

UNITED KINGDOM

FIGURE 37: SRI IN THE UK, DECEMBER 31ST, 2005



Source: Eurosif

KEY FEATURES OF SRI IN THE UK

The UK has a world leading asset management industry with the Investment Management Association (IMA) reporting that as of December 31st, 2005 an estimated £2.8 trillion (over €4 trillion) in assets was managed in the UK by their members.⁵¹ More broadly, the City of London is regarded as one of the key international centres for innovation in financial and business services. Modern SRI in the UK can be traced back at least to the 1920's, and the UK is now widely regarded internationally as a world centre for expertise in both sustainable finance and in corporate social responsibility consulting.

Since 2003, arguably the most significant area of development for SRI has been around improvements in integrating environmental, social and governance issues into investment decision-making. A key factor has been the creation of sell-side SRI teams and the resulting increase in financially-oriented SRI investment research. This has built on the UK's already strong positions in Engagement with companies on SRI issues and Core SRI practices.

MAIN PRACTICES

SRI strategies in the UK may be grouped as:

- Integration of material SEE issues into investment decision making in order to deliver improved financial returns. These issues are increasingly known also as "extra-financial" issues. This Integration is performed both for values-based investors and for investors looking purely for improved risk management or greater alpha.
- Engagement with companies about their SEE performance - monitoring corporate behaviour and intervening where necessary.
- Positive or Negative screening which takes account of the values of investing individuals or institutions.

- Thematic investment propositions based on SEE issues such as the transition to sustainable development and a low carbon economy.

Investments are often subject to some mixture of these strategies. Figure 38 shows the different layers of SRI.⁵²

FIGURE 38: SRI STRATEGIES AS APPLIED IN THE UK, DECEMBER 31ST 2005, € BILLION



Source: Eurosif

As a significant illustration of investors using a combination of strategies, the combination of Core SRI and Engagement is estimated at €21 Billion.

Who are the main investors?

Church and Charity Investors:

Church and charity investors remain the largest force in Core SRI within the UK. A new charity reporting standard (SORP 2005) introduced in 2005 requires charities with investments to report on "the extent (if any) to which social, environmental or ethical considerations are taken into account" in their investment policy.

Mass Market Individual Investors:

The UK retail market for SRI funds is now over 22 years old, with the first retail ethical fund launched in 1984. According to the Ethical Investment Research Service (EIRIS), there were 72 retail ethical funds offering Core SRI available in the UK as of December 31st, 2005,

51. <http://www.investmentfunds.org.uk/press/2006/20060704-01.pdf>

52. This study found that total AUM subject to "Best in class" screening forms only 10% of those subject to Ethical exclusions. As several retail funds offer "best in Class" screening, we conclude that this particular technique is used relatively rarely by church and charity investors.

with £6.1 billion AUM . In addition, some fund managers practice Engagement on behalf of investments held in unscreened retail funds.

High Net Worth Individual Investors:

In early 2005, UKSIF published evidence on the size of market demand for SRI from high net worth individuals. €1.8 billion (£1.2 billion; 6%) was managed under a bespoke SRI mandate from the €29 billion (£20 billion) in investments managed by a group of UKSIF members for high net worth individuals.

Occupational Pension Funds:

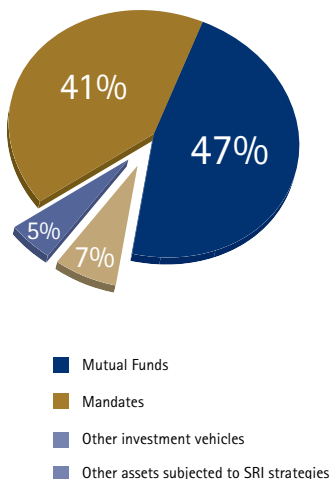
Major UK occupational pension funds form a significant force within the UK financial services market.⁵³ In total, self-administered pension funds held about £790 billion in assets at end 2004.⁵⁴ They also form a significant force within

Broad SRI. Further pension assets are held in occupational insurance-administered pensions (£160 billion) and in personal and stakeholder pensions (£430 billion). These further types of pensions are usually regarded as part of the retail market. Some provide access to Core SRI investment options (ethical funds). Investment in ethical funds via pensions has been accounted for in this study as part of the retail total.

Insurance Companies, Banks and Asset Managers:

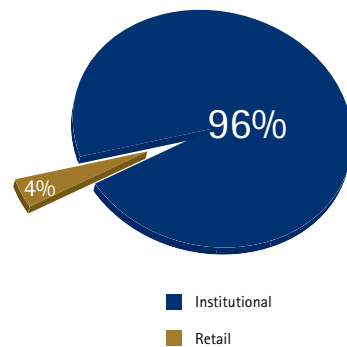
In order to manage risk and protect and enhance financial returns, some financial services companies require their asset managers to address Integration and/or Engagement on material SEE issues across all relevant asset holdings. These financial services companies are drawn from the banking, general insurance and life insurance and purely asset management sectors.

FIGURE 39: INVESTMENT VEHICLES IN UK SRI, DECEMBER 31ST, 2005



Source: Eurosif

FIGURE 40: INSTITUTIONAL AND RETAIL ASSETS IN UK SRI, DECEMBER 31ST, 2005



Source: Eurosif

53. Source: Pension Funds and their Advisers 2006.

54. Source: Pension Fund Indicators 2005, UBS Global Asset Management, May 2005 (quoted at www.napf.co.uk).

What do SRI fund managers and service providers offer?

The SRI services provided by UK fund managers may be grouped as follows.

SRI Service	Comments
Pooled SRI funds for individual investors	Normally such funds are positively or negatively screened and/or deliver a thematic investment proposition. Engagement with companies may additionally take place. "Engagement funds" which select/exclude stocks only on financial grounds and exert their impact by influencing companies are recently starting to be marketed to retail investors.
Pooled SRI funds for charity investors, pension funds and other institutional investors.	For charity investors, these may be charity-specific funds approved by the Charity Commission (CIFs) or other pooled SRI funds. A report on pooled funds for charity investors will be published in 2006 by the UKSIF/EIRIS Charity Project.
Segregated SRI mandates for institutional investors and high net worth individuals.	Allowing a customized approach.
Engagement on SEE issues to protect or enhance financial return.	<p>This Engagement takes place for:</p> <ul style="list-style-type: none"> • SRI funds as described above, • AUM not managed using overtly SRI criteria (including unscreened pooled funds not marketed as SRI and assets managed by investment subsidiaries for their parent bank or insurance company), • "Engagement overlays" where an "Engagement only" mandate is awarded to a different provider from the asset management mandate.
Investment services not necessarily marketed as SRI but which incorporate the Integration of material SEE issues to some degree.	The depth of Integration is arguably evolving over time as financially-oriented SRI research becomes increasingly sophisticated

MARKET EVOLUTION SINCE 2003

Over the last three years, the UK SRI market has been driven particularly by improved information provision by investment banks, by initiatives from leading asset owners such as the Environment Agency Pension Fund and the Universities Superannuation Scheme, and by increased Integration of and Engagement on SEE and CG issues by asset managers.

What is the growth rate of AUM?

This study has identified significant additional assets subject to Broad SRI within the UK since 2003.

This study found that over €600 billion (over £425 billion) in AUM in the UK were subject to the Integration of SEE into the investment process. Corporate governance issues were almost always also integrated. In the 2003 study, this figure was not quantified.

According to the current study, nearly €730 billion (over £480 billion) have been subject to Engagement policies. This contrasts with a figure of €285 billion (almost £200 billion) reported by asset managers in 2003. This is a gross growth rate of 157% and, measured against the MSCI UK performance, an adjusted growth rate of 98%.

Within the UK, increasing numbers of fund managers are seeking to address SEE issues to secure a financial edge or as part of their corporate governance approach. This has long been a goal of SRI practitioners and is very welcome. Significantly more fund managers have chosen to participate in this survey than in 2003. Meanwhile others are exploring the area but feel that it is not appropriate to include their concern about extra-financial issues within the totals reported. With this environment, detailed growth figures should be treated with caution.

Core SRI has remained more stable as a percentage of the market.⁵⁵ For example, the Investment Management Association reports that retail ethical funds have represented 1.2% of the market for investment funds consistently from 2003 to 2005.⁵⁶

What lies behind the growth?

Leadership Initiatives by Asset Owners and Asset Managers

Collaborative leadership initiatives by asset owners, sometimes working in partnership with asset managers, have been a notable feature. Many of these are international but with strong UK representation. They include:

Enhanced Analytics Initiative (www.enhancedanalytics.com)

This international collaboration between asset owners and asset managers aims to encourage investment research that take account of the impact of extra-financial issues on long-term investment. Launched in 2004, the Initiative represented total assets under management of over €00 billion by June 2006.

The Institutional Investors Group on Climate Change (www.iigcc.org)

This international forum for collaboration between pension funds and other institutional investors on issues related to climate change has over twenty six institutional investor members and appointed its first full-time Programme Director in 2005.

Initiatives by individual asset owners have included:

- The Environment Agency Pension Fund's award-winning investment management strategy addressing environmental issues.
- The competition on "Managing Pension Fund Assets As If The Long Term Really Did Matter" organised in 2003 by the Universities Superannuation Scheme, the UK's second largest occupational pension fund.

Myners, the Institutional Shareholders' Committee, Voting and Responsible Ownership

The Myners Principles are a set of principles codifying best practice for investment-decision making which are recommended for adoption by pension fund trustees on a voluntary "comply or explain" basis. They have played a high profile role in encouraging shareholder activism (Engagement and voting) in the UK.

55. This study reports Core SRI AUM managed by UK asset managers. In 2003, the UK reported Core SRI AUM held on behalf of UK asset owners. The change has been introduced to allow methodological consistency across Europe and therefore better cross-country comparison. However, it does mean that comparison of UK Core SRI data between the two studies is not meaningful.

56. <http://www.investmentfunds.org.uk/Statistics/Qtrly/2005/q411.pdf>

They were recommended in 2001 as a result of a study commissioned by the Chancellor of the Exchequer (the UK Finance Minister). Government research published in 2004 found that schemes which had decided to take action on shareholder activism represented 51% of all members even though they formed only 15% of schemes surveyed. They were therefore, on average, the larger schemes.⁵⁷

The Institutional Shareholder's Committee, consisting of the UK's leading institutional investment-related trade associations⁵⁸, published an updated Statement of Principles on the Responsibilities of Institutional Shareholders and Agents in September 2005 together with an associated commentary. The principles stated that "*Many issues could give rise to concerns about shareholder value. ... Instances when institutional shareholders and/or agents may want to intervene include when they have concerns about ... the company's approach to corporate social responsibility*".

The commentary highlighted that "there has been a general increase in the level of Engagement with investee companies" and that an IMA survey of its members in 2004 found that as of June 30th, 2004, the 34 fund managers covered represented 55% (£552 billion) of all UK equities managed within the UK. With two exceptions, these managers have a policy to vote all their UK shares and the majority vote all or some of their international shares. With one exception, these managers employ staff who are dedicated to Engagement on corporate governance or socially responsible issues and, since 2003, numbers had increased by about 10%. 33 of the managers had a clear policy statement on Engagement, with one manager's statement still in draft.

The Company Law Reform Bill currently passing through the UK parliament includes draft clauses giving government powers to require public disclosure of votes by asset managers and institutional asset owners. At the time of writing, it is not yet clear whether these clauses will become part of the final law.

Have new trends emerged?

The Sell-Side and SRI

A major development since 2003 has been the increased focus on material SEE and CG issues by major investment banks. A range of investment banks now both provide dedicated support to the buy-side SRI community and an increasing range of research reports on "ESG" issues. For the first time, we can talk about "the SRI buy side" and "the SRI sell side". This has been stimulated by many factors, such as the UKSIF/Thomson Extel Social Responsible Investment Survey (now in its fourth year), and increasing demand for such research, including but not restricted to the Enhanced Analytics Initiative.

SRI options in the UK's proposed new National Pension Savings Scheme

There is an evolving debate within the UK on how to ensure effective saving for retirement in the future. The UK government's pensions white paper published in May 2006 included a proposal to ensure that a range of investment options, including socially responsible investment, will be provided under the personal accounts proposed within a new National Pension Savings Scheme.

Regulatory and Technological Change

In April 2005, a significant change known as "depolarisation" took place in the regulation of the sales of retail investments. This made it possible for distribution channels to sell products from a limited range of providers rather than being "polarised" into selling products either from a single provider or on the other hand from the whole market. Meanwhile, technological change has resulted in increased sales of investment products via the internet as well as through traditional channels. It is too early to assess fully the implications of these developments for SRI. On the one hand, it should become easier for consumers to access distribution channels offering ethical funds. On the other, SRI products available from some of these channels may be difficult to locate in practice if there is a lack of appropriate signposting and marketing.

57. <http://www.dwp.gov.uk/asd/asd5/rports2003-2004/rrep213.asp>

58. In 2005, the members of the Institutional Shareholders Committee (ISC) were the Association of British Insurers (ABI), the Association of Investment Trust Companies (AITC), the National Association of Pension Funds (NAPF) and the Investment Management Association (IMA). The ISC statement of principles on the responsibilities of institutional shareholders (updated September 2005) and a commentary on it (September 2005) may both be found at www.napf.co.uk.

MARKET PREDICTIONS: 3 YEARS FROM NOW

Looking forward, we expect to see increased demand from asset owners, both institutional and individual, as the primary driver for the growth and development of SRI in the UK. The motivators for such demand are likely to be increases in:

- Support among the general public for “ethical consumption” and concern about sustainable development and climate change,
- Alignment between the corporate social responsibility policies of leading companies and the investment strategies of their pension funds,
- Implementation of the UN Principles for Responsible Investment by its inaugural and future signatories,
- Pressures for sustainable procurement of investment services by public sector pension funds,
- Increasing interest and demand for transparency among charity investors.

The UK currently faces two major long-term policy challenges: (1) managing the transition to sustainable development, including sustainable consumption and sustainable public procurement and (2) reforming pensions to ensure financial security in retirement for tomorrow's pensioners. It is important that both are achieved together, by a partnership not a trade-off. Looking forward, this is a major challenge and opportunity for SRI in the UK.