



WAITING FOR ETHICS: INVESTORS UNDER SCRUTINY FOR SOCIAL RESPONSIBILITY

If there is an ethical imperative to manage the huge retirement savings of the world's developed nations – those that 'have the money' – then investors are not fulfilling it.

Feature by NICHOLAS TAYLOR and OLIVER WAGG

In the developed world – those nations that 'have the money' – institutions such as superannuation funds, insurance companies and investment managers wield a significant amount of power. In Australia, superannuation funds alone account for around 75 per cent of this \$1.4 trillion investment industry. The core function of any pension system is to safeguard and grow these retirement savings on behalf of individual workers and retirees. Which begs the question: does the running of a super fund have a social responsibility as well as a financial one?

There is a general belief within the investment community that ethics have little to do with modern-day responsible investing – it's all about accounting for environmental, social and governance (ESG) factors because this protects and harvests hidden financial value.

"Responsible investors recognise that they



James Gifford, UNPRI executive director

are not coming from an ethical perspective, they are coming from a perspective that is more centred in the economy," says the United Nations Principles for Responsible Investment (UNPRI) executive director James Gifford.

A view broadly supported by Sustainable Asset Management's Francis Grey.

"To me ESG is an investment process built around one ethical proposition: sustainable development, and the building of sustainable economies," Grey says.

"Ethical investment as it was then constituted was far too narrow. It dealt

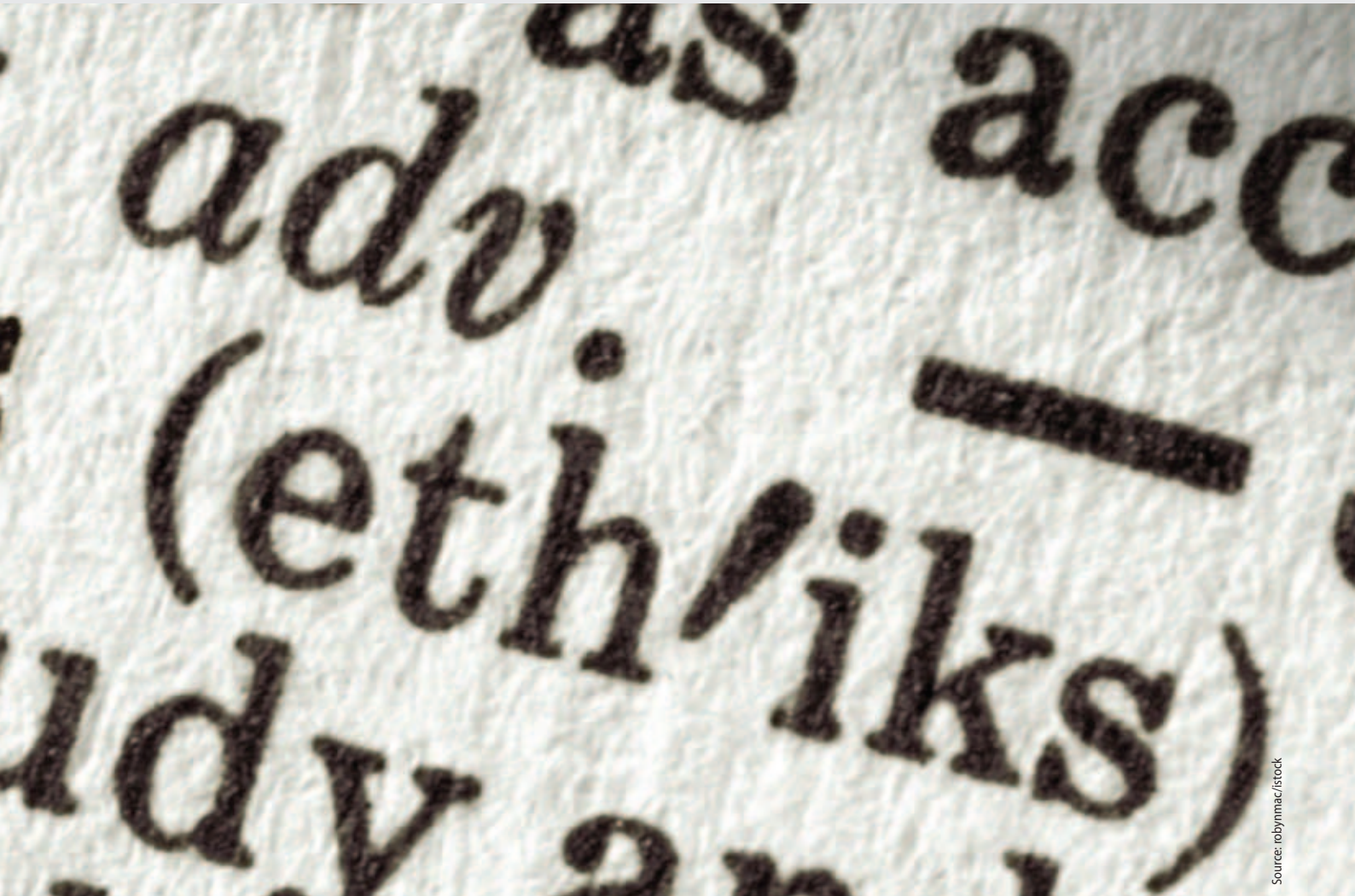
only with the headline ethical issues such as uranium, South Africa ... The smart proponents of ESG are looking at hundreds, thousands of such 'ethical' issues."

Anything has a price

Colonial First State Global Asset Management's head of sustainability and responsible investment, Amanda McCluskey, says there is still a persistent misunderstanding about ethical investing – or what she describes as the "screening out" of companies because of what they are doing – and sustainable investing, that is integrating what the companies are doing in order to factor it into what you are willing to pay for the company.

"There are going to be instances where companies do have environmental liabilities or have workplace issues and you might not like what they are doing. But the reality is that you can factor [these issues] into the price.

"We're not here as a large, mainstream investment manager to form a moral or ethical view. We're here to maximise returns for our clients and ESG issues are critical to the long-term performance of these. But we are not going to screen out a company just because we don't like what they are doing."



Source: robynmac/istock



Amanda McCluskey, Colonial First State Global Asset Management

Frank Jan de Graaf, a professor of international business in the Netherlands, says: "ESG is not ethical in itself. Often people and organisations use it to promote their own social values."

The best of both worlds?

When it comes to implementation, some funds see the clear benefits of incorporating ethical investment risk considerations as part of ESG valuation.

Angus Dennis, investment specialist at AMP Capital Investors, which runs the

Sustainable Share Fund and a range of Responsible Investment Leaders funds, says AMP and its investment managers are looking for opportunities in and risks from an ESG perspective, and social and ethical considerations are risk factors taken into account.

Is there a contradiction here? On one hand, AMP is using ESG valuation to invest in leaders within sectors, but on the other hand, stocks can be identified for issues that are problematic for those investors with predefined moral and ethical requirements.

"It's an interesting discussion, in the sense that you're talking about defining investors and where the industry is heading in terms of investment strategies. We see our funds as having a broad interest for investors who are concerned about both social and ethical issues," Dennis says. "And the global financial crisis provides a good example of how poor business ethics can have a direct impact on investment returns."

He says an integrated approach can still have clear relevance in that it is saying, for example, if a company is operating in an area with higher social risks, there is definitely a higher hurdle for it to be included.

"So there is an alignment for that

interested ethical investor. For some areas to be investment grade is quite difficult. For example, tobacco is an area where it is difficult for us to see a company that would make it."

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Amanda McCluskey, Colonial First State Global Asset Management

AMP Capital's sustainable and responsible funds both retain advisory committees. The Sustainable Share Fund's advisory committee has a range of industry experts, including

Reverend Tim Costello, CEO of World Vision, and Dr Simon Longstaff, executive director of the St James Ethics Centre. The Responsible Leaders Share Fund, which manages \$790 million, has an ethics committee, chaired by AMP Capital's Dennis, has client representation and an opportunity for dialogue. The fund has a charter with broad guidelines.

'Moral muteness of managers'

Longstaff believes many managers – in the investment space as well as in business – are making more and more decisions based on ethical positions while doing whatever they can to pretend they aren't.

"Many managers don't want to be seen by their peers as behaving according to an ethical position. But there's a delicious paradox here: if you only do good because it makes you more money, then you don't get the *whole* dividend. You don't get the upside in recruiting talented staff, for instance, if you're known to be only doing it because it's profitable.

"To cover up ethical decisions in this way is the 'moral muteness of managers'. That we don't necessarily want people knowing we're doing good is self-defeating, but increasingly common."

Toward a broader definition of social responsibility

The fixation on making money from socially responsible investment does prove to be the crux of the problem. Robert Rosen, a pioneer of the socially responsible investment movement in Australia (see box), says people are simply missing the point.

"The suggestion that you can invest sustainably without sacrificing investment performance rings very hollow, especially in such a small and resource-skewed equities market such as Australia's."


Benjamin Richardson, a professor at Osgoode Hall Law School at York University, Toronto, goes further, condemning the obsessive pursuit of alpha.

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"Responsible investing, in other words, is packaged as a way to be prosperous, rather than virtuous," he says.

The end-investor – the individual who has entrusted their retirement savings – in the meantime is left waiting for ethics to enter the fray.

Mike Musuraca, a former UNPRI director and trustee of the New York City Employees Retirement Fund, says pension funds must work toward aligning the interests of its citizens as retirees and future retirees with building a more sustainable economy.

"I'll leave it for you to decide whether or not this is ethical." 

Robert Rosen on ethical investment and sustainability



Robert Rosen

Defining ethical investment is actually quite easy. It is investment that takes into consideration one's personal values or ethics. Indeed perhaps the most valuable aspect of ethical investment is its capacity to empower people to invest in accordance with their personal values or at least to seriously consider the question of how to balance their values with investment risk and return. Once you try to establish an impersonal or universal set of ethics the waters inevitably get much muddied.

Fund managers would be best to stay away from making claims about how green, sustainable, ethical or responsible their particular product is. Although it is hard to keep a keen marketing department down. It is anyway naive for investors to take the advice of a fund manager about such matters. Ideally fund managers should just articulate what their investment criteria are and to then, as objectively as possible, detail how their investments perform against those criteria. One of the essential skills of a specialist ethical investment adviser should be to encourage investors to articulate their deeply held values and beliefs and to help them to incorporate these values into their investment decisions.

It is now abundantly clear that a very radical change in how we manage the earth's resources is required if we are to honour the lives of future generations

Sustainability is probably the most abused of the many terms in the ethical investment industry lexicon. The best standard here is still the Brundtland Commission original 1987 definition of sustainable development: "Development that meets the needs of the present generation without compromising the ability of future generations to meet their own needs."

It is now abundantly clear that a very radical change in how we manage the earth's resources is required if we are to honour the lives of future generations.

Very few Australian listed companies could be said to be operating sustainably and the suggestion that you can invest sustainably without sacrificing investment performance rings very hollow, especially in such a small and resource-skewed equities market such as Australia's. Similarly, to suggest that ESG is an investment process built around the proposition of sustainable development is very brave. One can only but wish that this was really the case.

Robert Rosen was the Australian signatory to a resolution presented to the Rio UN Earth Summit in 1992 by a coalition of SRI organisations. He is a former board member of the Ethical Investment Association (now the RIAA) and former director of ASrIA.