public pension funds in 1997 with the aim of implementing SRI strategies. Now counting 86 members, Ethos insists that, beyond its financial activity, its stated aim is to help build tomorrow's world. The Ethos Foundation manages seven portfolios, collaborating with a network of SEE rating agencies and an asset manager for financial analysis, in addition to its own resources for engagement and voting.

The seven portfolios are broken down as follows:

1. Four best-in-class, negative screening, and engagement equity portfolios.

- A first "ethical" filter is applied (negative screening): companies earning more than 50% of their turn over in weapons, nuclear energy or tobacco are automatically filtered out.
- A sector-based best-in-class filter retains the 50% top-performing companies.
- A financial filter is subsequently applied. The portfolio is then balanced to recover sector weightings based on the MSCI 650 index, thus creating the final composition of the portfolio.
- Subsequently, companies are subjected to active engagement dialogue and active exercise of voting rights.

2. One benchmarked corporate governance, engagement-oriented Swiss share segment enables Ethos to voice its corporate governance concerns through dialogue and voting, using its own Proxy Voting Guidelines.

3. Two screened obligatory segments invested in supranational, national and corporate bonds. National bonds are screened positively based on respect of social capital, natural capital, institutional capital (or democratic development), and ethical criteria such as weapons, nuclear energy and respect of the Kyoto Protocol.

This combined-approach methodology enables Ethos to know exactly what cost or benefit is brought by each of the filters and methodologies applied. It also allows the foundation to use specific tools for each of its aims: ethical exclusions, sustainable best-in-class, dialogue and voting-based approaches to corporate governance issues.

Source: ETHOS

COLLABORATIVE ENGAGEMENT AND VOTING

There is a growing trend within the SRI community to practice collaborative engagement. This type of cooperation among investors, pension funds, asset managers and others is widely justified by economic constraints, the steep learning curve of developing an engagement practice, and the clout associated with pooling investor power in order to achieve economies of scale.

In practice, collaboration takes many forms:

- It may mean pooling resources on researching issues. A typical example would be the Institutional Investor's Group on Climate Change (IIGCC), which brings together investors and asset managers willing to research and share experiences on the effects of climate change on corporations.
- But it may also mean pooling shareholder power. This is largely practised by pension funds in covering CG issues. Pension fund groups such as NAPF in the UK, or SCGOP in the Netherlands are active on this front. There are also larger, international investors groups, such as IFAS, ISC, ICGN or GIGN that promote good corporate governance, issue guidelines and communicate on best practices to their members and to the wider public.
- Collaborative voting has been common but discrete among institutional shareholders on traditional and CG issues. The internationalisation of portfolios leads to an increased need for understanding of and assistance on issues related to investments abroad.
- A related means to pool resources for investors is to pool targets: selecting a single issue that affects a large number of companies, such as accounting of stock options, and campaigning on it at all AGMs.
- Unions too have been active internationally on this front, as is illustrated in the case study below. In the UK, the TUC is looking at organising multiple campaigns every year using its wide trustee network.

Collaborative engagement is a trend on the rise and trustees and investors should look forward to the benefits associated with it by discussing opportunities with their peers and actors in the fund industry.

Case study: RIO TINTO Union Shareholder Campaign

Abstracts from "Presentation to The Politics of Shareholder Activism", by John Maitland National Secretary CFMEU Australia.

"...The second resolution has been characterised as a social justice one. It called for the company to abide by well-known international minimum standards with respect to the rights of its employees, and argued that doing so would reduce the risk to the company and to investors of being implicated in human rights abuses. That resolution scored 17.3% of the vote despite being unanimously opposed by the Board. The results were at the upper end of our expectations – they represented a massive vote of discontent against certain practices of the company, and were voiced despite the company being considered to be something of a darling of the share market. Investors seemed to be saying, "yes we like the profits, but that doesn't mean we don't care about good corporate governance, and we simply don't see why the company can't formally recognise basic labour standards."

...The large vote for the social justice resolution was the greatest shock; it gave the lie to the popular view that investors simply don't care about the social policies of the companies in which they invest. Tangible results in the workplace followed the shareholder voting results. Rio Tinto chairman Robert Wilson acknowledged that the company had made mistakes in its dealing with unions. The company then, over a period of six months, reached new collective agreements at all sites that were unionised.

...But we didn't start off small. Because Rio Tinto is dual listed in the UK and Australia we had to conduct the campaign in both countries. So we worked with unions in the UK. And because so much of the world's investment capital flows through the USA we also worked with American unions. It was the first ever truly international shareholder campaign by trade unions.

...So what was very interesting was that the union campaign received considerable support from major institutional investors. We came across many major investors who were prepared to tell us that they thought Rio Tinto's corporate governance needed improvement and they were prepared to vote that way. And especially in the UK we found many major investors who, on the labour standards resolution, simply found it amazing that the company wouldn't make a concession on what was an easy risk management issue."

Source: CFMEU web site - www.cfmeu.org

INTEGRATION

What is it?

Integration is a growing practice among both mainstream and SRI-specialised asset managers to include CG/SEE risk into traditional financial analysis. These asset managers are hoping to attract a large investor audience with this new take on CG/SEE issues.

The case for integration

Integration is the mainstream's acknowledgement of the long-term financial risks associated with some company CG/SEE issues.

While this approach highlights a more passive attitude compared to other strategies, it is also the easiest way for investors to take into account those risks without modifying their investment strategies. It is more comfortable for those investors concerned with respecting their fiduciary duty or currently dealing with a volatile investment environment.

Practitioners extol four reasons for the emergence of integration:

- The inclusion of a normative judgement rather than screening,
- The goal: to deliver profit, rather than sustainability,
- To take advantage of the market through under-analysed themes,
- To cope with increasing regulatory pressure on the social and environmental front.

Integration is an important and welcome sign that CG/SEE issues are entering the mainstream. Nevertheless, investors seeking to actively bring about change in companies in the short run, as opposed to passively viewing CG/SEE issues as just another risk, should consider more dynamic strategies such as screening, engagement or voting.

How do you do it?

Asset managers that have begun integration use a dedicated team to assess social or environmental risk, and are also using analysis from dedicated providers.

This is mostly reported in qualitative fashion, though some players in the field do quantify those risks. The reports are then passed on to the fund managers who, in their capacity, are then free to decide whether to take these elements into account.

Factors for the integration of that data by mainstream investors may be their individual sensitivity to CG/SEE risk, but also the visibility of the exposure of the company's sector to those risks.

The assessment of social and environmental risks can be used both in stock picking and selling. However, since the teams carrying out the CG/SEE assessment can be the same as the ones practicing CG/SEE engagement at specialist investment houses, the analysed information also has an impact on dialogue with companies. In fact, CG/SEE issues simply become part of the "general picture". When going to a meeting with a company, a mainstream financial analyst may join the manager's SRI analyst.

Eurosis believes that in the future, instead of having two teams, it will become more likely for asset managers to include CG/SEE assessment into the job description of mainstream analysts.





III . GETTING STARTED

What should I ask asset managers about SRI ?



Asset Managers (AM's), with the products and services they offer, are key players in enabling an SRI policy. Selecting the right manager is therefore a critical issue.

Trustees will want to talk to their in-house manager (if relevant), their current managers, as well as other players in the field. This chapter offers a Case Study illustrating how to create an SRI policy with current managers as well as a Tool-questionnaire.

Today, few AM's ignore SRI-related issues in their offer. Yet how they tackle these matters opens the door to a myriad of different strategies. Some AM 's have been leaders in developing products and services to cater to this growing market, and as of late, the mainstream has been following suit. Depending on their main markets, they will usually concentrate on one particular SRI strategy. For example, UK asset managers have a long history of practicing engagement.

As further signs of the evolution in this field, dedicated SRI and corporate governance teams of analysts are becoming standard practice as specialists and leading fund managers have the means and the information to implement an SRI policy. In fact, some of those companies even offer specialty engagement and voting services separately from the actual management of funds.

While the product range and capacity is increasing on the asset management side, trustees should ensure that their suppliers can come up with the most appropriate service. Trustees should start to ask AM's the questions presented in the tool below in order to verify their SRI capacity.

 See also the Engagement section in Chapter 4 "What Strategies are Available?"

Case study: How to collaborate with existing managers in developing SRI

An interesting illustration of the relationship between a Pension fund and the Asset Manager can be gleaned from the recently created Fonds de Réserve des Retraites in France (Retirement Reserve Fund, FRR). The Fund's board wishes to integrate CG/SEE issues into the management of a large share of its assets. Having given mandates to various asset managers for its different asset classes, the FRR has

decided to collaborate with each of them, post mandating, in order to decide the best ways to achieve this. The FRR raises four key issues:

- Collection, analysis and quality of CG/SEE-related information,
- Integration into the investment process,
- How to deal with conflicts of value and arbitraging with risk and return,
- AM's strategy and costs.

The FRR expects this process to take place over the next few years before mandates are renewed. This example shows that dialogue around SRI is not only possible, but also necessary in order to best define the contours of an appropriate responsible investment policy for each pension fund.

Source: Eurosif

Tool-Questionnaire: Criteria for the evaluation of Fund Managers

- Does the AM have dedicated teams (SRI/CG) and what is the size of the staff?
- What financial resources are dedicated to SRI management?
- What are the additional costs of implementation of an SRI strategy?
- Do managers integrate CG/SEE material risk as a part of regular decision-making?
- What is the AM's track record / history of SRI involvement?
- What are the AM's engagement and voting activities?
- What are the AM's proposed screening processes and methodologies?
- Does the AM collaborate with other interested parties: other pension funds or fund managers, rating agencies, NGOs, collaborative organisations, etc?
- What are the AM's reporting practices in terms of frequency and quality?
- Further references to Asset Manager selection: As a good illustration of contemporary thinking, the USS Pension Fund's "How to Be a Responsible Pension Fund" presents a clear case for evaluating a Fund Manager's SRI capacity and services.

The Just Pensions May 2001 "Guide for Trustees" offers similar advice on engagement practices.

Source: Eurosif

One frequent criticism in SRI is that involved parties are subjected to many conflicts of interest, thus making their positions on CG/SEE issues arbitrary. The conflicts become mostly apparent in engagement and voting strategies. However they should not stop investors from becoming active in SRI: a tool hints at how to address them.

There are multiple levels of conflicts of interest:

▪ Trustee conflict

For example, when a trustee representing employees in a company pension fund is considering the issue of delocalising production for a company where his union is present (and it could mean his own job!), is he really in a position to take into account what's good for the company in the long term? Can the trustee be expected to make a reasonable use of his shareholder power?

▪ Fund manager conflict

If an asset manager is working for both company A and company B, and company A asks that asset manager to vote against company B's management at an AGM, what is the asset manager to do?

▪ Company plan level conflict

When company A's plan is willing to engage with company B, and B is an important customer of A, will A's management agree to the engagement action of the plan? Additionally, company pension funds tend to fear retaliation by other company pension funds, in a "if you divest from me, I'll divest from you"-like attitude.

There is no simple and easy answer to these questions. But there are solutions, as provided by practitioners who have been confronted with those conflicts of interest in the past, in the following tool.

Tool: Getting past conflicts of interest

- Trustees should develop a specific and robust policy to deal with conflict of interest issues that could apply in different cases.
- Some say that since there are so many issues for investors to engage upon, it is acceptable for the engager to ignore an issue or company.
- Some propose that in case of conflict of interests, shareholder rights should be transferred to a third-party, such as another Asset Manager, as the ICGN Statement on Institutional Shareholder Responsibilities suggests.
- A frequent strategy by mainstream investors is to act "below the radar" on corporate governance, by discreetly involving other investors in the process for example.

Sources: *Eurosif, Just Pensions*

How to integrate CG/SEE into Investment Principles?

To communicate with investment professionals, trustees may want to professionalise their SRI concerns within a specific guideline of Investment Principles.

In fact, national legislations are increasingly requiring pension funds to publish Statement of Investment Principles (SIPs). The UK and Italy now specifically require the integration of SEE concerns into the SIPs. The EC 2003 Directive on Occupational Pensions, while not specifying SEE concerns, also requires SIPs from pension plans.

 See also Chapter 3 "What is the Legal Framework around it?"

Beyond legal obligation, the aim of producing the plan's Investment Principles is to ensure that clear directions are integrated into the mandates that are given out to fund managers – and henceforth that these directions are respected.

Tool: How you can integrate SRI into your Investment Principles

- Amend the governing documents of the pension plan to provide explicit direction to pension trustees to engage in socially responsible investment practices.
- Specify your expectations and commitments from/to companies as a shareholder in your governing documents.
- Develop a Statement of Investment Principles and Guidelines that include guidelines for socially responsible investment. It is advisable to include the following points in drafting the guidelines:
 1. Explicit authorisation to consider non-financial criteria,
 2. Appropriate diversification levels in accordance with any statutory or common law requirements,
 3. Discretion for trustees to not apply socially responsible investment guidelines where it would result in harm to plan beneficiaries.
- Develop and follow written procedures for developing investment policies and guidelines, selecting investments, advisors and agents, consulting with beneficiaries, and making other investment-related decisions.
- Establish procedures for the implementation and timely review of investment policies.
- Ensure safe risk/return and diversification levels.

Sources: Shareholders Association for Research and Education (SHARE) "Implementing Socially Responsible Investment Policies and practices in your pension plan" and the Hermes Corporate Governance Principles.

Case study: Universities Superannuation Scheme SIP Abstract (UK)

As an institutional investor that takes its fiduciary obligations to its members seriously, the trustee company aims to be an active and responsible long-term shareholder of companies and markets in which it invests. The trustee company pursues this policy in order to protect and enhance the value of the fund's investments by encouraging responsible corporate behaviour.

The trustee company therefore requires its fund managers to pay appropriate regard to relevant corporate governance, social, ethical and environmental considerations in the selection, retention and realisation of all fund investments. The management committee expects this to be done in a manner which is consistent with the trustee company's investment objectives and legal duties.

The management committee has instructed its internal fund managers and called on its external managers to focus their effort on the engagement option, and thus seeks to use its influence as a major institutional investor to promote good practice by investee companies and by markets to which the fund is particularly exposed.

The management committee expects the scheme's fund managers to undertake appropriate monitoring of the policies and practices on material corporate governance and social, ethical and environmental issues of current and potential investee companies.

The aim of such monitoring should be to identify problems at an early stage, and enable engagement with management to see appropriate resolution of such problems. The trustee company will use voting rights as part of this engagement strategy, where voting should be undertaken in a prioritised, value-adding and informed manner. Where collaboration is likely to be the most effective mechanism for encouraging company management to address these issues appropriately, the trustee company expects its fund managers to participate in joint action with other institutional investors.

The investment committee monitors this engagement on an on-going basis with the aim of maximising its impact and effectiveness. The trustee company's governance, social, ethical and environmental policies are also reviewed regularly by the management committee and, where appropriate, updated to ensure that they are in line with good practice for pension funds in particular, and institutional investors in general.

Source: USS web site-www.ussq.co.uk



Awareness of SRI among trustees is on the rise, but there is still a long way to go. Trustees only spend a limited amount of time working for their plan and usually have more immediate financial considerations, such as Asset Liability Management to keep themselves busy.

Quoting Reg Green: “whilst it is extremely important for all trustees to ensure that they have and maintain the necessary education and skills to be able to fulfil their roles effectively, there would still appear to be a long way to go in ensuring that this happens. This situation may be made worse if trustees – whose confidence and ability in other areas is evident – are unwilling to accept or admit that they are less competent in their roles as trustees. In addition, my impression is that induction of new board trustees can vary from the very good to very poor.”¹⁹

The encouraging news is that on the SRI front, this issue is being taken up increasingly by employee-side and union-affiliated trustees. Some unions indeed have taken a pro-active approach to SRI in recent years. In the words of Roy Jones, executive director of TUAC:

“The international labour movement campaign around workers’ capital includes the continued empowerment of labour trustees, so as to enhance their dialogue with and leverage over fund managers, and thereby strengthen shareholder democracy in the interests of working families. Trustees indeed have the power to rebuild financial market integrity, while effecting change in corporate behaviour, to the benefit of their pension beneficiaries.”²⁰

In another illustration, the American AFL-CIO Center for Working Capital has an ‘active stewardship approach’ to pension fund management by which it means:

“...a philosophy based on the belief that active trustees are more effective than passive trustees and that they are better equipped to fulfil their fiduciary duties. Capital stewardship encourages trustees and others to take an active interest in pension fund operations, develop effective fund governance policies and seek to meet the needs of (pension) plan participants and beneficiaries.”

Witness to this trend, the UK Social Investment Forum released the results of a pension fund survey of over 100 member nominated trustees with affiliations to the UK Trade Union Congress (TUC) in 2002. The TUC itself has been very active in SRI and pension fund management education.²¹ The UKSIF survey found that:

- Trustees believe that social and environmental issues will have a substantial impact on the financial performance of companies over the next five to ten years.
- Good corporate governance was rated as the most significant aspect of business performance that would impact on the market value of the FTSE 100 in both the short and longer terms.
- Additionally, the trustees reported that stock selection which took into account SEE issues featured in the statement of investment principles of 69% of respondents. These issues had some impact on the selection of 30% of fund managers, 24% of investment consultants and 18% of legal advisors.

Yet it has to be recognised that Pension Fund trustees are faced with multiple challenges not least of which is an understanding of complicated legal and financial issues. As a matter of fact, those that have been properly inducted as trustees and who are able to take advantage of high-quality continuing education and training in their role as trustees will be both more competent and more assertive. The growing interest on the side of trade unions and their international bodies suggests that member nominated trustees will be able to ask for assistance and more importantly, training, with these organisations, as a growing body of literature and know-how is becoming available to them.

To conclude this section and the toolkit, Eurosif proposes the following steps for trustees to utilise in their journey to successfully implement CG/SEE issues within their plans.



19. Reg Green is member of the Eurosif Pension Programme Advisory Board, in addition to being Head of Health, Safety and Environmental Affairs at the ICEM; Chairman of Henderson Global Investors SRI Advisory Committee and Chairman of a FTSE4Good Expert Committee.

20. Trade Union Advisory Committee to the OECD. Quote provided in an interview with Eurosif, August 2004.

21. In the UK, TUC has published a number of groundbreaking papers, such as “Working Capital: institutional investment strategy”, 2002 and “TUC Fund Manager Voting Survey 2004” or “Trade Unions and investor activism”.

Tool: What is the pathway to integrate CG/SEE issues into a pension plan?

1st STEP: Discuss

- Encourage other trustees in your plan to read the Eurosif toolkit and use other means to become familiar with SRI.
- Encourage discussion of SRI at trustee meetings.
- Find out about other existing SRI activities by pension funds in your country. Talk to your national SIF.
- Your plan, or Union, should be in a position to provide training on investment, corporate governance and SRI. Require it.
- Discuss legality with lawyers at your plan.
- Discuss existing possibilities with your current Asset Managers as well as other specialists in the market. Find out about their voting practices and records.
- Inquire about SRI collaboration possibilities, such as collaborative engagement or voting: inquire within your plan, within organisations your plan is associated with (such as NAPF, SCGOP, etc.), with other plans or organisations.

2nd STEP: Push

- Use your power as a trustee to push for implementation of an SRI policy at your plan.
- Seek commitment from other trustees and from the Executive Board.

3rd STEP: Decide

- Decide which CG/SEE issues are most relevant to your plan. This could be a means to approach Asset Managers and see how they can fulfil your needs.
- Based on your discussions, decide what SRI strategies best suit your plan.
- Based on practical and cost issues, decide whether to go it in-house or using external suppliers.
- Decide which amount of the plan's assets to initially allocate to your strategy. This could mean:
 - running a test SRI programme (see ABP case study) by creating a fund,
 - running a test SRI programme by buying into existing funds,
 - joining collaborative initiatives.
- In a Defined Contributions scheme, decide to offer SRI allocation options to members.

4th STEP: Draft

- Participate in drafting or redrafting your pension plan's Investment Principles or Code of Prudential Investment. Make sure that it specifies the importance of CG/SEE issues.
- Participate in drafting or redrafting your plan's Voting Policy.
- Communicate these documents to your asset managers and make them public.

5th STEP: Follow-up

- Ensure that you receive proper reporting and information from your Asset Managers on fund performance, engagement records, voting records and policy choices.
- Review performance of asset managers.
- Review policy in light of experience: step up to the next level.

Source: Eurosif

Notes



GLOSSARY

| Term | Definition |
|---------------------------------|---|
| Best-in-class | Specific approach within positive screening where the leading companies with regard to SEE criteria from each individual sector or industry group are identified and included in the portfolio. |
| CG | Corporate Governance |
| Collaborative engagement | An engagement strategy conducted in cooperation by multiple investors or asset managers in order to gain leverage. |
| Defined Benefits | A defined benefit plan spells out how much money an individual will get at retirement, and figures out how much he/she needs to contribute, to reach that goal. |
| Defined Contributions | A defined contribution plan defines how much an individual, and sometimes his/her employer, contribute during his active years, without specifying exactly how much he/she will receive in benefits, at retirement. |
| Divestments | When companies are sold from a fund portfolio because they no longer meet the SRI criteria for that fund, or for purely financial reasons. |
| Eco- Efficiency | The competence of the company in using environmental resources sparingly in its production. |
| Engagement | A long-term process of dialogue with companies which seeks to influence company behaviour in relation to their governance, social, ethical and environmental practices. |
| Exclusion | See negative screening. |
| Fiduciary duty | The duty of an institutional investor to carry out investment decisions in the primary or sole interest of its beneficiaries, though definitions may vary slightly by country, plan, investor type, etc. |
| Integration | The inclusion by asset managers of CG/SEE-risk into traditional financial analysis. |
| Negative screening | An approach that excludes sectors or companies from a fund if involved in certain activities based on specific criteria, such as arms manufacture, publication of pornography, tobacco, animal testing, human rights, etc. |
| Pillar system | Pension systems are made up of three pillars, the proportion of which in an individual's overall pension may vary according to each country's own system. The three pillars are: <ul style="list-style-type: none"> . 1st pillar: state pension . 2nd pillar: employer schemes . 3rd pillar: self-provision by individuals |
| Pioneer screening | Positive screening where funds specialise in the best-performing companies against a specific criterion, such as management of natural resources. |
| Positive screening | The selection, within a given investment universe, of stocks of companies that perform best against a defined set of CG/SEE criteria. |
| Privileged shares | Shares to which special rights are associated, such as voting rights. These may be owned by 'friendly' investors as a protection against hostile take-overs. |
| Prudent person rule | A common rule pertaining to fiduciary duty in Anglo-Saxon countries. "A fiduciary should discharge his or her duties with the care, skill, prudence and diligence that a prudent person acting in a like capacity would use in the conduct of an enterprise of like character and aims" (OECD). Applications vary by country. |
| SEE | Social, Environmental and Ethical |
| Shareholder activism | Another term for engagement. Alternatively, it is sometimes used to define the exercise of shareholder powers through general "protest" voting at Annual General Meetings, or the support of SRI-related shareholder resolutions. |
| Sin Stock | Stocks encompassing investments in tobacco, alcohol, nuclear, military, gambling, pornography. |
| Triple Bottom Line | An approach to investing based on People, Planet and Profit performance indicators (also known as triple-P). |
| Voting | The exercise of voting rights for investors to influence company policy. Part of an engagement strategy but also a stand-alone activity (see Explainer in Voting). |

Other toolkits & sources

Socially Responsible Investment among European Institutional Investors 2003, Eurosif
www.eurosif.org

Just Pensions Guide for Trustees, May 2001 (to be updated in November 2004)
www.justpensions.org

SHARE (Canada) publications on shareholder activism, proxy voting, SRI, etc.
www.share.ca

USS's "How to Be a Responsible Pension Fund"
www.usshq.co.uk

TUC: "Working Capital: institutional investment strategy", 2002 and **"TUC Fund Manager Voting Survey 2004"** or **"Trade Unions and investor activism"**.
www.tuc.org.uk

Articles & research

Corporate Shareholder Engagement, Hummels, Willeboordse, Timmer, 2004,
 Universiteit Nyenrode.

People and Profits? The Search for a Link between a Company's Social and Financial Performance, Margolis, J. D. and J. P. Walsh 2001.

International Evidence on Ethical Mutual Fund Performance and Investment Style,
 Bauer, Koedijk and Otten, November 2002.

Corporate Governance and Equity Prices, Paul Gompers, Joy Ishii and Andrew Metrick,
 February 2003.

The Eco-Efficiency Premium Puzzle, Derwall, Günster, Bauer & Koedijk, May 2004.

Department for Work and Pensions: Research Report No 213 -
 The Myners Principles and occupational pension schemes, Volume 2 of 2,
 Findings from quantitative research, London, July 2004.

SRI web sites

Economic research on SRI:
www.sristudies.org

Universal investor, fiduciary capitalism:
www.fidcap.org

Corporate governance:
www.ragm.com

Research on screening agencies:
www.mistra.org

Case study referrals

Best in class: www.abp.nl

Voting: www.hermes.co.uk/corporate_governance

Engagement: www.usshq.co.uk

Combined strategies: www.ethosfund.ch

Collaborative engagement and voting: www.cfmeu.org & www.scgop.nl



 Printed on Process Chlorine Free (PCF) Recycled paper

Project Leader

Jérôme Tagger

Editor in Chief

Matt Christensen

Editor

Sarah Clawson-Rio

Graphic Designer

Anne Laure Gimenez

Contributing Editors

Reg Green

Walter Kahlenborn

Céline Louche

Axel Hesse

Others Contributors

Dexia Asset Management

TUAC

Vigeo

Advisory Board

Rob Bauer

Dominique Biedermann

Reg Green

Harry Hummels

Stefano Pighini

Helen Wildsmith

Printed by

NTC



CREDITS