



TOTAL ENVIRONMENT CENTRE



Ethical? Investment

A Review of the SRI Industry in Australia

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PART TWO – KEY FINDINGS

4. INTRODUCTION

At a first glance it is difficult for TEC and its Project Partners to have confidence that SRI delivers on its promise. Some companies that have ongoing and protracted battles over their social and environmental performance are common inclusions in the portfolios of SRI Funds.

BHP Billiton has been condemned over OK Tedi, and has serious problems with their coal operations in the Sydney Water Catchment Area. Orica has been the subject of intense protest over waste disposal techniques at its Botany Plant and there are ongoing campaigns to eliminate Orica's production of Persistent Organic Pollutants such as HCB's. Patricks is, of course, remembered for its role in the disputes on Australia's wharves where they were found to have unfairly dismissed most of its workforce. Yet all three companies are popular targets for SRI Funds.

At its most simplistic level, it is expected that ethical investments exclude companies that engage in activities relating to alcohol, gambling, tobacco, uranium, old growth logging and weapons. Yet companies engaged in these very activities frequently appear in the prospectuses – Rio Tinto mines uranium but four SRI Funds invest in Rio Tinto. Foster's make beer and attract investment from two SRI Funds. Coles Myer and Woolworths generate significant income from the sale of tobacco and alcohol yet between the two they attract the investment of eight different SRI Funds.

Overall nearly every ASX100 company features in the portfolio of at least one SRI Fund.

Clearly views about financial returns ('fiduciary duty') are important and funds need to weigh the various risks – but how much rationalisation is too much? In their analysis of the scale of SRI investment in the fossil fuel industry, the Mineral Policy Institute (2002) points to the need to consider a three year average performance rather than quarterly analysis of minimum tracking error (normally five per cent above or below mainstream portfolio performance) - as a more consistent assessment of financial performance. SRI industry targets should not be assumed to be in such a mature stage as mainstream business (based as it is on long established practices of environmental degradation) - rather seen as responsible investment in social and economic change.

An associated argument that is deployed is that the investor and superannuation market is made up of 'deep greens' and 'moderates' in response to public opinion. This is debatable as most high priority environmental issues usually attract a large level of public support (e.g. saving the Franklin, stopping old growth logging, using more renewable energy). Funds run the risk of being embroiled in environmental controversies and damaging their reputation with the broad market, unless they avoid socially and environmentally risky areas.

SRI also needs to distinguish between easy targets, that is industry, which by its very nature produces products and services that are easily identified as green or socially

WWF believes that the integrity, reputation and long-term growth of the SRI industry will require SRI funds to:

- **Identify priority environmental and social issues for the sectors and companies that the fund may invest in. Environmental and social issues can be identified through research and broad consultation with interest groups;**
- **Incorporate performance measures into their screening methodology that enables investments being screened to be assessed on their environmental and social performance; and**
- **Ensure a high level of disclosure of the funds' investment strategy & values, screening methodology and investments. If the screening methodology has a number of screening tools – positive & negative screens, triggers and/or issues of concern – then the SRI fund should detail how these are combined and weighted in the screening process. This will enable potential customers of SRI funds to select a SRI fund that most closely aligns with their investment values.**

Furthermore, financial institutions with SRI funds need to communicate their long-term direction in relation to sustainability and their investment strategy. As metrics are developed and refined that will enable more sophisticated assessment of the benefits of incorporating environmental and social issues into investment decision making processes (ie risk management, managerial performance, long-term returns & growth etc), it is WWF's hope that the SRI industry will be the catalyst for the finance sector to incorporate sustainability in the 'mainstream'.

responsible, and more conventional industry where practices can change to reduce their ecological footprint. Both deserve investment, but the latter requires more active focus in terms of business practice and programs for change. For example, a SRI test should not only include 'environmental management systems' or bland assurances that problems are 'being managed', but also ongoing assessment of the significance of targets for environmental improvement by the company and its chain of supply and reported trends in reduced environmental impact. This will require more research, heavier screening and inevitably cost more, but it should result in bringing the fund will result in stronger growth and better investor loyalty to their SRI Fund.

Unless SRI Funds can prove they are 'making a difference', that is investing in companies that measurably contribute to environmental and social improvement and the development of new green industry and economy, then the tangible benefits of SRI must be questioned. It is simply an exercise of differentiation through marketing.

The results of our review do not show this to be the case for all participants in the SRI industry. Some are more advanced than others (which are hopefully on a learning curve and intend to reduce the influence of conservative corporate culture and obtaining financial returns through unacceptable environmental impact).

The following chart outlines key issues that need to be addressed in order to assure NGOs that the SRI industry will make a serious contribution. All issues are discussed in some detail later in this publication.

5. SRI PERFORMANCE IN KEY AREAS (Australian Equities Funds only)

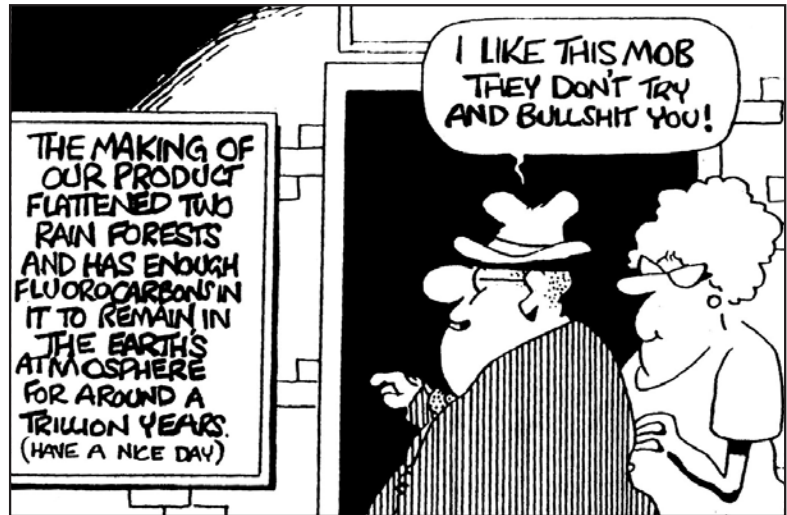
	Application of method is reflected in portfolio	Assessment criteria is based on published values	Offers high levels of Transparency	Uses an external verification process or advisory committee	Good use of negative screens to exclude harmful industries	Strength of broad Sustainability Assessments	Undertake constructive engagement activities
Australian Ethical Investment	👍	👍	–	👍	👍	–	👍
AMP Henderson	👎	–	👍	👍	👍	👎	👍
* BT Funds Management	–	–	👎	?	👎	👎	–
Challenger	👍	–	–	👍	–	👍	–
Equity Trustees	👎	👎	–	👎	👎	👎	–
Glebe Asset Management	–	👍	–	👍	👍	👎	👍
Hunter Hall	👍	👍	–	👎	👍	👎	–
IOOF	?	?	?	?	?	?	?
Perpetual Trustees	👍	–	–	👍	👍	👍	–
SAM Australia	👎	–	👍	👍	👎	👍	👍
* Rothschild / Sagitta	–	–	–	👍	–	–	–
Tower Asset Management	–	–	👎	👍	👍	–	👍
Warakiri Asset Management	–	–	👎	?	–	👎	–
* Westpac Investment Management	👎	–	👎	👍	👎	👍	👍

* Now Sagitta Wealth Management 👍 Doing good things in this area 👎 Needs to improve significantly – adequate ? unsure

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6. TRANSPARENCY

Transparency is an important issue for SRI Funds. All participating funds managers and their researchers were transparent in the broad details of methodology and processes that are employed and the resulting portfolio. This is distinctly different from the non-SRI funds that often don't even provide public details of their portfolio listings. Some SRI parties felt they needed to withhold specific details of their Funds to protect intellectual property. This may be a reasonable position so long as the overall approach and weightings can be understood and the company uses external, independent verification.



A key question revolves around the appropriate level of transparency. The availability of information is regarded as best practice on a range of aspects. A similar conclusion was drawn in the “Screen the Screeners” study (Mistra 2001). Transparency could involve disclosure of:

- Details of the principles and policies of the fund or process;
- Detail of the methodologies applied, including criteria, weightings, rankings and thresholds;
- Details of companies screened out and why; and
- Details of companies included and why.

The level of transparency varied between participants ranging from ‘no effort required’ to ‘substantial effort required’ in obtaining ethical methodologies. Of course this is only relevant if the investors can also be sure that these ethical policies are realistically implemented without bias.

The table presents the availability of information on the rating/screening score. The availability has been rated on a five tiered scale.

Fund Manager	Individual Investors	Rated Company	General Public
ABN AMRO Asset Management	NC	NC	NC
AMP Henderson	FDA	FDA	FDA
Australian Ethical Investment	FDA	FDA	FDA
BT Funds Management	NC	NC	NC
Challenger	ID	FDR	NC
Equity Trustees	NC	NC	NC
Glebe Asset Management	ID	ID	ID
Hunter Hall Investment Management	FDR	SID	SID
ING	NC	NC	NC
IOOF	FDR	NC	FDR
Perpetual	FDR	FDR	FDR
Sagitta	FDR	FDR	ID
SAM	SID	SID	SID
Tower Asset Management	FDR	SID	SID
Warakiri Asset Management	NC	NC	NC
Westpac Wealth Management	FDR	FDR	FDR

FDA Full Details Available
 SID Score and Investment discussion
 NC No Comment (Fund Manager/Researcher did not answer question)

FDR Full Details Available on Request
 ID Investment Decision Only

The following Fund Managers or Researchers provide details of rating results to individual investors, the rated company and the general public:

- AMP Henderson – principles and policies, overview of research results communicated through public pages on their website;
- Australian Ethical Investment - details of all investments and rationale are displayed on the website public pages and in public offer documents;
- Hunter Hall Investment Management - monthly and quarterly reports are available in their website. Investors and advisers are also invited to HHIM annual investors meeting where they can provide feedback;
- Corporate Monitor - through monthly publication of Ethical Investor Magazine;
- SAM - details of criteria, weightings, investments on their website; and
- Westpac – portfolio can be downloaded from their website (but not sufficient details).

The remaining Fund Managers and Researchers will provide details on request or transparency is only extended to their broad methodologies and ethical principles.

While a certain level of information about methodologies and processes is generally available throughout the industry, resistance to greater transparency grows as one approaches the specific data and weightings that guided investment decisions. In the light of new regulatory requirements to report on investments and the public scepticism towards 'black boxes', there should be easily publicly accessible data on each SRI website that clearly explains choice of company – including the full spectrum of considerations and their relative merits. For example, AMP is one of the few that provide a profile of the company's relevant social or environmental matters and this is welcomed. However, the information is less than satisfactory because the commentary is presented in a very positive light (e.g. management protocols invariably outweigh impacts; health services lack review of sustainable building management) and a full decision context is required.

7. CONFLICT OF INTEREST

It is common for financial institutions to have an investment management department or affiliated company. Conflict of interest policies need to be defined and effectively implemented so that analysis of the company is consistent with any other similar company in that sector. There are three parties who can potentially expose themselves to conflicts of interest:

Fund Manager or Company has equity in Rater or Research House

This analysis has highlighted a number of Fund Managers and/or Companies that have significant equity in Raters or Research Houses. IOOF has equity in its researcher SIRIS and Australian Ethical Investment hold a loan to CAER. In order to counter this, Researchers have established an independent board or committee that analyse methodologies and outcomes or ratings. The independent committee may include a selection of external stakeholders.

Researcher consulting to Company

Companies, in an attempt to gain ethical consideration in an investment portfolio, could seek the specialist advice of Raters or Research Houses. Should this occur, the consulting contracts need to be appropriately disclosed and policies need to be implemented so that those providing consulting advice do not rate the client's companies.

Researcher consulting to Fund Manager

Rater may consult to the Fund Manager in regards to portfolio construction. This should be disclosed particularly if the owner of the Fund Manager has equity in the Rater.

Best practice in relation to potential conflicts of interest includes:

- A published conflict of interest policy, identifying any potential issues and how they would be dealt with;
- Disclosure of potential conflicts of interest;
- The use of independent advisory boards to review any process or decision which has the potential to cause a conflict of interest; and
- Clear separation between consulting and assessment services.

It is important to note that TEC was satisfied that there were no inherent conflicts of interest between fund managers, researchers and target companies. Wherever potential conflicts of interest were identified appropriate independent verification processes were in place.

8. EXTERNAL VERIFICATION

Most researchers have an independent verification process. This may vary from an independent consultant undertaking reviews periodically to the establishment of affiliated and independent committees or advisory boards that monitor the methodologies constantly as part of the overall process. The table below gives details of researchers verification processes.

Research House	External Verification Process	Advisory Board
SIRIS	No comment made.	Independent Policy Advisory Board to ensure that social responsibility and sustainability research reflects and embraces appropriate social concerns, expectations and standards.
SAM	PriceWaterhouse Coopers undertake annual review.	A high-level management team from Dow Jones and SAM approve major changes and exclusions.
CAER	AEI has an investment committee that reviews each potential and existing investment for both ethical and financial considerations. If an issue is problematic then it is referred to the full board of AEI	CAER has instituted an independent board of trustees to provide an oversight role for their research. This board comprises academics, finance industry representatives, environmental representatives, representatives of other groups.
MSE	No comment made.	Advisory Board made of independent representatives established in September 1999. The board meets quarterly and gives critical feedback on methodology, rating instruments, weighting, and discusses controversial issues. Committee members do not have access to company research and ratings.

The SRI industry needs to ensure that it adopts strong levels of community consultation and a process of independent external verification of information regarding the social and environmental performance of a company. Where information cannot be verified independently it must use the precautionary approach, i.e. don't invest in the company until it is known that its activities are in line with your commitment to your investors.

It is important that advisory boards or consultative committees be engaged to oversee SRI methodologies and ensure that the application of methodologies are impartial and reflect investors' social values. External committees should be independent of the fund itself and should be comprised of a variety of stakeholders.

9. CONSULTATION WITH STAKEHOLDERS

The major stakeholders that are considered by research houses and funds managers with internal research capabilities include:

- The rated company
- Regulators
- Employees
- NGO's

It is important to an organisation's credibility that it has in place mechanisms to enhance two-way information flow between the organisation and its various stakeholders, both direct and indirect. Companies seeking to build respect for their performance will benefit from being able to demonstrate the ways in which they have established dialogue with those various stakeholders.

In particular, conventional ways of involving the community include:

- Direct involvement in community issues and activities;
- Surveying;
- Focus groups; and
- Perusal of local publications and other written material on environmental issues in the local area and the region.

However, an important indicator of genuine community engagement for the benefit of all involved is the extent to which this engagement is by way of real partnerships (for example, in agreeing methodologies) in which a dialogue based on equity, trust and mutual respect leads to shared decision making. The list of key stakeholders should also be publicly available, ensuring there is a cross section of environmental and social perspectives and indicating how information received from stakeholders is used.

10. GOOD INDUSTRIES OR GOOD APPROACHES?

'What they do' – Negative and positive screens

SRI needs to consider if there are industries or companies whose very nature means that they:

- Present an unacceptable hazard to the environment, health, or society; or
- Undertake activities that may significantly improve the environment, health, or society.

TEC considers this area of screening under the broad title of 'What they do'. The most effective way to assess companies on the basis of 'What they do' is to use screens to eliminate some activities and encourage other activities. Best practice for such screens includes – clear identification of the principles being promoted and of the criteria used to support the principles; and an explanation of how the screen interacts with other assessment methods so as to avoid contradictory results.

Negative screens

This is where individual companies are excluded from investment portfolios based on social, environmental or community criteria. Most common negative screens are used for alcohol, gambling, native timber harvesting, tobacco, uranium, or weapons manufacture. This is the simplest and most common method of screening SRI products.

The negative screen, in some cases, is applied via a percentage of company turnover – either excluded if it exceeds a certain amount or included if it is less than a certain figure.

Negative Screens

In relation to environmental issues, WWF believes negative screens are useful tools in the screening process to identify and eliminate companies with chronic, environmentally damaging practices. Negative screening will identify practices that do not meet minimum acceptable standards of environmental practice or corporate behaviour. For example, environmental issues and practices that can be incorporated into negative screens include:

- Disposal of mine tailings and waste in rivers;
- Forestry activities in high conservation value forests;
- Extractive and industrial processes that are highly inefficient, wasteful of resources and/or highly polluting (including greenhouse gas pollution); and
- Those where environmental externalities pose a significant risk to future generations ie nuclear.

Application of the negative screen by Fund Managers

Negative Screen	ABN AMRO	AMP	Aust. Ethical	BT	Challenge	Glebe	Hunter Hall	Equity Trustees	IOOF	Perpetual	Sagitta	SAM	Tower	Warakirri	Westpac
Armaments & Weapons	6	3			1	1	6	4	1	2	6		6	6	6*
Gaming	6	3			1	1	6	4	1	2			6	6	
Uranium Mining		3		6	1	1		1	1	2			6	6	1
Tobacco	6	3			1	1	6	4	1	2			6	6	
Alcohol		3			1	1		4		2	6		3	6	
Animal Rights	6	3	6		1		6		1	6			6		
Environmental Issues		6	6		6	6	6			6	6		6		
Human Rights Violations	6	6	6		6	6				6	6				
Logging of Native Forests		6		6	1				1				6		
Nuclear Energy	6	3		6									6		
Community													6		
Pornography	6	3				1		4							
Production of Fur	6	6											6		
Dumping in Developing countries			6			6									
Employment Practices	6				6	6							6		
Advertising - Offensive or Misleading			6			6									
Genetically Modified Organisms		6								6					
Customer Relations													6		
Chemicals harmful to environment		6													
International Standard Non Conformance	6														
Product Safety						6							6		
Support Oppressive Regimes	6	6				6									

Key

- | | |
|--|--|
| 1 Exclusion defined at 0% of company turnover | 2 Exclusion defined at 5% of company turnover |
| 3 Exclusion defined at 10% of company turnover | 4 Exclusion defined at 20% of company turnover |
| 5 Exclusion defined at 50% of company turnover | 6 General assessment of materiality |

*Westpac International Sustainability Fund.

Positive screens

Individual companies are included in investment portfolios based on a demonstrated commitment to social, environmental or community concerns.

It allows companies in socially undesirable industries to be included in SRI if they make a serious commitment to reducing environmental and social impacts. This, therefore, gives Fund Managers greater scope in achieving desired financial returns while managing volatility and risk through greater opportunity for diversification.

Other processes

A range of other assessment and screening processes are also used in conjunction with those discussed above. Some of these are well explained and articulated. Westpac/Monash use an "amplification or trigger" system to accommodate specific events or issues (such as a toxic spill or other incident). AMP has identified "sectors or issues of concern". These cover industries or activities, which may be of concern to

investors and set out the principles the Fund will apply. Whilst some are negative screens (such as companies involved primarily in road construction) others are clarification of fund policy, for example whilst a number of specific areas in the chemical industry are flagged as areas of concern, AMP notes the Fund may invest in chemical companies that demonstrate leadership in response to environmental and social concerns.

However, a number of protocols are also very broad and appear to give Fund Managers wide discretion to select companies in 'special circumstances'. In this regard, it is clearly preferable that transparent criteria, or guidelines are established to guide these decisions.

Use of screens in Australia

Nearly all Australian Equity SRI Funds use screens. Sustainable Asset Management is the exception to this rule employing no negative screens. Westpac SRI Funds screen for uranium related activity and weapons only and AMP Henderson's screens are quite extensive, but also include 'areas of concern' which appear to be enforced subjectively and can be based on unrelated Fund financial considerations.

Sagitta Rothschild, Challenger, Glebe, Australian Ethical Investment and Equity Trustees use positive screens.

'What they do' is important. Current trends in SRI assessments focus heavily on procedures, management systems, and reporting which while important, are only a part of the equation. It must be recognised that many companies with the best procedures, systems and reporting inevitably come from those industries that present the greatest hazards.

Positive Screens

WWF believes positive screening is the tool that enables the incorporation of responsible environmental and social performance into the screening process. WWF encourages SRI funds to actively develop positive screens that identify minimum performance requirements for environmental and social issues. Positive screens can identify responsible environmental practices including:

- **The supply and use of renewable energy;**
- **Broadly supported performance standards for natural resource management such as those of the Forest Stewardship Council and Marine Stewardship Council;**
- **Extractive and industrial processes that are energy and resource efficient, recycle or re-use resources, demonstrate responsible product stewardship, and/or minimise pollution; and**
- **Processes that demonstrate high level or engagement with stakeholder on environmental and social issues.**

Furthermore, positive screens can help to identify those companies who are developing the internal processes to support the implementation and communication of their sustainability strategy ie quantifying their environmental footprint, setting targets and timelines for improving environmental performance, public environmental reporting etc.

TEC believes the average SRI investor does not want to see their money invested in industries that are generally regarded as destructive and/or dangerous. Accordingly the use of common negative screens is important and should be expanded to reflect the serious social concerns identified in part four of this review.

There is significant room to expand screens to reflect current critical issues that are very much part of the mainstream social concerns of everyday Australians. Equal employment opportunity, dependence on the extraction of fossil fuels, animal welfare, product dumping in developing nations, and the use of Genetically Modified Organisms (particularly in food) are all examples of issues of major community concern where negative screens could be applied, to ensure that SRI Funds better reflect current social values.

Negative screens should also be applied in areas where any truly 'ethical' investment should adopt a zero tolerance policy. Slavery and the exploitation of children in developing nations must trigger the automatic and permanent exclusion from SRI portfolios, as should any act that is blatantly illegal and immoral, e.g. such as the dumping of banned products in developing nations, or the deliberate unfair dismissal of the majority of a workforce.

The use of 'materiality' should also be assessed as it allows 'controversial' companies to obtain investment, even when the controversial aspect is a small portion of its activity. A further test should be used – demonstrable proof the company is withdrawing from the activity.

'How they do it' – Beat systems and processes

The second area screening a company for a SRI portfolio comes from reviewing how well a company undertakes its practice. 'How they do it' is certainly a vital process in screening, particularly in a best of sector approach to a SRI Fund.

Yet there is an inherent risk involved in this approach. As stated earlier, the companies with the highest risks are often the best process managers and with this in mind it is critically important that any screening applies a weighting that factors in the level of inherent risk that the sector presents. For example, the mining and chemicals industries should reach extremely high levels of environmental and social management and target setting, to meet a SRI criteria. (This is not to say that easy targets such as health care should not also have high levels of environmental performance, for example, the industry should construct 'green buildings' and practise waste minimisation, water and energy conservation).

With this in mind the 'How they do it' approach needs to be tempered by either the use of negative screens (preferable) or a weighting that ensures high risk industries are in fact best-in-class risk managers.

Best of sector

Under this approach companies are rated on their social and environmental performance and an investment is made in the best performers within each sector of the economy. This approach attempts to drive improved social and environmental performance through competition in each

A Restricted Investment Universe

Planet Ark's major concern is the 'restricted investment universe' of SRI fund managers. In line with their mainstream counterparts, they see this as the ASX 200. The vast majority of economic activity is outside these 200 companies and it is ludicrous to ignore this.

Much sustainable economic activity comes from:

- **Specific purpose listed companies outside the top 200 eg Advanced Energy Systems.**
- **Many smaller unlisted ethical businesses that need access to equity or loan funds, eg Bionomics P/L, manufacturer of Planet Ark/Aware laundry powder who received loan and equity investment at a crucial time of their development. Some may never be listed but have an important role in the 'small is beautiful' sustainable economy.**

Mainstream SRI also focuses on one class of investment, share equity, ignoring loan and property investments. With no 'Green Bank' in Australia, this is a particularly important role for the SRI industry.

sector (picking leaders). Westpac and SAM use a best of sector approach and AMP Henderson's Funds appear influenced by the best of sector approach.

Key methods used to screen for a best of sector approach include: the collection of public information; reviews of regulatory compliance and prosecutions for non-compliance; use of questionnaires to assess workforce, governance, social and environmental performance and community consultation.

The emergence of the best of sector approach and the subsequent screening methodologies to assess overall environmental and social screening - has led to much of the SRI industry undertaking broad sustainability assessments where social and environmental management systems, reporting, and overall record of performance become significant focuses for assessing a company's suitability for inclusion into a SRI Fund. It can allow choice of good financial performers despite their scale of environmental impact.

There are distinct differences in approach, for example SAM restricts its 'investment universe' to the best 30% of any sector in the ASX200, on the basis of sustainability. Other SRI Funds appear to set the bar lower by eliminating the worst and choosing the rest. AMP Henderson and Westpac apply a methodology that in theory appears rigorous, but leads them to choose far more entrants than other SRI Funds.

While any best of sector approach without any negative screens or weightage to account for the inherent risk of industry concerns us, best of sector in an Australian equities product seems a less than successful approach, as there appears to be little to differentiate many best of sector approaches from the mainstream funds management industry. Often SRI Funds explain that the small ASX market, unlike overseas, limits the ability to be selective, accordingly we do not believe that it is the most appropriate primary technique at this time. It should be associated with negative and positive screening; or a greater entry threshold given to industries with a high inherent risk with the entry bar set where there is comprehensive evidence of significant reform of practice; or selection of companies that are engaged in key waste, recycling and pollution minimisation activities for that sector.

Connecting Investor's Values to SRI Portfolios

Charters and policy statements are used to state a set of values for a SRI Fund, and then research is undertaken to select companies whose activities are consistent with the charter. This method of establishing what is an appropriate 'investment universe' is an excellent approach. These documents assist in ensuring that a fund is transparent. They also enable a fund to establish a clear criterion with which to 'marry' the investor's values to companies selected for the portfolio.

Policy Statements and Charter based funds tend to use negative and positive screens to select a company and may also operate a more complex overall evaluation, similar in methodology to the best of sector approach. Australian Ethical Investment and Glebe Asset Management both make use of a charter in their approach and this enhances their reputation, while ABN AMRO make use of a strong and detailed policy statement.

Best of Sector

WWF believe that when combined with minimum performance benchmarks (through the use of positive and negative screens), best of sector approach enables the leaders in a sector that meet or exceed acceptable standards of performance, to be identified.

There is the risk however, that in the absence of minimum performance requirements, a best of sector approach may select the 'best of a bad lot'. That is, the performance of the leaders within a sector does not meet acceptable standards.

11. LINKS BETWEEN THE COMMUNITY AND SRI FUNDS

Shareholder advocacy

Shareholders are able to raise issues of concern with management through voting resolutions.

Although not as common as social screening in the investment selection, shareholder advocacy can prove to be a powerful tool for shareholders with social and environmental consciences. This trend is gaining momentum in the United States and United Kingdom.

AMP Henderson's Constructive Engagement process is also influenced by the concept of shareholder advocacy, though it is a rigorous process, focused on highlighting issues to large companies whether they are included in the portfolio or not. AMP undertakes issues papers, seeks to engage companies and support NGO's on advocacy matters.

Australian Ethical Investment, Glebe Asset Management and SAM encourage NGO and community groups to come to them with concerns and are known to raise issues with companies within their portfolio. Glebe in particular are interested in expanding their role in this area having joined the coalition 'The Christian Centre for Socially Responsible Investment' to increase the level of influence they can exert when they "take their case to a company's management".

Tower's recent support for the Wilderness Society's efforts to force the Commonwealth Bank to divest its equity in the Tasmanian logging company Gunns Ltd is a good example of the role that SRI Funds can undertake as shareholder advocates. Tower (and many other investors) supported a resolution to change the CBA's constitution so that it could no longer financially support companies that benefit from logging old growth forests.

Community based investments

This involves providing capital to organisations for community based projects. Australian Ethical Investment is the only Australian Fund that we reviewed which undertakes community based investments. Tessa Tenant, (Executive Chairperson – Association for Sustainable and Responsible Investment in Asia), has singled out Australian Ethical Investment and Calvert (a US Fund) as the global leaders in the community based investment approach. AEI lends funds to unlisted companies and businesses such as schools and organic farms and also supports charities with unsecured loans etc. AEI believe that community based investment is an important part of their portfolio and have stated that their charter requires an ongoing responsibility in this area.

The Ethical Investment Association point a number of other 'specialist' Community Based Investment Funds. Details of these funds can be found listed under the heading of "Cash Management Funds" in each issue of Ethical Investor Magazine.

12. REGULATION AND MINIMUM STANDARDS

It is understood that different funds have different social and environmental criteria, yet the absence of industry minimum standards and a lack of transparency in justifying why a company is a socially responsible investment makes it difficult for the public to understand how some SRI Funds are different from mainstream funds – if a SRI Fund can't demonstrate that it is responsible in its prospectus and targets, they need to expect that their methodologies will continue to be questioned.

It could be argued that a variety of funds allow consumer choice. But the credibility of the SRI industry is important. Minimum standards will help protect the industry – further public auditing could then take place via NGOs or even government agencies.

There is a tendency in the business community to resist regulation because of the belief that the free market should be allowed to operate largely unimpeded and that this will lead to better resource allocation decisions. However, the growth of environmental regulations over the last several decades has had significant community support as the voluntary mechanisms embodied in the market have failed to deliver substantial or rapid environmental gains and the environment continues to decline.

Government regulation and the ratifying of international treaties such as the Kyoto Protocol help remove the disadvantages faced by new industry when entering a marketplace with inbuilt subsidies (for example, by non pricing of environmental costs) that support conventional business. The calls by important parts of the Australian business community for the nation to ratify the Kyoto Protocol on the basis of encouraging greener energy supplies and participation in the emerging renewable energy economy, reflect the importance of regulation in overcoming barriers to new industry and practices.

The SRI industry should broadly embrace regulation that will safeguard its reputation and prospects for sustained growth. As noted above, the growing funds at its disposal are critical to the achievement of social and environmental objectives. It is clearly in its financial and policy interests and that of NGOs that environment protection and repair along with key social issues, receive investment, and become mainstream activities as soon as possible.

13. CURRENT ISSUES

Funds also need to continue to review their SRI criteria to ensure they reflect current social values and concerns. Alcohol, gambling, tobacco, uranium, old growth logging and weapons remain major social issues. In this day and age the community places a great deal of weight on issues such as - equal employment opportunity (particularly the role of women in management); relations with indigenous peoples (both in Australia and around the world); a reliance on greenhouse polluting practices; use of Genetically Modified Organisms in food products; and the destruction of ecologically sensitive areas by developers and resources companies. While some Funds reflect all of these concerns and many reflect some through their negative and positive screens we feel that their could be overall improvement in addressing and maintaining a clear link between community concerns and SRI focus.

Part Four of this report examines some key issues in more detail.



TOTAL ENVIRONMENT CENTRE

Level 2, 362 Kent Street

Sydney NSW 2000

Ph 02 9299 5599

Fax 02 9299 4411

Email green.capital@tec.org.au

www.tec.org.au