

## TITLE

# Sustainable Investing

Marrying sustainability concerns with the quest for financial return for superannuation trustees

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## ABSTRACT

Trustees of Australian superannuation funds are coming under increasing public pressure to take sustainability factors (such as the Environment, Social & Governance) into account in their investment strategies. Their reticence to embrace sustainability is entirely understandable and stems from the conventional wisdom that a range of practical and legal impediments stand in their way. We review that conventional wisdom and find that there are now cogent answers to each of the impediments. Thus, whilst trustees should not underestimate the practical issues that arise, we believe that the way is open for them to embrace a more positive approach to Sustainable Investing.

# Introduction

*"Social responsibility... is fundamentally subversive... there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits." <sup>1</sup>*

Milton Friedman, 1970

*"I would like to warn the gentlemen of the City and High Finance that if they do not listen in time to the voice of reason their days may be numbered. I speak to this great city as Jonah spoke to Nineveh.... I prophesy that unless they embrace wisdom in good time, the system upon which they live will work so very ill that they will be overwhelmed by irresistible things which they will hate much more than the mild and limited remedies offered them now."*

John Maynard Keynes (Collected Works xix)

Concern for the environment and sustainability is growing in prominence. Institutional investors are increasingly questioning how to reconcile their role as investment delegates with broader Environmental, Social, and Governance (ESG) considerations.

Attention to such issues has typically been deemed inappropriate for fiduciary decision-makers in the past. However the debate has moved beyond the stalemate of the 1990s. We are now seeing a global effort to recognise the interests of a wider range of stakeholders and to incorporate timeframes longer than is common in the investment management industry. We use the term 'Sustainable Investing' to distinguish it from other, similar-sounding but distinct approaches such as Socially Responsible Investment (SRI) and Ethical investing.

Despite the pressure exerted on the investment and superannuation industry, many organisations possess little knowledge of what their individual members, clients, or legislation may require of them. Instead, conventional investment wisdom stands on a number of arguments which we will re-examine here.

In doing so, we find that there are now better, more compelling, ways to start to address sustainability concerns without compromising the quest for financial return.

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<sup>1</sup> Friedman, M. (1970); 'The responsibility of business is to increase profits', *TIME Magazine*, September 1970.

## A Preliminary Note

The subject matter of this paper has attracted spirited debate across the industry. Two preliminary points therefore need to be made:

**Personal vs. Delegated Discretions.** This paper focuses on the issues facing someone with delegated investment responsibilities, such as the trustee of a superannuation fund. The decisions an individual can take on their own behalf are different to those possible when they are acting on behalf of others. This issue is particularly acute where the individual, personal interests of the underlying beneficiaries are not directly observable or are not homogeneous. Both of these complicating factors are likely to be present in many superannuation funds.

**Descriptive vs. Normative Objective.** This paper attempts to discern what 'is' rather than what 'ought to be'. This distinction is not always respected in the literature and commentary surrounding Sustainable investing. It is however important for fiduciary decision-makers attempting to meet their obligations in a practical, real-world context.

# Testing the arguments against Sustainable Investing

*"On Wall Street, there has always been the belief that if you don't like how a company is run, you can simply sell your stake and move on--the so-called 'Wall Street Walk'".*

Forbes, 17/05/2007

*"Two forces are colliding: an emerging set of sociopolitical megatrends...that are upending the lives of people, communities, and societies, as well as ever more-powerful stakeholders wielding wide influence."*<sup>2</sup>

McKinsey & Company, 2006

Institutional investors and fund managers are often accused of having a narrow and short-term perspective. This is not necessarily their fault. The institutional structure of markets reinforces this orientation in a number of ways, to the detriment of the financial system as a whole.

Some investors, however, are now questioning whether such a myopic perspective is required. It has been suggested we are witnessing the metamorphosis of the stockholder into a 'universal owner'.<sup>3</sup> A universal owner is one who "holds its shares for the long-term, and on the whole does not trade except to maintain its index. As such, cumulative long-term returns are determined not by the performance of each individual firm it owns, but by the performance of the economy as a whole".<sup>4</sup> According to this theory, the universal owner may be compelled to evaluate an investment's long-term sustainability as well as its near-term financial soundness. This is the essence of Sustainable investing.

In Australia, whether or not they perceive themselves to be a universal owner, trustees must act both in the 'best

interests' of their members and satisfy the Sole Purposes Test.<sup>5</sup> The courts have repeatedly confirmed that best interests in this context means financial best interests and that the sole purpose of a superannuation fund is to provide monetary retirement benefits to its members. Despite this, the *Parliamentary Joint Committee on Corporations and Financial Services*, as recently as June 2006, questioned the financial definition of best interests and called on the Australian Prudential Regulation Authority (APRA) to provide guidance on the legislation for trustees.<sup>6</sup> Some trustees and investment managers seem to agree, but few have done anything material about it. Perhaps one reason for this is that the devil is in the detail – the issues are more complicated than is commonly recognised. More difficult still, in some areas the analysis provides neutral results and, all too often, ambiguity promotes inertia.

For investors to invest in businesses that are operating sustainably there must be a suitable supply of investment opportunities. The Government has started encouraging business to incorporate sustainability concerns within their

<sup>2</sup> Bonini, S.M. & Mendonca, L.T. (2006); McKinsey Quarterly: *'When Social Issues Become Strategic: Executives Ignore Sociopolitical Debates at their own Peril'*, April 2006 No.2.

<sup>3</sup> Monks, R. A.G. & Minnow, N. (1995); *Corporate Governance*, Cambridge University Press.

<sup>4</sup> Hawley, J.P. & Williams, A.T. (2001); *The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic*, University of Pennsylvania Press.

<sup>5</sup> A recent research report found little evidence of institutional investors adopting the universal owner terminology, despite evidence that those investors were concerned about the efficacy of the "Wall Street Walk" as a way to signal their concerns to company management; Anderson, Marshall and Ramsay, I. (2007); *'Do Australian Institutional Investors Aim to Influence the Human Resources Practices of Investee Companies?'*, Centre for Corporate Law and Securities Regulation, University of Melbourne.

<sup>6</sup> Parliamentary Joint Committee on Corporations and Financial Services (2006); *'Corporation responsibility: managing risk and creating value'*, Commonwealth of Australia, June 2006.

day-to-day pursuit of profits, by embracing some form of corporate social responsibility (CSR). As the Honourable Chris Pearce MP, Parliamentary Secretary to the Treasurer has outlined, "the challenge for the Government is to identify and remove obstacles to the economic influences that would otherwise encourage company directors to adopt sustainable business practises."<sup>7</sup> The Government has not yet gone so far, however, as follow the lead of the U.K. in requiring company directors to have regard for the interests of employees, customers and suppliers and the environment, in addition to the interests of shareholders.<sup>8</sup> Indeed the *Parliamentary Joint Committee on Corporations and Financial Services* report mentioned above specifically rejected such a move. It has, however, since announced plans to establish a domestic emissions carbon trading scheme by 2012.

Not all companies, however, are awaiting more formal direction on what a smaller government and climate change will mean for their business. Recently Australia's largest energy provider, Australian Gas Light (AGL), voluntarily joined the Chicago Climate Exchange, which is "the world's only global system for emissions trading based on all six greenhouse gases."<sup>9</sup> Other large Australian companies have announced similar strategies. BHP recently announced its climate change policy as part of its broader sustainability strategy.<sup>10</sup> Westpac Banking Corporation has expressed a deep commitment to sustainability, extending across its business to include lending, resource management and environmental impact.<sup>11</sup> News Corporation has also recently expressed its intention to become carbon neutral by 2010, as part of a package of measures designed to lessen the environmental footprint of the company.<sup>12</sup>

There is strong public pressure for the guardians of Australia's superannuation assets, the fund trustees and their investment managers, to participate in this movement. In our opinion, Sustainable Investing is not simply a more sophisticated re-working of the failed economic targeting strategies of the 1980s. Nor is it a transitory cultural phenomenon that has gained air-time because of the phase of the electoral cycle. We strongly believe trustees should start to come to grips with the issues surrounding Sustainable Investing to ascertain its relevance to their funds. Trustees accepting this invitation will quickly encounter a number of arguments intended to dampen, or in some cases reverse, their enthusiasm for Sustainable Investing. We have distilled the traditional areas of concern into the following five commonly-heard arguments:

1. Definitional confusion hinders acceptance;
2. Investment returns are constrained;
3. Fiduciary responsibility is compromised;
4. Incorporating sustainability into existing investment approaches is a challenge; and
5. Investors are not interested.

Our analysis suggests that there are now cogent answers to all of these arguments but that trustees should not underestimate some of the practical issues that arise. We will now examine each of the arguments in turn.

<sup>7</sup> The Hon. Chris Pearce MP, Parliamentary Secretary to the Treasurer (2006); Address to the New South Wales Supreme Court and the Law Society Conference, 21 August 2006; cited in: Finsia (2006); 'Sustaining Our Future: Investing for the long haul', *Finsia Consumer Research*, September 2006.

<sup>8</sup> Section 172 of Companies Act 2006 (U.K.), amending s309 of the Companies Act 1985 (U.K.). Notably, there is no direction on how the competing interests are to be balanced, prompting one learned commentator to dub it 'either one of the most incompetent or one of the most cynical pieces of drafting on record', Professor Len Sealy, quoted in Austin, R.P. (2007); *Company Directors and Corporate Social Responsibility. U.K. and Australian perspectives*, Ross Parsons Centre for Commercial, Corporate and Taxation Law, University of Sydney.

<sup>9</sup> AGL media release, 19 March 2007.

<sup>10</sup> More detail can be found at <http://hsecreport.bhpbilliton.com/2006/>

<sup>11</sup> Westpac Banking Corporation, *An Enhanced Approach to Embedding Environmental, Social and Governance (ESG) considerations in business and institutional lending*, 18 June 2007. More detail can be found at [www.westpac.com.au](http://www.westpac.com.au).

<sup>12</sup> See further, News Corporation, *Global Energy Initiative*, May 2007, available from [www.newscorp.com](http://www.newscorp.com)

# ARGUMENT 1:

## “Definitional confusion hinders acceptance”

*“... this confusion is quite understandable: The concept of socially responsible investing has itself evolved over time, and has suffered somewhat from changing definitions at the hands of both practitioners who are within the industry and others in the “mainstream” who are trying to understand it.”<sup>13</sup>*

George Gay & Johann Klaassen, 2005

This whole area is beset by definitional confusion.<sup>14</sup> Much of the confusion between the terms ‘ethical’, ‘socially-responsible’, and ‘sustainable’ stems from their protracted evolution and the use of the term SRI to refer to all such forms of investment. We believe ‘Sustainable investing’ is distinct from both Ethical and Socially Responsible Investment (SRI), and an adaptation of the Environmental, Social and Governance (ESG) movement. The differences are not merely semantic, nor arbitrary – though we have focused on the differences to highlight the distinctions. Clearly some strategies and products would fall across our definitions. It is useful then to briefly define and differentiate the relevant terms.

### 2.1.1 Ethical investing

*“Ethical investing is an investment process which reflects the values and beliefs of individuals and mission-based organisations regarding the environment, society, labour rights, governance and ethics.”*

Ethical Investment Association, 2006

Ethical investors are primarily focused on pursuing investment strategies that conform to a predefined set of beliefs, which often, but not always, contain a non-financial element.<sup>15</sup> Put another way, ethical investors are concerned with “the size of the prospective financial

return and the risk attached to it, but also its *source*” (emphasis added).<sup>16</sup> For ethical investors, therefore, the primary consideration is personal, not financial.

Centuries before the term Sustainable Investing was coined, investors adopted ethical screens to satisfy their moral concerns and beliefs.<sup>17</sup> In Australia, entities such as Friends Provident (now part of Tower), Independent Order of Odd Fellows (IOOF) and Order of the Sons of Temperance (OST, now part of IOOF) grew out of this tradition.

Ethical investing is typically an ‘exclusionary’ concept. That is, companies (or possibly entire industries) are excluded from investor portfolios based on a series of predefined social criteria best representing the ethical stance of the investor. Some examples of ‘sin stocks or sectors’ are tobacco companies and those relating to birth control.

Excluding stocks or sectors has resulted in ethical investment being viewed negatively by many traditional investment professionals. They reason that a smaller investable universe constrains investment performance and thus contradicts a trustee’s fiduciary responsibility to its members. (More on this later). Alternatively, investors may adopt a ‘positive screen’ where investments are sought that support a set of predefined beliefs.

<sup>13</sup> Gay, G.R. & Klasseen, J.A. (2005); ‘Retirement Investment, Fiduciary Obligations, and Socially Responsible Investing’, *Journal of Deferred Compensation*, Vol.10, No.3.

<sup>14</sup> For an Australian end-investor perspective, see: Finsia (2006); ‘Sustaining Our Future: Investing for the Long-haul’, *Finsia Consumer Research*, September 2006.

<sup>15</sup> We include Islamic funds, i.e. those that are built to conform to Shariah law, in the category of ‘ethical’ funds.

<sup>16</sup> Cowten, C. (1994); ‘The Development of Ethical Investment Products’, *ACT Guide to Ethical Conflicts in Finance*, Blackwell Publishing.

<sup>17</sup> Shank, T.M et al (2005); ‘Is it better to be naughty or nice?’, *Journal of Investing*, Fall 2005. See also, White, C.F. (2005); ‘SRI Best Practices: Learning from the Europeans’, *Journal of Investing*, Fall 2005. See also, Social Investment Forum (2006); ‘2005 Report on Socially Responsible Investing Trends in the United States: 10-year Review.’

The challenge for ethical investors has always been two-fold. First, ethical issues are inherently personal and so it is impossible from a practical perspective to achieve a consensus across all possible ethical issues. Even setting aside religious, spiritual and moral differences, one person's ethical priorities will seldom match another's in all details. Second, companies typically do not align themselves neatly on ethical issues; usually it is a matter of timing, judgment or degree.

### 2.1.2 Socially Responsible Investment (SRI)

*"Socially Responsible Investing is an investment process that considers the social and environmental consequences of investments, both positive and negative, within the context of rigorous financial analysis."*

Social Investment Forum, 2006

Socially Responsible Investing (SRI) pursues "investment objectives that combine social, environmental and financial goals".<sup>18</sup> As it appears to be commonly implemented, SRI serves a dual purpose: financial and social. The absence of predefined requirements enables SRI to be implemented on a 'best-of-breed' approach where all firms are eligible for investment, but are ranked according to sustainability factors. This results in a flexible mechanism of underweighting and/or overweighting stocks to reflect their sustainability amongst conventional financial metrics. For example, if a uranium company is one of the most sustainable materials firms, it may be included in an SRI portfolio.

Alternatively, a 'screen' approach, such as that taken with ethical investment, may be adopted, thereby reducing the investable universe. This could potentially exclude investment in the uranium company in the above example for instance.

### 2.1.3 Environmental, Social & Governance (ESG)

*"There is a growing view among investment professionals that environment, social and corporate governance (ESG) issues can affect the performance of investment portfolios."*

UN Principles for Responsible Investment, 2006

Incorporating corporate governance and risk measures is the key differentiator between SRI and Environmental, Social and Governance (ESG) analysis. The added focus on Governance strengthens the argument that sustainability may have a material effect on investment returns since, "companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets."<sup>19</sup> In this way, ESG is more closely related to the concept of the 'universal owner' discussed earlier than is SRI.

With more emphasis on the long-term affect of sustainability on investment returns,<sup>20</sup> the U.N. Environmental Program Finance Initiative recently launched a set of aspirational U.N. Principles for Responsible Investment (U.N. Principles) based on the ESG approach to Sustainability.

<sup>18</sup> Sparkes, R. (2002), *Socially Responsible Investment: A Global Revolution*, John Wiley & Sons

<sup>19</sup> Cited in: UN Global Compact (2005); 'Conference Report: Investing for Long-term Value – Integrating Environmental, Social and Governance value drivers in asset management and financial research', UN Global Compact Conference, Zurich, 25 August 2005. See also: Weiser, J. & Zadek, S. (2002); *Conversations with disbelievers*, Brody and Weiser.

<sup>20</sup> UN Environmental Program (2006); 'Principles for Responsible Investment'.

## What does ESG consider in regard to company and investment value?

### Environmental issues:

- Climate change and related risks
- The need to reduce toxic releases and waste
- New regulation expanding the boundaries of environmental liability with regard to products and services
- Increasing pressure by civil society to improve performance, transparency and accountability, which might otherwise lead to reputational risks
- Emerging markets for environmental services and environment-friendly products

### Social issues:

- Workplace health and safety
- Community relations
- Human rights issues at company and suppliers'/contractors' premises
- Government and community relations in the context of operations in developing countries
- Increasing pressure by civil society to improve performance, transparency and accountability, leading to reputational risks if not managed properly

### Corporate Governance issues:

- Board structure and accountability
- Accounting and disclosure practices
- Audit committee structure and independence of auditors
- Executive compensation
- Management of corruption and bribery issues

Source: UN Global Compact (2004), 'Who Cares Wins'

## 2.1.4 Sustainable Investing

Sustainable Investing is focused on incorporating consideration of long-term Environmental, Social and Governance (ESG) factors into traditional investment approaches. The consideration of ESG factors is a complement to the current focus on short-term financial evaluation, and does not detract or conflict with them. In this way, Sustainable Investing is an evolutionary synthesis of traditional investment approaches with a proactive stance on Sustainability.

We describe Sustainable Investing as *an approach that recognises the **financial implications** of economic activity over a **broader range** and **longer timeframe** than traditional investment approaches.*

Stated this way, it is clear that we are not proposing any specific strategies, since there are many different ways in which the approach could be implemented. Nor are we specifying any particular causes; the threats to sustainability will likely change over time. Indeed the description is disarmingly close to the way shareholders would ordinarily express their interests. As we note below, though, this general aspiration must be distilled into objectives that are sufficiently finite, concrete, unambiguous, realistic and measurable as to be capable of practical implementation. This is good governance but it also reduces the risk that the strategy will become so vague or diffuse that it has no impact, or alternatively that it will be hijacked by interest groups with ulterior motives.

## 2.1.5 A Concluding Comment

Whilst there are undoubtedly thematic similarities between the various camps, we believe the observation that the approaches sometimes result in similar stocks in a portfolio is simplistic. Share markets do not offer 'pure' Ethical or Sustainable exposures. They offer a mechanism for the investors to exchange shares in existing public companies, some of which companies may satisfy ethical and/or sustainability criteria in regards their business operations. Moreover, as we shall see below, modern approaches to Sustainable Investing (but less so Ethical investing) recognise a variety of shareholder mechanisms for achieving sustainability objectives, not just purchase or sale of the company's securities.

## ARGUMENT 2: “Fiduciary responsibility is compromised”

*“A pension fund trustee is not the guardian of the moral welfare of the fund members, and modern developments in social conditions do not compel the conclusion that he should assume this role.”*<sup>21</sup>

Lord Nicholls of Birkenhead, 1995

*“As more evidence unfolds supporting the connection between sustainability and financial performance, those who do not consider these factors in investment decisions could ultimately leave themselves open to charges of imprudence.”*<sup>22</sup>

Jed Emerson & Tim Little, 2005

Historically, investment approaches of the type considered in this paper have been thought to contradict the trustees’ fiduciary responsibility to act in the ‘best interests’ of its members.<sup>23</sup> The courts in the U.K. and Australia have been adamantly opposed to the application of non-financial criteria to investment decisions by trustees.<sup>24</sup> This derives from the fundamental principle of trust law that states trustees must exercise their powers for a proper purpose (i.e. the purpose for which the power was granted).<sup>25</sup> In a trust whose purpose is to provide financial benefits to its beneficiaries, the purpose of the investment power can be none other than to augment, if possible, the value of the financial benefits to those members.<sup>26</sup> The courts have been particularly intent on recognising the moral plurality of Anglo-Australian society, counselling strongly against the incorporation of moral prejudice into fiduciary decision-making.<sup>27</sup> Collateral<sup>28</sup> benefits, such as may satisfy a moral imperative, may accrue, but trustees must first and foremost pursue the purpose of the trust.

Some links in this chain of logic are enshrined in statute in Australia. Section 52(2)(c) of *Superannuation Industry (Supervision) Act 1993* (SIS) provides that trustees must act in the ‘best interests’ of their members, which is interpreted to mean their best financial interests. Section 62 of SIS requires that the ‘sole purpose’ of a superannuation fund is to be the provision of benefits to members upon their retirement.<sup>29</sup> Finally, section 52(2)(b) requires that a trustee exercise “the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide.”

These provisions have a disarming simplicity. Unfortunately they have led some commentators to underestimate what the law requires of trustees seeking to incorporate Sustainable Investing principles into their investment strategies. The analysis that appears below may therefore appear narrow, or perhaps even

<sup>21</sup> Lord Nicholls of Birkenhead, in ‘Trustees and their Broader Community: Where Duty, Morality and Ethics Converge’, presentation to *Superannuation 1995 Conference*

<sup>22</sup> Emerson, J. & Little, T. (2005); *The Prudent Trustee: The Evolution of the Long-Term Investor*, Generation Foundation.

<sup>23</sup> Kinder, P.D. (2005); ‘New Fiduciary Duties in a Changing Social Environment’, *Journal of Investing*, Fall 2005.

<sup>24</sup> See most notably Megarry V-C in *Cowan v Scargill* (1985) Ch 270. The principles in that case were affirmed in Australia in *Buckland v AG for Victoria* (unreported judgment of the Supreme Court of Victoria, No.10536 of 1992), and more recently in *Asea Brown Boveri Superannuation Fund v Asea Brown Boveri* [1999] 1 VR 144, *Knudsen v Kara Kar* (2000) NSWSC 715, *Crowe v SERF* (2003) VSC 316 and *Invensys v Austrac Investments* (2006) 198 FLR 302.

<sup>25</sup> *Balls v Strutt* (1841) 1 Hare 146 at 149; 66 ER 984 at 985

<sup>26</sup> This principle was clearly expressed in *Harries v Church Commissioners* [1992] 1 WLR 1241, a case involving a charity associated with the Church of England, a situation where one might have expected ethical considerations to have some influence. In that case Sir Donald Nicholls V-C held that: ‘investments are held by trustees to aid the work of the charity in a particular way; by generating money. That is the purpose for which they are held. That is their raison d’être. Trustees cannot use assets held as an investment for other, viz, non-investment, purposes. To the extent that they do they are not properly exercising their powers of investment.’

<sup>27</sup> See for instance *Harries v Church Commissioners, re Wyvern Developments* [1974] 1 WLR 1097; *Martin v City of Edinburgh District Council* [1989] 2 PBLR 8.

<sup>28</sup> The courts and commentators often use the adjective ‘ancillary’ to refer to this type of benefit. We have used the term ‘collateral’ here to avoid confusion with the reference to ‘ancillary purposes’ in s62(b) of SIS.

<sup>29</sup> This is discussed further in APRA, *Superannuation Circular No.III.A.4: The Sole Purpose Test*. At paragraph 31 it notes, ‘It is not the type of investment which must be considered ... but rather it is the purpose for which the investment is made and maintained that is relevant to the test.’



reactionary, to some. However the analysis pays close attention to the complex provenance and interaction of the general, case-based law and the statutory provisions, as they pertain to Australian institutional investors.<sup>30</sup> In particular it recognises that there is a wide range of trustee duties and principles that affect the exercise of a trustee's investment power, not just 'best interests' and the 'sole purpose' test. Not surprisingly, detailed analysis of this type derives a more complex set of principles than is sometimes expressed by commentators.

Listed below are a set of observations that emerge from close analysis of the cases and the relevant jurisprudence. For simplicity, we have chosen to collect them into two categories: those that relate to the quality of the decision process and those that relate to the motives of the trustee.

### 2.2.1 The Motivation for the Decision

- **The investment power must be exercised in the 'best interests' of the members**, which is interpreted to mean their financial best interests.<sup>31</sup> The sole purpose test focuses this definition even more closely; trustees of superannuation funds must apply their efforts towards the provision of financial benefits to members on retirement. The assets of the fund cannot be employed to achieve other objectives, however admirable.
- The fact that certain decisions may result in outcomes that advantage individuals who are not members, or which advantage members in some way not connected with the financial benefits they receive upon retirement, will not attract criticism from the courts.<sup>32</sup>
- **The connection between the purpose and the benefit to the beneficiary must be material and direct.** "Speculative and remote" benefits, such as the impact of a single superannuation fund on the economy, will not suffice.<sup>34</sup> The courts are thus likely to deem the positive influence of Sustainability-minded investors on the economy as a whole as inadequate of itself to justify Sustainable investing by a trustee.
- **Trustees are required to act impartially in balancing the interests of different members of their fund.** An argument that a strategy may have some beneficial impact when measured over a long (greater than 20 years) timescale, as for instance with climate change initiatives, raises the prospect of inter-generational inequity if the shorter-term effect of the strategy is negative on performance. The current structure of most superannuation plans means that this is really only an issue within the default option they offer to members.
- **The trustee may be required to rebut an assertion that the decision to pursue a Sustainable approach was motivated by some improper purpose**, such as the furtherance of union policy (as in *Cowan v Scargill*) or some personal moral or ethical ground (as in *Harries v Church Commissioners*).<sup>35</sup> Again this

<sup>30</sup> There are, for instance, ongoing debates around the relationship between the statutory and general law requirements to act in the best interests, and the content of the general law requirement itself. Cf Stone, M (2007); 'The Superannuation Trustee: Are Fiduciary Obligation and Standards Appropriate?' *Journal of Equity* [167]; Vriskakis, M. (2006); 'The best test of (or the bestest) interests or members', 17(9) SLB 138; Lehane, J.R.F. (1995) 'Delegation of Trustees' Powers and Current Developments in Investment Funds Management', 7 *Bond Law Review* 36 at p.37; and Leigh, A., "'Caveat Investor': The Ethical Investment of Superannuation in Australia", (1997) 25 *Australian Business Law Review* 341. Many commentators seem blissfully unaware of this uncertainty.

<sup>31</sup> *Cowan v Scargill* [1985] 1 Ch 270. The principle was first endorsed in Australia in *Crowe v SERF* (2003) VSC 316. Earlier Australian cases cite *Cowan v Scargill* in support of other principles, or in obiter dicta.

<sup>32</sup> *Fuller v Evans* [2000] 1 All ER 636.

<sup>33</sup> *Cowan v Scargill* [1985] 1 Ch 270.

<sup>34</sup> *Cowan v Scargill* [1985] 1 Ch 270 per Megarry V.C at 296.

<sup>35</sup> The court's practical perspective in *Martin v City of Edinburgh* (above) has much to commend it. Murray LJ in that case noted that: 'if it means that each individual trustee in genuinely applying his mind and judgment to a trust decision, must divest himself of all personal preferences, of all political beliefs, and of all moral, religious or other conscientiously held principles, then I do not think that this proposition is either reasonable or practicable. What he must do, I think, is to recognise that he has those preferences, commitments or principles but none the less do his best to exercise fair and impartial judgment on the merits of the issue before him.'

principle is subject to certain exceptions, albeit that they are likely to be extremely narrow. For instance, it seems safe to assume that the courts will be loathe to impugn a decision to avoid investments involving child slavery (for instance) in deference to the evidence of unanimous moral condemnation of such a practice.<sup>36</sup>

- Some commentators have argued that trustees seeking to incorporate non-financial criteria into their decision-making could do so either by “dressing up” the rationale in financial terms,<sup>37</sup> or by saying nothing at all (on the basis that the courts are more prone to review decisions where the trustee has disclosed its reasoning). This approach is neither laudable nor sustainable (sic), since irrespective of any trustee communications, the courts will be quite prepared to assess whether the strategy meets the requirements in SIS. In addition, the courts have, on occasion, sidestepped such a tactic by choosing to examine the ‘objective’ purpose of a decision rather than a subjective purpose claimed by the trustee.<sup>38</sup>
- It seems safe to assume that the reference to the ‘prudent person’ in section 52(2)(b) invokes the notion of prudence present in general law. The fact that Parliament chose to codify a prudent ‘person’ rule in SIS, rather than the prudent ‘investor’ rule seen in some jurisdictions, or the prudent ‘expert’ rule that was widely expected, is worthy of note, though its practical import may be limited.<sup>39</sup> There is a more subtle point here, however. The notion of prudence is necessarily

linked to contemporary beliefs and practice.<sup>40</sup> In this limited sense, then, the fact that the trustees of other funds have chosen a Sustainable Investing strategy could influence a court trying to establish whether the strategy by a particular trustee meets the s52(2)(b) requirement. Note however that this reference to the behaviour of its peers does not remove the trustee’s obligation to act independently, with skill, care and diligence, and to have regard to the interests of its fund’s members. Nor should trustees allow the decisions of other trustees to positively influence them towards a decision.

## 2.2.2 The Quality of the Decision Process

- Section 52(2)(b) restates the general law principle that trustees must be able to demonstrate that they took due care and exercised appropriate levels of skill and diligence in coming to their decisions.<sup>41</sup> This means that **any investment strategy chosen by a trustee must be founded on objective evidence**, which has been rigorously analysed and carefully considered by the trustee. In the current context that means that the link between Sustainability and the financial benefit to members must be demonstrable (Section 2.3.3 discusses some of this evidence).
- Trustees are required to **give explicit consideration to whether their decisions are in the interests of their beneficiaries**.<sup>42</sup> Whilst such enquiry might be simply assumed for minor decisions, consideration should be explicit in more strategic decisions such as

<sup>36</sup> The anti-apartheid policies pursued by some trustees (and quasi-trustees) in the 1970s and 1980s were an interesting litmus test of this principle. The investment policies under scrutiny in both *Cowan v Scargill* and *Harries v Church Commissioners* included prohibitions on investing in South Africa but the courts sidestepped direct assessment of that element of the policies, and focused attention on other, more obviously (in the court’s view) inappropriate policies. Indeed Sir Donald Nicholls V.-C. in *Harries* specifically did not impugn a more limited set of restrictions which included prohibitions on South African investment.

<sup>37</sup> See for instance Leigh, A. (1997); “Caveat Investor”: The Ethical Investment of Superannuation in Australia’, 25 *Australian Business Law Review* 341. Notably, Mr Leigh does not approve of the practice.

<sup>38</sup> See for instance *Hillsdown Holdings v Pensions Ombudsman* [1997] 1 All ER 862. The same distinction was made in Australia by Brennan J in *Magna Alloys v FCT* (1980) 49 FLR 183 at 185. Also Finn, P.D., (1976) *Fiduciary Obligations*, at para. 86.

<sup>39</sup> This is because the courts will look to the context in which the trustees were acting, which in the situations under consideration here necessarily involve the investment of large sums of money. The comment in note [41] with respect to professional and expert trustees applies also.

<sup>40</sup> *Nestle v Westminster* [1993] 1 WLR 1260 per Dillon LJ at 1268. There can of course be a time-lag caused by the inherent conservatism of the courts, seen for instance the delay in recognising the principles of modern portfolio theory; Finn, F.J., and Zeigler, P.A. (1997); ‘Prudence and Fiduciary Obligations in the Investment of Trust Funds’, ALJ 329.

<sup>41</sup> Although not specifically stated in the legislation, the care, skill and diligence benchmarks are likely to be higher for professionals than for volunteers, and higher for experts than for lay-people; *ASC v AS Nominees* (1995) 133 ALR 1 at 14.

<sup>42</sup> This is most clearly stated in *Martin v City of Edinburgh* (1988) SCT 329, which reviewed the adoption of an anti-Apartheid investment policy in trusts administered by a local council. Although a Scottish case, the principle is good law in Australia and the U.K. generally.

incorporating a Sustainable Investing approach into the fund's investment strategy. Detailed attention to the impact of such a decision on the interests of the fund's beneficiaries should therefore be made, and minuted, in the trustee's board meeting.

- The general law grounds on which a court will review the decision of a trustee are very clear. They have to do with an absence of good faith, the influence of an improper purpose (as discussed above) or the absence of real and genuine consideration (see above).<sup>43</sup> The courts will not review a trustee's decision simply because they don't agree with it.<sup>44</sup> SIS is arguably even narrower. Section 52 requires only that trustees "have regard for" the need for diversification, liquidity, an appropriate risk/return balance and so on. SIS does not say that the investment strategy must actually have those characteristics. **The courts are highly unlikely, therefore, to participate in a determination of the relative merits of different investment strategies**, so long they possess some basic level of plausibility and the procedural elements (independence, impartiality, loyalty, prudence, objectivity, care/skill/diligence etc) are satisfied. This highlights the importance of the finding (reported in 2.3.3 below) that Sustainable Investment approaches do not necessarily affect a fund's expected investment outcomes if defined carefully and implemented efficiently. It also highlights that claims that there is a positive duty imposed on trustees by the law to consider sustainability are overstating the law as it currently applies in Australia.

### 2.2.3 Summarising the current state of the law

Our analysis suggests that a strategy which includes consideration of Sustainability is unlikely to be impugned by an Australian court, so long as the strategy is:

- carefully considered, designed and implemented (see Sections 2.3.3 and argument 4);
- not expected by the trustees to prejudice the financial outcomes for members on retirement; and
- not polluted by outside motivations.

Equally, the courts in Australia are unlikely to impugn a strategy on the basis that it does not follow a Sustainable approach. We recommend that trustees seeking to incorporate Sustainable Investing approaches into their investment strategies in any of the ways discussed in this paper to seek legal advice specifics of their plan to implementation.

### 2.2.4 Future directions

There are a variety of factors which may see a loosening of the traditional legal attitude to Sustainable investing in Australia. The first is the evolution (discussed in 2.3.1) of discussion away from ethical and moral grounds for investing and towards more economically-grounded Sustainable grounds. This evolution will almost certainly reduce the intensity of the antipathy felt by the courts to these strategies.

The second factor is the *Financial Services Reform Act 2001* which now requires institutional investors offering investment products to disclose "the extent, if any, to which labour standards, environmental social or ethical considerations are taken into account in the selection, retention or realisation of the investment." Whilst this

<sup>43</sup> Per McGarvie J in *Karger v Paul* (1984) VR 161. A fourth ground, where the trustee discloses its reasons and they are not sound, is more limited than it appears. Even in that circumstance, the courts will not impose its subjective judgment over that of the trustee. It will still look for evidence that, for instance, the trustee considered the wrong issues or misunderstood the relevant law, but the fact of disclosure will make this investigation easier; *Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896, applied in Australia in *Maciejewski v Telstra Super Pty Ltd* (1998) 44 NSWLR 601.

<sup>44</sup> *Vidovic v Email Superannuation Pty Ltd* (1995) Unreported judgment of NSW Supreme Court. The same is true for administrative bodies such as APRA and the Administrative Appeals Tribunal; Re VBN and APRA [2006] AATA 710, at para. 329.

does not create an obligation to consider such issues, the provision signals that Parliament believes that investors (presumably including trustees of superannuation funds) have a legitimate interest in knowing what their investment delegates are doing in the area.<sup>45</sup>

Another factor stems from an unexpected source. The introduction of Member Investment Choice to many funds means that trustees may be able offer some form of Sustainable investment choice for members and thereby curtail the trustees' fiduciary responsibility to determine an appropriate strategy for that member.<sup>46</sup> Any members who choose such an option within a fund, assuming relevant communications were in place, could reasonably be held to have understood the implications of their choice.

There is also a trend overseas towards greater acceptance of sustainable principles. In the U.S., *Employee Retirement Income Security Act* (ERISA) plans have for some time been required to consider issues such as those now identified in the *Financial Services Act*. Similarly, pension fund trustees in several European countries (notably Norway and Sweden), as well as New Zealand, actively pursue sustainable principles. Importantly, differences in the legal systems of these countries may prevent direct application of authority in those countries to Australia.<sup>47</sup>

In the U.K., perhaps the closest legal relative to Australia, pension trustees have been under a statutory requirement to disclose their SRI policies since 2000. The *SRI Pensions Disclosure Regulation* requires trustees of occupational pension schemes to disclose in their Statement of Investment Principles (SIP):

*"The extent (if at all) to which social, environmental or ethical (SEE) considerations are taken into account in the selection, retention and realisation of investments; and their policy (if any) in relation to the exercise of the right (including voting rights) attaching to investments."*

There is also evidence that many U.K. fund managers took ethical considerations into account even before the regulation coming into force.<sup>48</sup> However there is currently no statutory provision that directly counters the prevailing legal scepticism to the use of Sustainable-style decision criteria by pension fund trustees and other, similar fiduciaries.

Significant pressure is also being exerted by intergovernmental bodies and industry groups to clarify the legal position in those countries perceived to be laggards in this area. Indeed in 2005 the World Economic Forum predicted that "the most likely tipping point (to increased funds under management) in the complex framework of impediments to and opportunities for mainstreaming responsible investment is likely to be found in the area of pension fund governance".<sup>49</sup>

### 2.2.5 A Concluding Comment

Trustees of superannuation funds in Australia have solid grounds for believing that they can pursue Sustainable Investment strategies that have been precisely formulated and carefully implemented. However no amount of public spiritedness will defend a trustee whose strategy is shown to have been improperly motivated, poorly designed or inefficiently implemented. What you do, and why you did it, matters.

<sup>45</sup> There is an element of redundancy here as the regulation overlays the general requirement on fund promoters to disclose to potential investors the information that would be reasonably required to make an informed decision on the investment. If the ethical/SRI/Sustainable criterion is material, it will be caught by the general provision; if not, then disclosure of it is unnecessary. The importance of the regulation therefore lies in its existence, not its content.

<sup>46</sup> See Donald, M.S. (2007); 'The Prudent Eunuch', *Russell Research*, for more detail on how investment choice affects the fiduciary obligations of the trustees of superannuation funds.

<sup>47</sup> Whilst the US, Canada and NZ are characterised as Common Law jurisdictions, important differences in the development of fiduciary principle in these countries, as well as the intervention of statute, mean that reference to these jurisdictions is more common in industry commentary than in actual judicial decision-making.

<sup>48</sup> Reported in Donnan, J. (2002); 'Regulating Ethical Investment: Disclosure under the Financial Services Reform Act', *Journal of Banking and Finance Law and Practice*, Vol.13, at p.161.

<sup>49</sup> World Economic Forum (2005); 'Mainstreaming Responsible Investment'.

## ARGUMENT 3: “Investment returns are constrained”

*‘Stock markets go up and down, but no matter what the economy is doing, people worldwide continue to drink, smoke, gamble, and fight. Why not invest in vice?’<sup>50</sup>*

Daniel Ahrens, 2004

### 2.3.1 The Theoretical Argument

Traditional ‘purist’ theorists have been very sceptical about the claims of Sustainable Investing (and its predecessors, ethical investing and SRI). The *coup d’ grace* for them was the truism that investment approaches which reduce the size of the investment universe must be sub-optimal. In a purely mathematical sense, that must be correct since the constrained set of outcomes is merely a sub-set of the unconstrained set. Translated into finance-speak, sub-sets of the market portfolio by definition contain non-systematic risks that are not, on average, compensated.

Proponents of Sustainable Investing cannot fault that logic. However they can change the point of attack, and that is precisely what they have done. They argue that modern Sustainable Investing approaches do not exclude stocks, but rather attempt to exploit a performance advantage on the part of strategies oriented towards sustainable criteria. This line of argument sidesteps the logic of the purists as well as some of the legal proscriptions described in the previous section.<sup>51</sup> Evaluating its cogency is more complex than it seems.

If empirical research showed there was consistently higher performance to be earned from Sustainable Investing, finance theory would suggest that the ‘Sustainable effect’ would suffer the same fate as other efficient market hypothesis (EMH) ‘anomalies’. Markets that are even weakly efficient would quickly impound such information in stock prices, eroding any systematic

performance advantage.<sup>52</sup> One of two things would then happen: either Sustainability would become a ‘style factor’ or it would be competed away entirely.

#### **(a) Sustainability becomes a Style Effect**

The Sustainable effect might become a style effect, in the sense of the Fama /French risk factors.<sup>53</sup> The Small Cap effect ‘discovered’ in the early 1980s<sup>54</sup> provides a useful illustration of what this would mean. The persistently large performance differentials for small cap stocks observed by Banz in the early 1980s were quickly eroded to the point where small cap out-performance is now episodic and unpredictable. For the Sustainability effect to follow this example, there would need to be something about it that was itself episodic (analogous to the fluctuations in investor risk appetite and/or liquidity preference that appear to affect small cap stocks). It is not clear what that might be in the case of Sustainability.

#### **(b) Sustainability gets Impounded Completely**

We believe it is more likely that any Sustainability effect would disappear altogether, being subsumed into the melange of publicly available information routinely and continuously impounded into stock prices. That would mean that the Sustainability effect would become invisible at a macro level. That doesn’t mean it would be unimportant, just that the ability to generate excess returns by focusing on it as a factor across the market would have gone. If investors stopped paying attention to sustainability for a while, the effect would reappear until the excess returns from exploiting it were competed away again.<sup>55</sup>

<sup>50</sup> Ahrens, D. (2004); *Investing in vice: The recession-proof portfolio of booze, bets, bombs, and butts*, New York: St Martins Press.

<sup>51</sup> They might alternatively have argued that many active managers effectively operate with constrained universes, such as those following articulated styles (Growth, Value, Small Cap) or oriented towards specific sectors. We surmise that they have not chosen this route because they aspire to have sustainable criteria applied to the whole portfolio, and not just a part.

<sup>52</sup> This seems an uncontroversial proposition given that the vast majority of Australian institutional assets are invested in large and medium cap stocks (and sovereign bonds) within the major markets of the world.

<sup>53</sup> Fama, E. F., and French, K.R. (1992); ‘The cross-section of expected stock returns’, *Journal of Finance* 47, 427-465.

<sup>54</sup> Banz, R. (1981); ‘The Relationship between Return and Market Value of Common Stocks’, *Journal of Financial Economics* 9

<sup>55</sup> This would be quite literally a microcosm of the effect of active management on market efficiency – the competition between active managers promotes efficiency, which limits each of their ability to find mispriced securities.

The Sustainability traits of individual stocks would continue to be recognised by the market. For instance, companies with operations that posed high long term environmental risks would find their share price discounting that possibility, companies with sustainable HR practices would be rewarded, and so on. But those attributes would be 'priced' in the market price for the company's securities. Continuous disclosure would reinforce the market discipline.

### **Implications**

This analysis would suggest that Sustainable investments ought to earn a lower return than other companies, precisely the opposite of what many proponents of Sustainable investing expect. This should not be a surprise; it is merely a restatement of the idea that lower risk equates to lower expected return. If Sustainable companies are inherently more careful about long term risks, make better use of their human and other resources and are more financially stable than others on the sharemarket, that 'quality' factor ought to see them command a premium price in the market. The flipside of the premium price is of course a lower expected rate of return to shareholders.

In fact we believe **Sustainable investments are unlikely to generate returns statistically different from any other shares when account is taken of different operational risk levels, different industries, capital structure and so on.** That is where the logic of the Sustainable investment argument takes you in an efficient market. It is also coincides with our evaluation of the documented empirical studies in the area.

### **2.3.2 The Empirical Results**

There are dozens of documented studies into the efficacy of ethical, SRI or Sustainable Investing. In the interests of brevity, the conclusion we draw from the empirical studies can be stated simply as two propositions:

1. There is no necessary performance penalty from pursuing a Sustainable approach; and
2. There is unlikely to be a performance premium from pursuing a Sustainable approach when account is taken of appropriate risk and style effects.

Lest this be seen as merely a compromise between two intensely vocal camps, we outline below a little more of our thinking, including the implications of the conclusion we have drawn. We profile and list the 40+ empirical studies we consulted in reaching our conclusion in Appendix A.

#### **Interpreting the Empirical Results**

Both proponents and opponents of Sustainable Investing can point to studies demonstrating the cogency of their case. The reason is simple; there is considerable variety in the questions being asked and in the way the studies have been conducted.

In the first place, there are material differences across the studies with respect to definition (ethical vs. SRI vs. Sustainable, and all the variations in between).<sup>56</sup> This variation is particularly obvious when account is taken of the date of the study. Inevitably the earlier studies focused on ethical investing as SRI and Sustainable Investing are comparatively recent developments. As noted above, there is even a line of argument (which we have heard but do not endorse) that it was the apparent failure of ethical and SRI approaches to add value that spawned the notion of Sustainable Investing.

<sup>56</sup> This is true even within the narrow class of ethical investing, see Perks, R.W., Rawlinson, D.H. and Ingram, L., (1992); 'An Exploration of Ethical Investment in the U.K.', *British Accounting Review* 24(1)

The analytical method chosen also needs to be considered when reviewing the studies. It is tempting to assume that studies using actual funds (as opposed to hypothetical portfolios) are based on more reliable data. This is a furphy. Studies based on actual funds are likely to suffer from the distortion noted above; ethical funds have a much longer history than their newer SRI and Sustainable cousins. More pernicious, the study of actual funds embroils the analyst in a 'dual hypothesis' conundrum: any finding derived from the analysis could be attributed to either the investment approach or to the active management skill of the manager responsible for the fund.<sup>57</sup>

There are some technical differences also. The most important is that analytical techniques have grown more sophisticated over the thirty years of the studies we reviewed. The use of multi-factor models in particular has highlighted that the conclusions from some of the early studies (and some less rigorous recent ones) are quite unreliable. Some of the so-called effects have for instance been found to be driven more by market cap, style and sector biases than by pure ethical factors.

Less important differences include the market investigated (usually the U.S., occasionally the U.K. and only recently other markets) and the time period observed. The reason we don't believe this is a major issue is that variety is endemic to any literature review and, in fact, is a key part of any serious research activity. The consistency of findings across time and different markets is a key indicator of robustness. Rather, readers need just to be alert to the differences and attempt to see the broader pattern of results rather than focus on a small subset.

Finally, some popular commentators attempt to apply the findings from Corporate Social Responsibility (CSR) research to Sustainable Investing.<sup>58</sup> At first blush this appears reasonable, but, as numerous management gurus have discovered, well-run companies do not necessarily make good investments, nor do they necessarily sustain their commercial advantage.<sup>59</sup> Indeed, as Camejo points out, the ability to pursue a CSR policy may signal certain things about the company (stability, long term focus etc) that may be the actual drivers of corporate performance.<sup>60</sup> That is, CSR may be the result, not the cause of any above average corporate performance. Nevertheless, we have included it as an 'engagement option' in section 2.4.4.

### **Implications**

The absence of a strong positive or negative finding will be troubling to some. We don't view it that way. We believe there is a risk that the claims of Sustainable Investing will be oversold by incautious proponents. Our analysis points to a finding that is entirely adequate to justify action from prudent trustees and renders over-optimism unnecessary. If adding Sustainable elements to an investment approach is consistent with the pursuit of long term risk-adjusted returns, that is sufficient to satisfy the legal requirements outlined in the previous section.

<sup>57</sup> The technical solution to this problem is to adjust the benchmark to reflect the investment opportunity set of the fund manager. Few, if any, of the studies do this.

<sup>58</sup> The repeated reference in the literature to the groundbreaking 1972 article Moskowitz, M.R. (1972); 'Choosing Socially Responsible Stocks', *Business and Society Review* highlights this risk.

<sup>59</sup> The most celebrated example is the decline into financial difficulty of the one in three of the 'excellent' companies identified in Peters' and Waterman's, *In Search of Excellence* within five years of the publication of the book. See Business Week 'Oops. Who's excellent now?', November 5, 1984.

<sup>60</sup> See for instance Camejo, P. (2002); *The SRI Advantage*

### 2.3.3 The Elephant in the Room

It is worth noting that the discussion so far has not addressed whether the investment approaches of the kind discussed in this paper achieve the underlying objective to which they aspire; namely influencing economic behaviour in favour of more ethical, responsible or sustainable approaches. Although there is a great deal of rhetoric supporting such a connection, the academic research on this point has been less convincing.<sup>61</sup>

In addition, some of the examples used to demonstrate the power of SRI and ethical approaches, such as the re-rating of certain stocks following the rescission of sanctions on South Africa, for example, are capable of alternate views. Companies with an exposure to South Africa enjoyed a fillip to their share price when the sanctions were lifted, but was that the result of the removal of demerits or simply recognition that future profitability would be higher in the new environment? The fact that the sanctions against Apartheid South Africa were part of a multi-lateral, multi-faceted strategy which exerted concerted pressure and still took over a decade to achieve its goal also needs to be recognised.

There is another trap for the unwary. Investors should not follow the lead of popular commentators by attempting to justify a broad-based programme, such as suggested in this paper, by reference to a handful of cause celebre (such as the fall of Apartheid, Enron, AWB or James Hardie's asbestos settlement). The day-to-day operation of a Sustainable Investing approach is much more mundane, more nuanced and less celebrated.

There are, however, two grounds for suggesting that the pessimism may lift. In the first place, most researchers agree that the small quantum of funds invested in these approaches has historically limited their potential to effect real change. A groundswell of assets towards these

approaches would change their small market-share, which raises the possibility that these types of investors may prove more influential in the future. Secondly, the pressure on corporations arising from ethical, SRI or Sustainable approaches may not always be discernible from stock price movements. The threat, or indeed the experience, of adverse publicity may cause corporate managers to change their ways. There is increasing evidence that institutional investors prefer to exercise influence 'behind closed doors' to bring about change.<sup>62</sup>

<sup>61</sup> See for instance Haigh, M. and Hazelton, J., (2004); 'Financial Markets: A Tool for Social Responsibility?', *Journal of Business Ethics*, Vol 52 and Johnsen, D.B., (2003); 'Socially Responsible Investing: A Critical Appraisal', *Journal of Business Ethics*, Vol 43(3). A contrary example, the re-rating is reported in Kumar, R., Lamb, W.B. and Wokutch, R.E., (2002); 'The End of Ownership of the South African Sanctions, Institutional Ownership, and the Stock Price Performance of Boycotted Firms', *Business and Society*, Vol 41(2).

<sup>62</sup> See for instance, IFSA (2001); *Shareholder Activism Among Fund Managers: Policy and Practice*, and Anderson, Marshall and Ramsay, I. (2007) 'Do Australian Institutional Investors Aim to Influence the Human Resources Practices of Investee Companies?', Centre for Corporate Law and Securities Regulation, University of Melbourne.



## ARGUMENT 4:

# “Incorporating sustainability into existing investment approaches is a challenge”

*“The Committee supports the further adoption of these U.N. Principles by Australian institutional investors and fund managers, and in particular recommends that the recently established Future Fund should become a signatory.”<sup>63</sup>*

Parliamentary Joint Committee on Corporations and Financial Services, 2006

It is undoubtedly difficult to marry Sustainability concerns with the quest for financial return in a practical way. This does not mean that it can not be done. Importantly there are more sources of assistance for institutional investors than there have ever been.<sup>64</sup>

Section 2.3.1 demonstrated the importance of defining precisely what form the investment approach will take. The distinctions we made were not arbitrary nor without consequence. Certain types of objectives (particularly those associated with processes defined to be ethical) cause investment managers to implement exclusionary (or negative) screens to existing portfolios, thereby avoiding certain stocks or sectors and accepting the potential loss of return.<sup>65</sup> Given the comments we have made in 2.3.1 and 2.3.2, we believe trustees of superannuation funds should be very wary of adopting such an approach. Other would-be Sustainable investors engage in stewardship, or advocacy alongside traditional methods of evaluating investments. Still others choose to support organisations that orientate their portfolio via a best-of-breed, non-exclusionary approach. Carefully calibrated and implemented, these latter approaches seem to offer more potential for prudent fiduciaries.

A myriad of other practical methods exist for implementing a Sustainable approach to investing. Evaluating all of them is well beyond the scope, or

intention, of this paper.<sup>66</sup> We have therefore stopped short of a generic recommendation that trustees dedicate all or parts of their portfolios to Sustainable Investing approaches. The reason is simple; we believe trustees need practical, concrete entry-points to Sustainable Investing. Beyond the general comments presented above, it is not sensible to attempt to design highly detailed investment strategies that will affect the financial well-being in retirement of many thousands of members. Such a step must have reference to the circumstances of the specific fund under the trustees’ control and to the available skills in the investment manager community. We have, instead, identified four types of engagement readily available to institutional investors and super funds.

### 2.4.1 Incorporate Sustainability concerns into existing investment approaches

#### (a) U.N. Principles of Responsible Investment (U.N. Principles)

The U.N. Principles offer a set of six aspirational principles with which to begin embedding ESG factors into existing investment processes. Currently the U.N. Principles bring together 160 institutional investors (super funds and investment managers) representing over \$8 trillion of assets globally.

For more information: [www.unpri.org](http://www.unpri.org)

<sup>63</sup> Parliamentary Joint Committee on Corporations and Financial Services (2006); ‘Corporation responsibility: managing risk and creating value’, *Commonwealth of Australia*, June 2006.

<sup>64</sup> See for example a discussion of implementation issues faced by institutional investors in 1971 in; Malkiel, B.G. & Quandt, R.E. (1971); ‘Moral issues in investment policy’, *Harvard Business Review*, March-April 1971.

<sup>65</sup> Gay, G.R. et al (2005); ‘Retirement Investment, Fiduciary Obligations, and Socially Responsible Investing’, *Journal of Deferred Compensation*, Vol. 10, No.3, Fall 2005.

<sup>66</sup> For an examination of implementation issues for institutional investors see: Sparkes, R. (2002); *Socially Responsible Investment: A Global Revolution*, John Wiley & Sons; also Emerson, J., Freundlich, T., & Berenbach, S. (2004); ‘The Investors Toolkit: Generating Multiple Returns through a Unified Investment Strategy’, *Blended Value Working Paper*.

**(b) Enhanced Analytics Initiative (EAI)**

The Enhanced Analytics Initiative (EAI) is an international collaboration to improve the quality of 'extra-financial issues' into traditional investment approaches. As present the EAI has signatories with over A\$3.1 trillion in assets under management.

For more information: [www.enhancedanalytics.com](http://www.enhancedanalytics.com)

**(c) Investor Group on Climate Change – Australia & New Zealand (IGCC)**

Representing over \$225 billion of funds under management, the IGCC – Australia/New Zealand encourages factoring the risks and opportunities associated with climate change into investment decisions.

For more information: [www.igcc.org.au](http://www.igcc.org.au)

**Case Study: VicSuper and institutional engagement**

VicSuper Fund is one of Australia's largest public offer superannuation funds with over 225,000 members and over \$6 billion in net assets.

VicSuper aims to create value for members by building a sustainable super fund through the integration of economic, social and environmental considerations into all of its decision support systems. In pursuit of this objective, VicSuper is a signatory to the UN Principles and Chair of the IGCC – Australia/New Zealand. VicSuper see institutional engagement as one of the most effective method of advocating the nexus between environmental, social and governance issues and the long-term value of investments.

VicSuper has applied a Sustainable approach to investments in 10% of listed Australian and international equity investments and also through engagement with VicSuper's external direct property investment manager. In addition, VicSuper is applying this approach to 10% of international and Australian private equity investments. VicSuper has also commenced constructive engagement on these issues with the majority of the companies listed on the Australian Stock Exchange in which it is a shareholder.

Source: VicSuper

**2.4.2 Encourage the disclosure of sustainability factors by business:****(a) Carbon Disclosure Project (CDP)**

By far the largest initiative, the CDP calls for the annual disclosure of corporate emissions. Currently over 280 institutional investors and super funds, with \$41 trillion in assets, signed this years CDP5 request to 2400 of the largest companies around the world.

For more information: [www.cdproject.net](http://www.cdproject.net)

**(b) Global Reporting Initiative (GRI)**

The GRI assists firms disclose their social, economic and environmental (SEE) footprint in annual reports. At present over 10,000 organisations globally use the GRI as their reporting framework.

For more information: [www.globalreporting.org](http://www.globalreporting.org)

### Case Study: Westpac and corporate disclosure

Westpac see Corporate Responsibility simply as good management practice. A strong commitment to Environmental, Social and Governance (ESG) issues continues to unlock real value for Westpac through lowering risks, delivering greater efficiency, enhancing reputation and contributing to innovative product offerings

Corporate responsibility and sustainability underpins and facilitates the core business strategy with a view on driving value over the long term; an overall management approach we describe as ‘managing deep, managing broad and managing long’:

- Managing broad – taking account of interests of stakeholders beyond shareholders because this fundamentally impacts our business in terms of risk, resilience and revenue upside;
- Managing long – avoiding the pitfalls of short-termism and resisting market demands to maximise near-term value at the expense of future value; and
- Leading through strong values – ensuring we operate in a responsible and ethical way consistent with accepted community and business norms.

Westpac presently disclose their emissions as part of the Carbon Disclosure Project. Westpac standardises its reporting through the Global Reporting Initiative for evaluation by Sustainability analysts around the world.

Source: Westpac Banking Corporation

### 2.4.3 Offer a Sustainable investment option to members (or build a fund)

Member Investment Choice permits superannuation fund trustees to ‘test the waters’ with their current members on the subject of Sustainable investing. Trustees could for instance survey members to gauge their level of interest in having a Sustainable Investment option added to the suite of investment choices made available by the trustee. Or the trustees could simply go ahead and make the option available without formal member feedback, but with due consideration of the costs and benefits to the members. Notably, the legal constraints outlined in 2.2.1 are considerably loosened if the members themselves have the ability to choose to have their moneys invested in a Sustainable way.<sup>67</sup> Trustees would still be required to ensure that any fund option they made available to

members was capable of satisfying the requirements of s52(2) of SIS, that it was managed efficiently and that its details were communicated in a way that members and their advisers could reasonably be expected to form a considered assessment about it.

This would seem to be a prudent first step before committing the wider portfolio to a Sustainable approach. A strong positive signal, either from member feedback or through strong take-up of the Sustainable Investing option, would be persuasive evidence of the relevance of the approach to the funds members. The trustees of the fund would still have to exercise prudence, care, skill and diligence in forming their own views on the appropriateness of the approach for the members of the fund, but a demonstrated groundswell of interest from members should make their task easier.

<sup>67</sup> For more detail see Donald, M.S., (2007) Prudent Eunuch, *Russell Research*

Once a decision is taken, the Ethical Investment Association (Australasia, EIA) provides a Sustainable, SRI and ethical certification program. The 'SRI Certification Program' is designed to ensure a consistent standard of educational information and disclosure is provided to the market. Super funds and investment managers each have their own category.

For more information: [www.eia.org.au](http://www.eia.org.au)

#### **2.4.4 Adopt sustainable business practices in your operations:**

There are now a range of organisations that assist businesses to neutralise their carbon and climate emissions – through day-to-day operations, producing compliance products or by purchasing and funding other projects. Other firms choose to adopt Corporate Social Responsibility (CSR) into their business operations. The attention paid by Russell's clients to governance issues in their own operations is a key first step in any sustainability strategy but trustees may also want to consider whether the day-to-day activities of their fund, such as reporting, administration and member education, might be conducted in a more sustainable manner.

For more information: [www.accsr.com.au](http://www.accsr.com.au)

#### **2.4.5 A Concluding Comment**

There is clearly a risk that any form of Sustainable investing will divert attention from the investment risks inherent in day-to-day stock selection and portfolio management to satisfy other, personal and political motivations.<sup>68</sup> We believe this risk can be managed using the governance strategies familiar to most Australian superannuation fund trustees, such as Investment and Audit committees, formally contracted external managers and comprehensive and transparent reporting to the trustee board and members.

Regardless of what level of engagement is chosen, in Russell's view it is important for trustees to communicate to members clearly what they have decided and to pursue the strategy carefully and efficiently. The potential for inefficiencies and misunderstandings in this area is high. This, coupled with the heart-felt convictions felt by many individuals in this area, means the chance of disappointment is disproportionately higher than in most other areas of trustee decision-making. We don't believe this should discourage trustees who judge that some form of Sustainable Investing approach is relevant for their fund, but it underscores the importance of doing it (whatever 'it' happens to be) well.

<sup>68</sup> Barber, B. M. (2006); 'Monitoring the Monitor: Evaluating CalPERS Activism', *Working Paper, Graduate School of Management, UC Davis*. See also: Romano, R. (1993); 'Public pension fund activism in corporate governance reconsidered', *Columbia Law Review*, 93, 795-853; and Romano, R. (1995); 'The Politics of Public Pension Funds', *Public Interest*, 119, 42-53.

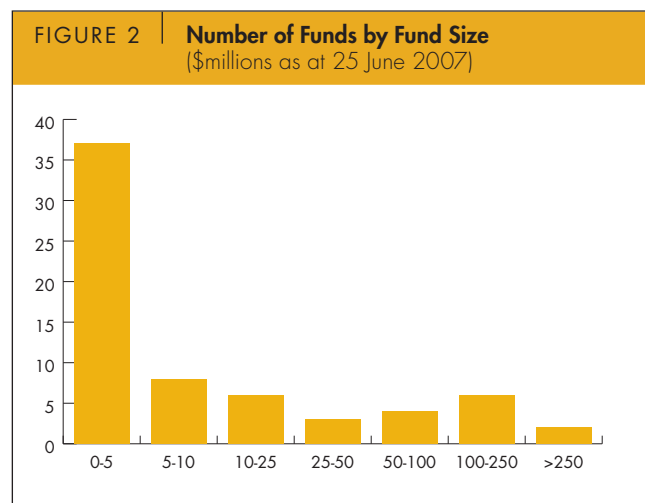
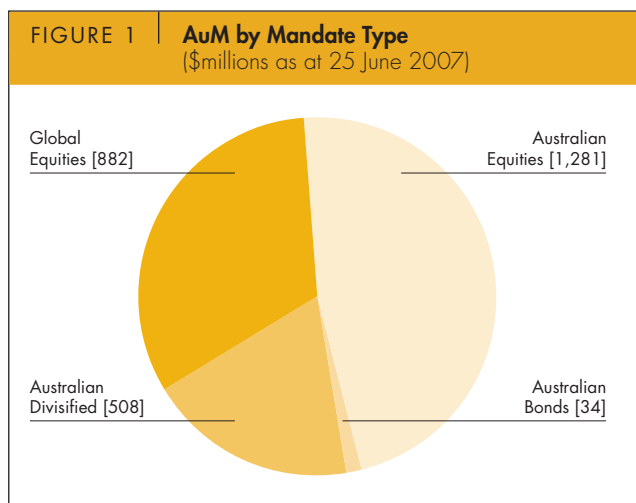
# ARGUMENT 5: “Investors are not interested”

*“As the ultimate beneficiaries [of sustainable investing] come to realise the importance of universal owners acting as such, more fund managers will find the political room to act on the potential that universal owners possess.”<sup>69</sup>*

James P. Hawley and Andrew T. Williams, 2000

A common argument levied against Sustainable investing is the lack of assets actually invested in SRI and Ethical funds. This is of course an empirical fact. Figure 1 and Figure 2 below profiles the retail ‘ethical’ fund industry in Australia.

**Figure 1 and Figure 2:**



Source: Morningstar, Data compiled from www.morningstar.com.au on 25 June 2007

Even the recent apparent upsurge in institutional investment in Australia is slightly misleading, stemming as it does from the re-classification of two large infrastructure projects as ‘sustainable’ and the decision by a major superannuation fund to dedicate a portion of its entire portfolio to sustainable practices. When total assets in a sector are small, such moves have a dramatic effect on the measured rate of growth.

We believe the current political climate makes it inappropriate to assume that investor apathy will necessarily continue.

First, there is increasing evidence of a broad trend taking place throughout business and society.<sup>70</sup> The momentum building around the issue of climate change is central to this trend. Since the first United Nations (U.N.) Intergovernmental Panel on Climate Change (IPCC) at the turn of the century, it has been widely accepted that current levels of global emissions are unsustainable and that human activity has been largely responsible for a global change in climate.<sup>71</sup> Climate change is not the only issue, however. Issues such as corporate governance (for instance arising out of the Enron and AWB scandals and discussions around executive compensation),

<sup>69</sup> Hawley, J. & Williams, A. (2007); ‘Universal Owners: challenges and opportunities’, *Corporate Governance*, Vol. 15, No. 3, May 2007

<sup>70</sup> World Economic Forum and International Business Leaders Forum (2004); ‘Values and Communicating the Strategic Importance of Corporate Citizenship to Investors’, World Economic Forum. See also: UN Global Compact (2004); ‘Who Cares Wins – One Year On’.

<sup>71</sup> Intergovernmental Panel on Climate Change (2007); ‘Climate Change 2007: Fourth Assessment Report (AR4)’, Working Group I of the Intergovernmental Panel on Climate Change.

medical research, employment relations, food technology (for instance genetic engineering, organic production and animal cruelty) are all gaining greater attention than in any decade since the 1970s. Over time we have also seen a growing tendency towards 'smaller government' in policymaking, requiring a social contract between society and business, rather than between society and government.<sup>72</sup> This groundswell of interest in issues included within the Sustainability banner<sup>73</sup> is accompanied by an increasing awareness that individuals can themselves contribute to change. This makes it more likely, in our view, that Sustainability will gain increasing momentum in coming years.

This can happen at two levels: at an individual level and at the trustee level. There is also growing promotion of Sustainable investing by the commercial funds management sector.

#### **(a) Individual discretion**

There are two ways that individuals may direct their superannuation monies towards Sustainable Investing approaches. Member Investment Choice offers a means by which individuals within large superannuation, and master trusts can direct their investments to reflect their personal preferences. An increasing number of funds now offer Sustainable-related investments within their menu of options. A survey conducted in 2005 found that two-thirds of respondents were "more likely to consider it (a sustainable option) if it was offered by their current fund."<sup>74</sup> In 2005 the Ethical Investment Association (Australasia, EIA) reported 119 super funds offered 317 responsible investment options, up from only 10 in 1996.<sup>75</sup>

This positive note must however be tempered by the observation that fewer than one in four superannuation fund members elects to move away from the default option. The result is that sustainable options account for less than 1.5% of total superannuation assets.<sup>76</sup> Moreover, despite the introduction of Member Investment Choice and Choice of Fund legislation in Australia, individuals have demonstrated little knowledge, or interest, in the traditional investing principles necessary to secure their financial future.<sup>77</sup> It is possible that other non-financial considerations may come to influence their decision-making process and selection of investment options.<sup>78</sup> Whether they choose to do so remains to be seen.

The second way that individuals may support Sustainable investing is through the growing Self-Managed Super Fund (SMSF) sector.<sup>79</sup> To date there have been no rigorous studies of the way in which SMSF assets are invested but it is worth noting that such funds typically hold assets directly or invest in retail or wholesale pools, so any material move towards Sustainable Investing in this sector of the superannuation market would have been observed in increasing flows to retail or wholesale Sustainable funds.

It therefore seems reasonable to assume that Sustainable Investing will not comprise a significant segment of total superannuation assets unless the second possible source, trustee-driven changes to the way default options are designed, provides significant impetus.

<sup>72</sup> Wood, (1991); 'Corporate social performance revisited', *Academy of Management Review*, 16:691-718

<sup>73</sup> A recent survey of Finsia fellows found that 71% thought "Australia's financial markets overall are factoring certain ESG risks" to 'a significant extent', 'an increasing extent' or 'some extent'. Further, in relation to reporting sustainability risks some "70% of members supported a voluntary requirement (subject to an 'if not, why not' requirement), while 50% supported a mandatory reporting framework". See: Finsia (2007); "Have Your Say" *Industry Opinion Poll*.

<sup>74</sup> Ethical Investment Association (2005); 'Sustainable Responsible Investment in Australia',.

<sup>75</sup> Ethical Investment Association (2004) and (2005); 'Sustainable Responsible Investment in Australia',.

<sup>76</sup> APRA, *Annual Superannuation Bulletin 2005* at 31.

<sup>77</sup> Schubert, S. (2006), 'Investment Choice: Evolution is Relative', *Russell Forum*, April 2006. Also, Finsia (2006); 'Sustaining Our Future: Investing for the long haul', *Finsia Consumer Research*, September 2006.

<sup>78</sup> Finsia (2006); 'Sustaining Our Future: Investing for the long haul', *Finsia Consumer Research*, September 2006. For a US perspective, see Krumsiek, B.J., (1997); 'The emergence of a new era in mutual fund investing: Socially Responsible Investing comes of age.' *Journal of Investing*, Winter (6)4.

<sup>79</sup> The SMSF sector is estimated to account for approximately 20% of total superannuation assets (\$234bn out of \$1, 080bn) as at 31 December 2007.

**(b) Trustee discretion**

As noted in the previous section, perceptions about the legal environment have made trustees in Australia hesitant to expressly incorporate Sustainability criteria in the investment strategies for which they have been responsible.<sup>80</sup> Very few of the largest 10 super funds, for instance, have joined responsible investment associations. There are signs that this is changing, albeit slowly with the announcement earlier this year that Australian Super and UniSuper have signed the U.N. Principles.

In our view this caution has been warranted. Definitional clarity, investment rationale and regulatory approval are all important preconditions for prudent investing. However we believe that the movement may have reached critical mass, a 'tipping point' to borrow the term popularised by Malcolm Gladwell, at which some careful moves to bring Sustainable issues into play in the design of their investment strategy can be considered by trustees.

**(c) Australian investment manager engagement**

There is a higher level of engagement by top-tier investment managers in Australia, in responsible investment initiatives and organisations. Three of the top 10 managers are members of the Investor Group on Climate Change – Australia/New Zealand (IGCC), and four are presently signatories of the UN Principles launched in 2006. Similarly, at a global level, the U.N. has attracted signatories with more than \$8 trillion in assets since being launched in April 2006, whilst the latest Carbon Disclosure Project (CDP) initiative was signed by organisations representing over \$41 trillion in assets.

*Mercer's 2006 Fearless Forecast*, a survey of 157 investment managers from around the world, forecasts 'client demand' for 'the integration of ESG analysis into investment decision-making' is expected to rise from 13% in 2006 to 38% in 2009. Notably, Australian respondents forecasted this demand to grow from 0% in 2006 to 44% in 2009.<sup>81</sup>

It should of course be noted that investment managers face slightly lower barriers to adopting Sustainable Investing practices than the trustees of, say, a corporate or industry superannuation fund. As commercial entities they can arguably offer new funds managed in a Sustainable way without the same intensity of fiduciary responsibility that other types of Responsible Entity might face.

<sup>80</sup> Strictly, the provision of Sustainable investment options falls within the ambit of the fund's investment strategy under s52 of SIS, but here we are referring to those parts of the portfolio where the trustee has direct control over the asset allocation attributed to member accounts.

<sup>81</sup> Mercer IC (2006); 'Fearless Forecast: What do investment managers think about responsible investment'.

# Conclusion

*"We have a hard time understanding how people on the scene were ambivalent as to what lay in wait for them".*<sup>82</sup>

Peter L. Bernstein, 1998

In this paper we considered the cogency of five common concerns about Sustainable Investing. Without wishing to appear flippant, these concerns could be summarised as:

- What precisely are we talking about?
- Will the law let us do it?
- Does it stack up from an investment standpoint?
- Is it practical?
- Will anyone thank us?

To which our answers are:

- **Sustainable Investing** (as opposed to ethical or socially responsible investing);
- **Yes**, so long as the purpose is the financial advancement of members rather than an altruistic or collateral motivation;
- **Yes**, but don't expect sustained excess returns: competitive risk-adjusted returns are realistic and sufficient;
- **It can be**, so long as the strategy is carefully specified and pursued in a disciplined manner; and
- **Yes**, (though they won't necessarily send fan mail).

Sustainability issues are important for mankind at large. That, of itself, does not mean that institutional investors should modify their objectives, strategies or tactics. There are plenty of other institutions in the public realm that can, and do, have a major role to play in promoting and protecting Sustainability. However we believe there are practical ways in which Australian superannuation fund trustees can play a role. Moreover, the role need not compromise the mandate held by those trustees if implemented thoughtfully and carefully. We believe that the way is open for superannuation funds to embrace a more positive approach to Sustainable investing.

## Further reading

Collie, B. Clark, M. and Ilkiw, J. (1999); 'Socially Responsible Investments. Does your SRI policy pass five tests?', *Russell Monograph No.10*.

Gardner, G. and Ilkiw, J. (2001); 'How have SRI-screened Portfolios Performed relative to Non-screened portfolios', *Russell Consulting Practice Note, No.21*.

Russell Investment Group, BT Financial Group, & State Street Global Advisors (2004); *A collaborative perspective on SRI and Investment Governance*.

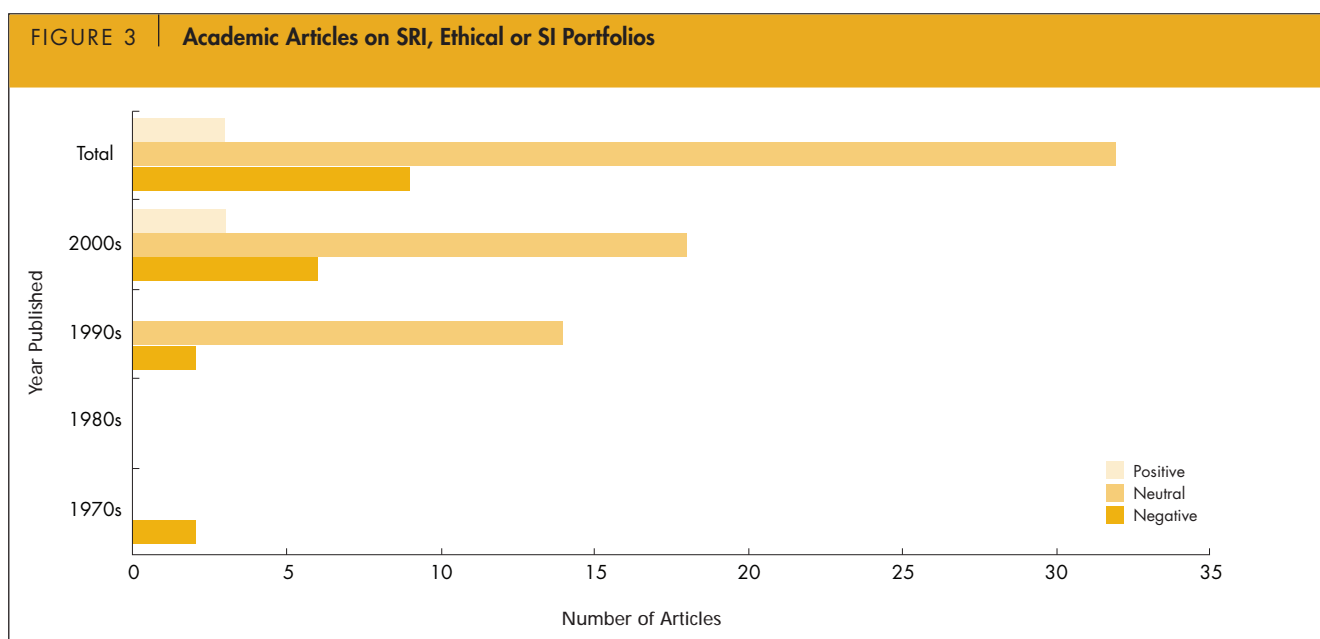
<sup>82</sup> Bernstein, P.L. (1998); *Against the Gods; The Remarkable Story of Risk*, Wiley



# APPENDIX A: An exhausting but not exhaustive list of empirical studies into the performance of Ethical, SRI and Sustainable investing approaches

The articles and books listed in this Appendix employ a wide range of analytical methods and data sets. No attempt is made in this Appendix to evaluate the relative merits of the studies listed here (our conclusions are documented in Part 2.3.2 of this Research report). Articles and books are listed chronologically in three rough categories: 'Negative', 'Neutral' and 'Positive'.

**Figure 3:**



## Negative: Studies finding that ethical, SRI or Sustainable approaches impair investment performance

Malkiel, B.G. & Quandt, R.E. (1971); 'Moral Issues in Investment Policy', *Harvard Business Review*, Vol.49 No.2.

Tepper, J.A. (1992); 'Evaluating the Cost of Socially Responsible Investing', *The Social Investment Almanac: A Comprehensive Guide to Socially Responsible Investing*, eds. Kinder, P.D., Lydenberg, S.D. & Domini, A.L., Henry Holt & Co., New York.

Gregory, A. Matatko, J. and Luther, R. (1997); 'Ethical Unit Trust Financial Performance: Small Company Effects and Fund Size Effects', *Journal of Business, Finance and Accounting*, Vol 24, No.5

Tippett, J. (2001); 'Performance of Australia's Ethical Funds', *The Australian Economic Review*, Vol 34(2)

Ali, P.U. and Gold, M. (2002); 'An Appraisal of Socially Responsible Investments and Implications for Trustees and Other Investment Fiduciaries', Centre for Corporate Law and Securities Regulation, University of Melbourne.

Geczy, C., Stambaugh, R. & Levin, D. (2005); 'Investing in socially responsible mutual funds', Working Paper, University of Pennsylvania.

Gold, M. (2006); 'Corporate governance, activism and the role of trustees', *Jassa*, Winter

Jin, H.H., Mitchell, O.S., & Piggott, J. (2006); 'Socially responsible investment in Japanese pensions', *Pacific-Basin Finance Journal*, 14.

Girard, E., Rahman, H., & Stone, B. (2007); 'Socially Responsible Investments: Goody-Two-Shoes or Bad to the Bone?', *Journal of Investing*, Spring 2007.

### **Neutral: Studies finding that ethical, SRI or Sustainable approaches neither materially impair nor enhance investment performance**

Perks, R.W., Rawlinson, D.H. and Ingram, L. (1992); 'An Exploration of Ethical Investment in the U.K.', *British Accounting Review* 24(1)

Luther, R.G. Mataiko, J. and Corner, D. (1992); 'The Investment Performance of U.K. Ethical Trusts', *Accounting, Auditing and Accountability Journal* 5(4)

Hamilton, S, Jo, H & Statman, M. (1993); 'Doing Well While Doing Good? The Investment Performance of Socially Responsible Mutual Funds', *Financial Analysts Journal*, November/December.

Luther, R.G. and Mataiko, J. (1994); 'The Performance of Ethical Unit Trusts: Choosing an Appropriate Benchmark', *British Accounting Review* 26

Diltz, J.D. (1995); 'The Private Cost of Socially Responsible Investing', *Applied Financial Economics*, Vol.5.

Mallin, C.A., Saadouni, B. and Briston, R.J. (1995); 'The Financial Performance of Ethical Investment Funds', *Journal of Business Finance and Accounting*, Vol.22, No.4

D'Antonio, J., Johnsen, T. & Hutton, R.B. (1997); 'Expanding Socially Screened Portfolios: An Attribution Analysis of Bond Performance', *Journal of Investing*, Winter 1997.

Kurtz, L. (1997); 'No Effect, or No Net Effect? A Review of studies on Socially Responsible Investing', *Journal of Investing*, Winter.

Guerard, Jon B., Jr. (1997); 'Additional Evidence on the Cost of Being Socially Responsible in Investing', *Journal of Investing* 6(4): 31-35.

Guerard, J. B. (1997); 'Is There a Cost to Being Socially Responsible in Investing?', *Journal of Investing*, Summer

Sauer, D.A. (1997); 'The Impact of Social-Responsibility Screens on Investment Performance: Evidence from the Domini 400 Social Index and Domini Equity Mutual Fund', *Review of Financial Economics*, Vol.6.

Gottzman, L. & Kessler, J. (1998); 'Smart Screened Investments: Environmentally Screened Equity Funds that Perform like Conventional Funds', *Journal of Investing*, Fall.

Reyes, M.G. & Grieb, T. (1998); 'The External Performance of Socially-Responsible Mutual Funds', *American Business Review*, January.

Goldreyer, E, & Diltz, D. (1999); 'The performance of socially responsible mutual funds: Incorporating Sociopolitical information in portfolio selection', *Managerial Finance*, Vol.25 Is.1.

Statman, M. (2000); 'Socially Responsible Mutual Funds', *Financial Analysts Journal*, Vol. 56.

Abramson, L. & Chung, D. (2000); 'Socially Responsible Investing: Viable for Value Investors', *Journal of Investing*, Fall

Cummings, L. (2000); 'The Financial Performance of Ethical Investment Trusts: An Australian Perspective', *Journal of Business Ethics*, Vol. 25

diBartolomeo, D., and Kurtz, L. (2000); 'Managing Risk Exposures of Socially Screened Portfolios', Working Paper, Northfield Information Services, Boston, Mass.

Naber, M. (2001); 'Catholic Investing: The effects of screens on financial returns', *Journal of Investing*, Winter.

Asmundson P. and Foerster, S.R. (2001); 'Socially Responsible Investing: Better for your soul or your bottom line?', *Canadian Investment Review*

Stone, B.K., Guerard, J.B., Gultekin, M.N., & Adams, G. (2001); 'Socially Responsible Investment Screening: Strong Evidence of No Significant Cost for Actively Managed Portfolios', Working Paper, June.

Bauer, R., Koedijk, K., and Otten, R. (2005); 'International evidence Ethical Mutual Fund Performance and Investment Style', *Journal of Banking and Finance*, Vol. 29

Kreander, N., Gray, R.H., Power, D.M., & Sinclair, C.D. (2005); 'Evaluating the Performance of Ethical and Non-ethical Funds: A Matched Pair Analysis', *Journal of Business Finance & Accounting*, 32(7) & (8).

Shank, T.M., Manullang, D.K., & Hill, R.P. (2005); 'Is it Better to be Naughty or Nice?', *Journal of Investing*, Fall

Statman, M. (2005); 'Socially Responsible Indexes: Composition and Performance', Working Paper.

Vermier, W., Van de Velde, E. & Corten, F. (2005); 'Sustainable and Responsible Performance', *Journal of Investing*, Fall

Bello, Z.Y. (2005); 'Socially Responsible Investing and Portfolio Diversification', *Journal of Financial Research*, Vol. XXVIII, No. 1, Spring

Evans, J., Guido, R., and Guo, M. (2006); 'Analysing sustainable securities', *Jassa*, Autumn

Bauer, R., Otten, R. and Tourani Rad, A. (2006); 'Ethical Investing in Australia, is there a Financial Penalty?', *Pacific Basin Finance Journal* 14(1)

Statman, M. (2006); 'Socially Responsible Indexes: Composition, Performance and Tracking Error', *Journal of Investing*, Spring 2006.

Bauer, R., Derwall, J. and Otten, R. (2007); 'The Ethical Mutual Fund Performance Debate: New Evidence from Canada', *Journal of Business Ethics*, Vol. 70

Gregory, A. & Whittaker, J. (2007); 'Performance and Performance Persistence of 'Ethical' Unit Trusts in the U.K.', *Journal of Business Finance & Accounting*, 1-18.

### **Positive: Studies finding that ethical, SRI or Sustainable approaches enhance investment performance**

Kumar, R., Lamb, W.B. and Wokutch, R.E. (2002); 'The End of Ownership of the South African Sanctions, Institutional Ownership, and the Stock Price Performance of Boycotted Firms', *Business and Society*, Vol 41(2).

Edwards, E. and Samant, A. (2003); 'Investing with a Conscience: An Evaluation of the Risk-adjusted Performance of Social-responsible Mutual Funds', *Mid-American Journal of Business*, Spring, Vol.18, Issue 1.

Hussein, K. & Omran, M. (2005); 'Ethical Investment Revisited: Evidence from Dow Jones Islamic Indexes', *Journal of Investing*, 14(3).

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