No. 1|2010

International Pension Papers

Doing Good by Investing Well? Pension Funds and Socially Responsible Investment: Results of an Expert Survey

Allianz Global Investors

Contents

Key Points 3
Introduction 4
Traditional and New SRI 5
SRI and Pension Funds: A Case of Mutual Attraction? 7
The Promise and the Investment Performance of SRI 9
Pension Funds and SRI: What to Expect in the Future 11
Future SRI Growth 12
SRI Drivers 14
SRI Criteria 16
Conclusion 18
Recent Publications 19

Key Points

- Socially responsible investment has evolved from being an approach that matches investments to ethical values to one that considers the impact of long-term changes in the business environment on companies and their share price.

- Thanks to their long-term horizon and asset size, pension funds are one of the main drivers of socially responsible investments.

- A survey conducted by Allianz Global Investors and the Centre for European Economic Research (ZEW) among pension experts in France, Germany, Italy, the Netherlands, Switzerland and the United Kingdom on the future of socially responsible investment in pension fund portfolios showed the following results:
  - On average, most of the pension experts surveyed believe that, in the future, SRI criteria will play an increasingly important role in how pension funds make investment decisions. While French and Dutch pension analysts were very optimistic, their British counterparts were quite pessimistic.
  - The majority of experts surveyed believe the SRI approach will be extended to include asset classes other than equities. Again, the French and Dutch participants were the most optimistic. Apart from Germany, most experts are expecting pension funds to become more active owners.
  - Environmental criteria are considered to be the most important element of the SRI concept. Respondents agreed that the growing SRI trend is being driven much less by the expectation of higher returns or lower risk as it is by public pressure.

Introduction

According to the American writer Henry David Thoreau, "goodness is the only investment that never fails." The relationship between goodness and investment is not only a literary theme, more and more it is becoming a hot topic for asset owners and asset managers as well. In the past, socially responsible investment was mainly a subject for ethical investors. Today, it is an investment strategy that promises to do good while delivering good returns. This double dividend is considered to be rooted in a long-term and more comprehensive take on the corporate world that considers extra-financial indicators in security selection. But it is not only the corporate world that can be rated according to environmental, social and governance criteria (ESG). These criteria are becoming increasingly applicable to other asset classes as well (e.g. bonds, real estate).

Any new investment idea is going to require investors, and one that is focused on long-term goals will likely to be very appealing to the generally decades-long orientation of pension funds. In fact, pension funds are one of the most important drivers of socially responsible investment strategies. The first part of this paper examines the principal concepts and evolution of socially responsible investment (SRI)[1] as well as SRI performance and the reasons why SRI can be particularly interesting for pension funds. The second part of this paper presents the findings of a survey taken of European pension experts in France, Germany, Italy, the Netherlands, Switzerland and the United Kingdom on the likely future development of SRI[2] and includes the following key results:

- On average, most of the pension experts surveyed believe that, in the future, SRI criteria will play an increasingly important role in how pension funds make investment decisions. While French and Dutch pension analysts were very optimistic, their British counterparts were quite pessimistic.

- The majority of experts surveyed believe the SRI approach will be extended to include asset classes other than equities. Again, the French and Dutch participants were the most optimistic. Apart from Germany, the majority of experts are expecting pension funds to become more active owners.

- Environmental criteria are considered to be the most important element of the SRI concept. Respondents agreed that the growing SRI trend is being driven less by the expectation of higher returns or lower risk than it is by public pressure.

1 Socially responsible investment (SRI) goes by many names, each of which indicates subtle differences in investment approaches, e.g. responsible investment (RI), sustainable investment (SI) or sustainable and responsible investment (also abbreviated SRI). For the purposes of this study, we chose to use socially responsible investment (SRI) as it is the most established term and was the most likely to generate a common understanding among our survey participants. ESG (environmental, social and corporate governance) issues are considered in these approaches. Corporate Social Responsibility (CSR) includes the initiatives companies take in these same areas.

2 The survey was part of a larger survey carried out by Allianz Global Investors in cooperation with the Centre of European Economic Research (ZEW) on the future of defined contribution plans in Europe (see Allianz Global Investors, 2009: Defining the Direction of Defined Contribution: Results of an Expert Survey, *Allianz International Pension Papers* 4/2009, Munich ►

Traditional and New SRI

Religious communities were the first group to use socially responsible investing of sorts. In the United States, Methodists and Quakers refused to invest in 'sin stocks' such as those related to alcohol, tobacco and gambling. But there have been other religious communities who have excluded – and continue to exclude – certain types of industries from their investment portfolios. The Catholic Church, for example, refuses to invest in companies involved in contraception. Such religious-based approaches were long the preeminent form of SRI, however things began to change in the 1960s and 1970s. With the Civil Rights Movement, the environmental movement and the subsequent Anti-Apartheid Movement came a renewed interest in SRI – giving birth to the first SRI mutual fund in the 1970s – however with an obviously different twist. Whereas the general focus on exclusion was similar to the religious approach, different moral criteria were applied. Companies were now excluded if they were involved in industries considered socially unethical, such as those manufacturing land mines and cluster bombs or those conducting business with South Africa in the 1980s.[3]

Since the 1990s, environmental, social and governance (ESG) issues have begun to dominate the SRI debate, particularly in Europe. And with this new focus has come a fundamental shift in the overall approach taken towards socially responsible investing. Having moved away from ethically driven exclusion, SRI now considers how a company approaches environmental, social and governance issues and what the impact is on investment performance. In other words, the concept behind SRI assumes that the way in which a company tackles these issues and addresses them in their corporate strategies will have a substantial impact on their future profitability and – with it – share price.

To put it differently, it can be argued that the business environment is in flux and companies are going to have to adapt accordingly. Those that do so quickly will have a competitive advantage and generate outperformance for their investors. Since these extra-financial factors may have severe financial repercussions, SRI strategies use ESG criteria in addition to financial indicators to screen investments. And since it is assumed that the changing business environment has long-term implications that will become obvious and material only over time, SRI strategies encourage long-term investments. For example, should regulations be introduced as a response to climate change that would make CO_2 emissions more expensive in the future, then any company able to lower CO_2 emissions today would have a cost advantage and possibly even a reputational benefit, which would then be reflected in its future share price.

Clearly, the differences between the old and new SRI strategies are significant. Traditional SRI strategies in the past focused on the investors' ethical and religious values by excluding specific investment options regardless of their potential for return. New SRI approaches look to generate outperformance over the long term by incorporating ESG factors. Generally speaking, the new SRI approach, sometimes referred to as sustainability investing, seems to be more common in Europe than in the United States, where greater emphasis is put on the social purpose of SRI and personal values. Whereas the main SRI actors in the United States are retail investors and exclusionary screens are popular, the focus in Europe is on financial objectives and the main actors are institutional investors that promote quantitative measurements.[4] The new SRI approach is applied to companies in all sectors without leveling moral judgment. A subcategory of the

http://publications.allianzgi.com/en/PensionResearch/Pages/PensionStudiesandPapers.aspx).

3,4 See Louche, Céline and Lydenberg, Steven, 2006: Socially Responsible Investment: Differences between Europe and the United States, Vlerick Leuven *Gent Management School Working Paper Series* 2006/22, Ghent.

new SRI approach is thematic investments that focus on companies and sectors expected to profit from changes in the business environment, such as water and renewable energy. The difference here to other SRI strategies is that investments are only made in one or a few related sectors and that ESG factors are not necessarily considered in thematic investments.

Besides screening according to specific SRI criteria, socially responsible investing is also closely linked to investor engagement, which assumes that investors will take a more active role in the companies they are invested in – for example by supporting investor interests and standpoints through active voting and dialogue with management. Investor engagement is a reaction to a variety of corporate scandals and is being pursued by large public U.S. pension funds in particular.

There is a growing demand for SRI products and strategies. According to the European Sustainable Investment Forum (Eurosif), totals SRIs in 2007 amounted to €2.7 trillion (17.6% of the European asset management industry), with demand increasing depending on how the individual SRI was defined.[5]

5 See Eurosif, 2008: European SRI Study 2008, Paris. http://eurosif.org/publications/sri_studies. Core SRIs include strategies that use positive screening, negative screening or a combination of the two, as well as thematic funds. Broad SRI includes investment strategies that incorporate simple screening (up to two negative criteria), engagement or integration (the explicit inclusion of ESG factors into financial analysis). In 2008, broad SRI assets amounted to €2.2 trillion and core SRI assets to €512 billion.

SRI strategies

SRI selection criteria and strategies differ in keeping with varying underlying goals. There are two main SRI approaches. These can also be combined.

Positive screening: Identifies companies that are best performers according to selected extra-financial indicators. Primary motivation: financial (best-in-class approach).

Negative screening: Excludes specific companies, industries or countries that are in conflict with the ethical attitudes of investors. Primary motivation: social.

SRI and Pension Funds: A Case of Mutual Attraction?

Due to their main characteristics – size, investment horizon and diversification – pension funds are often thought to be natural supporters of SRI strategies. SRI takes an explicitly long-term approach, incorporating structural factors thought to impact a company's future development. Since pension funds take a decades-long approach, SRI would be particularly appealing. And according to the 'universal owner' hypothesis, pension funds have become so big that they are not as much invested in single companies as they are in broad markets, making their investment performance dependent more on how the aggregate market develops and less on how individual companies perform. Therefore, universal owners cannot escape (negative) externalities – the negative economic effect of how one company's conduct impacts another company or the broader public for which they do not have to pay.

Pollution is a classic example and provides a good illustration of how externalities can impact universal owners. While other investors may not be concerned with an individual company's pollution performance – indeed, they may even benefit from it if the costs of pollution are externalized by the firm – pollution is something universal owners have to consider. The argument here is that while 'normal' investors can easily switch between single securities, universal owners are invested in the whole market so that the cost of pollution might crop up in some of their other investments.[6] Given this perspective, pension funds tend to favor SRIs because they are good for the health of the corporate economy as a whole.[7]

The development of pension fund assets over the past decades underscores the critical impact pension funds can have on the world's financial markets. In 2007, pension funds managed assets of $18.6 trillion, making them the third largest institutional investor group on the world's financial markets. Though insurance companies and investment funds managed $20.7 and $22.2 trillion, respectively, a substantial portion of this business was also directly and indirectly related to pensions. All in all, the OECD estimates that 60% of all institutional investor assets are retirement related.[8]

SRI strategies of pension reserve funds

Pension funds – particularly large public pension funds such as those found in the United States – were among the first to put SRI strategies on the corporate and public agenda, especially in terms of investor activism. Over the last few years, a different type of pension fund has been adding to the SRI trend, namely public pension *reserve* funds. The common goal of these publicly instituted funds is to support public pension systems, contributing to their financing when age-related pressures become a serious threat. Such reserve funds have been implemented in Australia, China, France, Ireland, Norway, South Korea, Spain and Sweden. While not all of these funds use SRI principles to make investment decisions, some of the important ones do.

French and Norwegian funds are especially active in this area. According to Norwegian reserve fund regulations, reserve funds are subject to ethical guidelines established by the Ministry of Finance. An ethics council serves as an advisory body to recommend what types of investments should be excluded and the fund's assets are managed by Norway's central bank, which pursues ►

6 See Mercer, 2006: Universal Ownership: Exploring opportunities and challenges, Conference Report from April 10–11, Saint Mary's College of California, Moraga, California.

7 Other factors of concern to pension funds are political and regulatory initiatives designed to foster SRI, especially among pension funds. The key instrument here is improved SRI disclosure. Since 2002, German pension funds are required to report to investors each year on whether and how they have included ESG factors in their investments. In France, the savings funds of French employees are obliged to disclose their SRI strategy in their Annual Reports. UK pension fund trustees are also required to spell out their investment principles, particularly with respect to SRI.

8 See OECD, 2009: Private Pensions Outlook 2008, Paris.

a policy of active ownership. This policy aims to safeguard the fund's financial interests and calibrate its investments based on extra-financial criteria, including social issues such as child labor and children's rights as well as climate issues.

The French *Fonds de réserve des retraites* (FRR) is also pursuing a policy of active ownership whereby external investment managers are required to exercise their voting rights. The principles of socially responsible investing are part and parcel of the portfolio. The fund has allotted several specialized SRI mandates and encourages managers of its other equity mandates – particularly managers of European equities – to make extra-financial indicators part of the selection process and share data with each other. The specific mandates do not exclude individual companies, but rather apply a best-in-class approach. The *Fonds de réserve des retraites* goes even a step further. In 2006, a process was initiated that aims to assess the entire portfolio on the basis of extra-financial criteria. In 2008, the fund established a responsible investment strategy based on five objectives. Among these are putting even more effort into including SRI criteria in portfolio management, actively exercising shareholder rights, and improving safeguards against extra-financial risks.

The Promise and the Investment Performance of SRI

The relationship between socially responsible investments and performance – especially the prospects of outperformance – is a hotly contested issue. Taking a traditional portfolio theory point of view, a SRI approach would lower risk-adjusted returns because the SRI screening process would reduce the overall investment universe. SRI proponents, however, believe the screening process provides other advantages that would generate outperformance. The idea here is that by including environmental, social and governance criteria to evaluate companies, it is easier to identify companies that offer better prospects and so generate alpha for investors. In other words, material issues addressed by SRI approaches are currently not factored into security valuations, but will have a material impact in the future. Therefore, SRI strategies are thought to be capable of exploiting these market anomalies and provide a tool for improved security selection.[9] The following is an overview of the most important advantages ascribed to SRI approaches:

- **Changes in the business environment:** Since SRI strategies focus on changing business environments (e.g. climate change, scarce resources) and a company's reaction to them, any long-term investment approach that incorporates these extra-financial issues is expected to be better equipped to assess both a company's future financial viability and the quality of its management, leading to superior financial performance in the future.

- **Intangible assets and reputation:** A related argument supporting socially responsible investing is that intangibles such as brand, reputation, management quality, and social and intellectual capital are having a bigger impact on a company's worth now than they did in the past. Therefore, analyzing extra-financial factors could provide a more comprehensive picture. Maintaining a good reputation can offer other competitive advantages such as attracting customers or highly skilled employees.

- **Eco-efficiency:** Investing in green technologies by anticipating future regulations can give companies a competitive edge and generate first-mover advantages, which can pay off significantly in the long run.[10]

Whether SRI strategies will actually perform better, equal or worse than conventional strategies is an empirical question and a considerable amount of research has already been devoted to this question. However, any research is complicated by both the varying selection criteria used by SRI approaches and their mostly short track records. In addition, every industry has its own SRI challenge. For instance, climate change and regulatory reactions to it are likely to affect the automobile industry more than the banking sector, which – in turn – is more likely to be affected by corporate governance issues. Investment performance might also be influenced more by some unobserved bias in stock selection (e.g. a bias towards small firms or growth stocks) than by the SRI factors themselves.

Given this complexity, it can come as no surprise that empirical research has not yet established a consensus on how SRI impacts portfolio performance. Results to date are inconsistent. However, three prominent studies investigating the link between SRI and portfolio performance are representative. A meta study carried out by the United Nations Environment Programme Finance Initiative (UNEP FI) and Mercer reviewed the results of 20 studies on how ESG factors impact portfolio performance. Ten studies showed a positive relationship, seven a

9 See Jan de Graaf, Frank and Slager, Alfred, 2009: Guidelines for Integrating Socially Responsible Investment in the Investment Process, Amersfoort, Netherlands. ssrn.com/bstract=919108.

10 From the company perspective, however, such actions would require making an investment, which could have a positive or negative effect on profitability and share price depending on the cost and benefits. See von Arx, Urs and Ziegler, Andreas, 2008: The Effect of CSR on Stock Performance: New Evidence for the U.S.A and Europe, Working Paper 08/85, Swiss Federal Institute of Technology, Zurich.

neutral and three a negative relationship, suggesting that performance downsides are not to be expected.[11] A follow-up study reviewed the most recent studies carried out between 2007 and 2009. Of the 16 new studies, ten reported a positive, two a negative to neutral and four a neutral relationship.[12]

In another study, the Centre for European Economic Research (ZEW) reviewed SRI equity indices and compared them to their benchmarks. Though there was not a significant difference in performance, the study did find that most SRI indices carry a higher risk.[13] And finally, a recent study carried out by the EDHEC Risk and Asset Management Research Centre that focused on SRI funds distributed in France found a more negative relationship. The great majority of funds under investigation showed negative alpha, though not at a significant level. Only a few SRI funds exhibited positive alpha, but also not at a significant level.[14] However, these findings are disputed.[15]

Studies on how SRIs impact portfolio performance do not give a clear conclusion of their alpha-generating capacity. However, analyzing the effects of SRI accurately may not be possible until SRI approaches have become more standardized, so that consistent groupings are more likely. Empirical studies so far have all been plagued by the varying measurement methods used, and the different understandings and concepts of what SRI actually is. While some focus on social concerns, others focus on environmental concerns. To make it even more difficult, performance is compared to different benchmarks. While this clearly allows investors to choose the investment strategy that best fits their preferences and values, it makes comparing the greater SRI concept more complicated.

11 See UNEP Finance Initiative and Mercer, 2007: Demystifying responsible investment performance, Châtelaine, France. http://www.unepfi.org/publications/investment. Though this report reviews key academic and broker research on ESG factors, it should be noted that the studies reviewed investigated various geographical regions and applied different SRI definitions or focused on different components.

12 See Mercer, 2009: Shedding light on responsible investment: Approaches, returns and impacts, London.

13 See Schröder, Michael, 2005: Is there a difference? The performance characteristics of SRI equity indexes, Discussion Paper 05-50, Centre for European Economic Research, Mannheim.

14 Amenc, Noël and Le Sourd, Veronique, 2008: Socially Responsible Investment Performance in France, EDHEC Risk and Asset Management Research Centre. http://www.edhec-risk.com/edhec_publications/all_publications/RISKArticle.2009-01-20.0956?newsletter=yes.

Pension Funds and SRI: What to Expect in the Future

Given that pension funds are one of the most notable SRI drivers, their behavior will have a tremendous impact on the future of SRI. To gain a better understanding of current trends, their drivers and future developments, it seemed natural to ask the opinions of experts closely involved in pension fund strategies.

Therefore, SRI-specific questions were embedded into a larger survey having to do with the future of defined contribution in Europe carried out by Allianz Global Investors in cooperation with the Centre for European Economic Research (ZEW). The survey includes the insights of 216 pension experts in academia, pension funds, asset management and insurance companies, consultancies, associations, international organizations and regulatory agencies from Europe's six largest retirement markets (France, Germany, Italy, the Netherlands, Switzerland and the United Kingdom).[16] The assumption here was that, given their particular expertise and knowledge, they would have a better understanding of current trends and their drivers, making their predictions more credible. Experts can, of course, be wrong. However, if nothing else, their predictions provide a benchmark against which future developments can be measured.

The survey addresses the following questions considered crucial to the further development of SRI among pension funds:

- Will SRI continue to grow and will it be expanded to other asset classes?
- What is driving the growing trend towards SRI among pension funds?
- What are the most important components of the SRI concept?

15 A follow-up study conducted by Altedia Consultants focused on more than 200 SRI funds over a three-year period. The results of this follow-up study found that not only did best-in-class SRI funds perform in keeping with market indices and their own benchmarks, volatility was also lower.

16 See Allianz Global Investors, 2009: Defining the Direction of Defined Contribution in Europe: Results of an Expert Survey, *Allianz International Pension Papers* 4/2009, Munich. http://publications.allianzgi.com/en/PensionResearch/Pages/PensionStudiesandPapers.aspx.

Future SRI Growth

There is no denying that SRI has captured the attention of many pension funds and gained considerable acceptance. According to survey participants, the future outlook is positive, with most experts anticipating a further upswing of SRI approaches in pension fund investing. However, there is a wide variation among countries. This is mirrored in how the individual countries appraised the prospects of SRI approaches being expanded to include asset classes other than equities. And despite the expected upswing in SRI approaches, the minority believes that return enhancement and risk reduction are the main drivers.

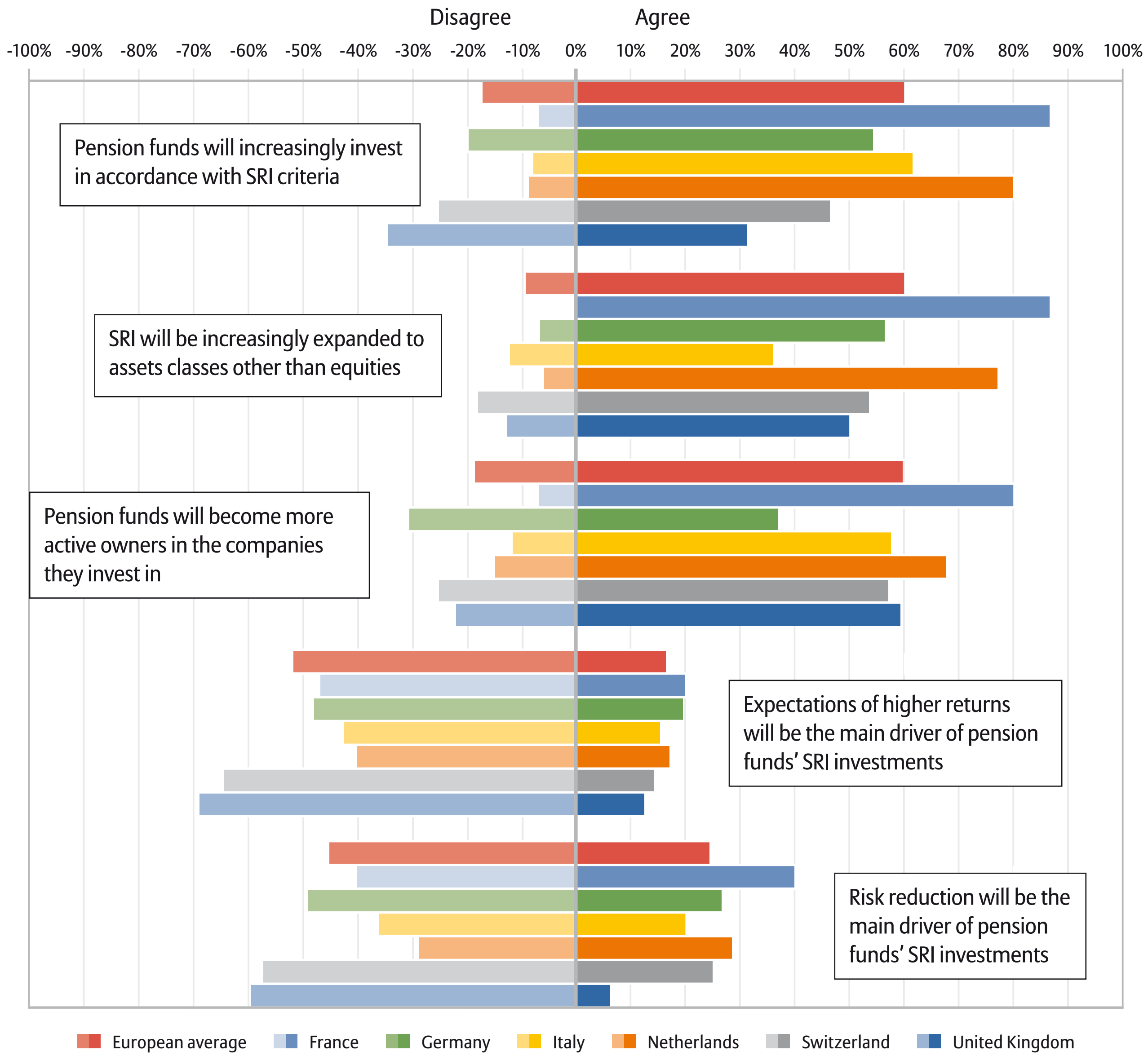
Future growth: A majority of the analysts (60% on average) believe pension funds will include SRI criteria more and more in their investment decisions. However, this overall average masks unusually wide country-specific discrepancies. Almost 90% of the French respondents are optimistic about the future implementation of SRI approaches. And while Dutch (80%) and Italian (62%) experts share their optimism, their German and Swiss counterparts (54% and 46% respectively) are more reserved and feedback from the United Kingdom was vague – slightly less than a third expect the importance of SRI to increase in British pension funds.

Expanding asset classes and active ownership: So far, SRI has mostly been involved in equities and analyzed the extent to which listed companies address environmental, social and governance concerns. However, SRI need not be limited to equities. SRI can also be used for other asset classes such as bonds, real estate or private equity and many of the analysts are expecting exactly that to happen: an overwhelming majority of respondents in France (87%), 77% in the Netherlands, 57% in Germany, 54% in Switzerland and exactly half of the British respondents. Italian analysts on the other hand are more skeptical – only slightly more than one third can imagine the scope of SRI principles increasing. The active ownership of pension funds – that is, exercising shareholder rights and monitoring management – is widely expected to increase in importance. Around 60% of Italian, Swiss and British experts are predicting this, with considerably more in the Netherlands and France. Germany is the exception. Less than 40% of the German experts surveyed are expecting pension funds to become more active owners in the companies in which they are invested.

Risk and returns: Given the positive general outlook for SRI, surprisingly few experts believe SRI will be driven by the expectation of higher returns or lower risk – two of the leading arguments in its favor. On average, only 17% believe that an expectation of higher returns is driving SRI. Again, the French brought in the most favorable results, but even that was only 20%. And though there is a wider belief that risk reduction will drive SRI, with an overall average of 24% (high: 40% in France; low: 6% in the United Kingdom), it is still quite muted.[17]

17 It should be noted that the percentage of respondents taking a neutral position was high in some countries, especially in Italy and the Netherlands, and amounted to over 40%.

Figure 1: Future SRI growth



Question: How strongly do you agree with the following statements?

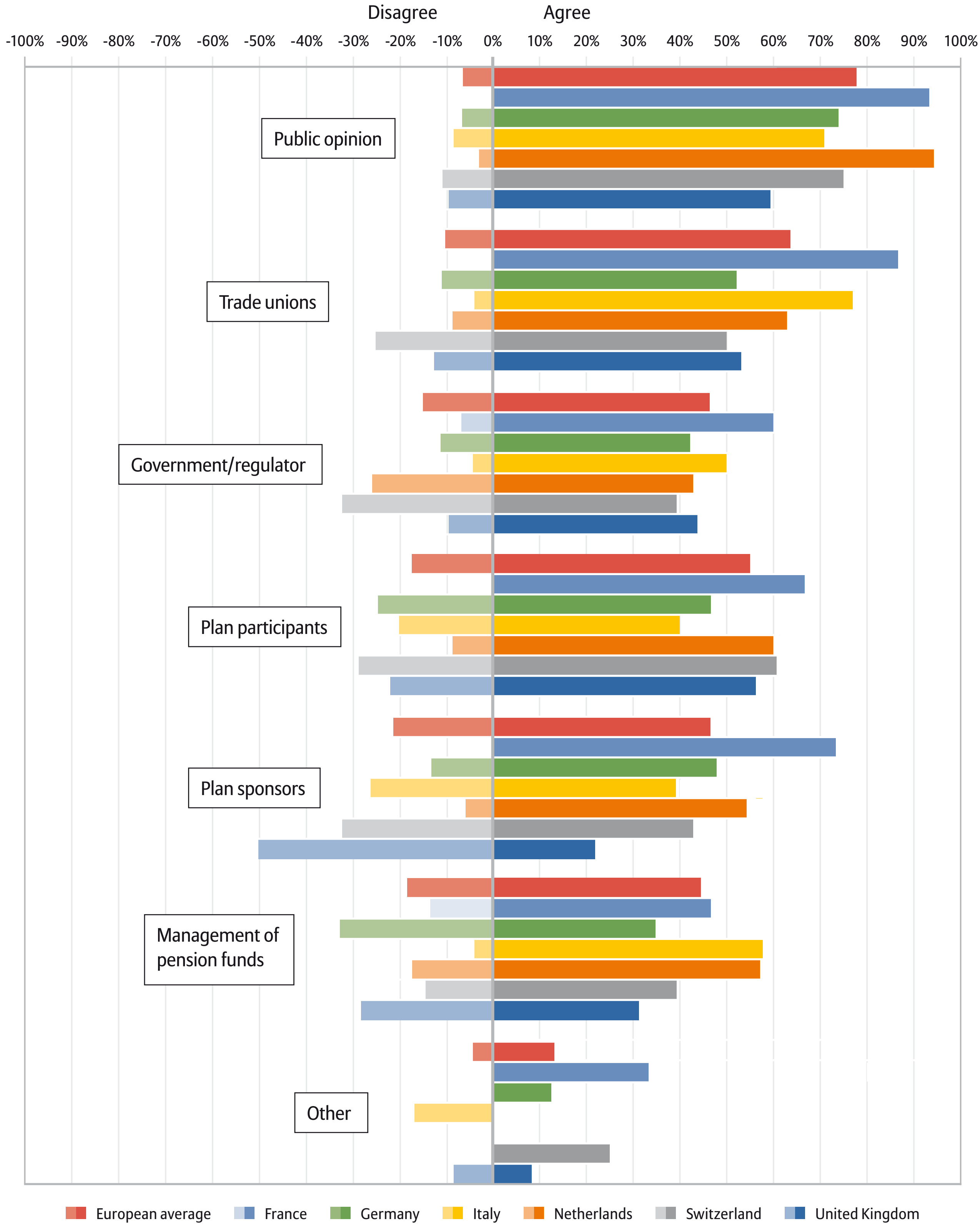
SRI Drivers

Any positive trend has its drivers. In the case of SRI, these drivers can be the players directly associated with pension funds (e.g. beneficiaries, plan sponsors or pension fund managers) or outside stakeholders (e.g. trade unions, governments or public opinion). The results of our survey show that external stakeholders are given the most credit for the trend in pension funds investing in SRI, with the key driver being public opinion followed by trade unions. And though internal players are considered less important, plan participants are considered to play the largest role among them.

Public opinion/trade unions/governments: Public opinion is considered to be the single most important factor driving SRI (78% on average). In France and the Netherlands, 94% and, respectively, 95% agree, and in Germany, Switzerland and Italy more than 70% agree. These results indicate that even if SRI is not thought to lower investment risk, reputational risk seems to be a major issue for pension funds. Most of the experts surveyed (64%) believe trade unions are the second most important group of stakeholders supporting SRI approaches. This is particularly true in France (86%) and Italy (77%). In comparison, governments and regulators are considered to have much less of an impact. On average, less than 50% believe the government is driving the demand for SRI.

Plan participants/sponsors/pension fund management: Compared to external stakeholders, survey participants found internal stakeholders to be of secondary importance. Of those surveyed, 55% believe plan participants will drive SRI demand, 46% believe it will be driven by plan sponsors and 45% by pension fund management. Plan participants in France, Switzerland and the Netherlands are considered to be most open to SRI approaches. However in Germany and Italy, plan participants are not expected to be particularly interested in having pension assets invested in SRI-related funds. Plan sponsors in France are expected to be big supporters of SRI, with over 70% of French analysts expecting them to drive future SRI demand.

Figure 2: SRI drivers



Question: Who do you think will drive the demand for SRI in DC plans?

SRI Criteria

The SRI field has generated a broad array of concepts and approaches. This is due to the fact that many extra-financial indicators have the potential to impact companies. There are also many ethical attitudes that could impact investment strategies. The main categories of concern are environmental, social and governance (ESG). Since there is no general consensus on how these criteria should be weighted or whether there is some type of hierarchy between them, this survey explored their relative importance. In addition to considering general SRI factors when making investor decisions, themed sustainability investments are often included among SRI. Such investments exploit investment opportunities that arise mainly from environmental change, for example investing in renewable energy or water. The results of our survey show that environmental criteria are considered to be the most important components of socially responsible investing, followed by social and governance. Thematic investment strategies were given equal importance. Most analysts agree that ethical criteria carry less weight.

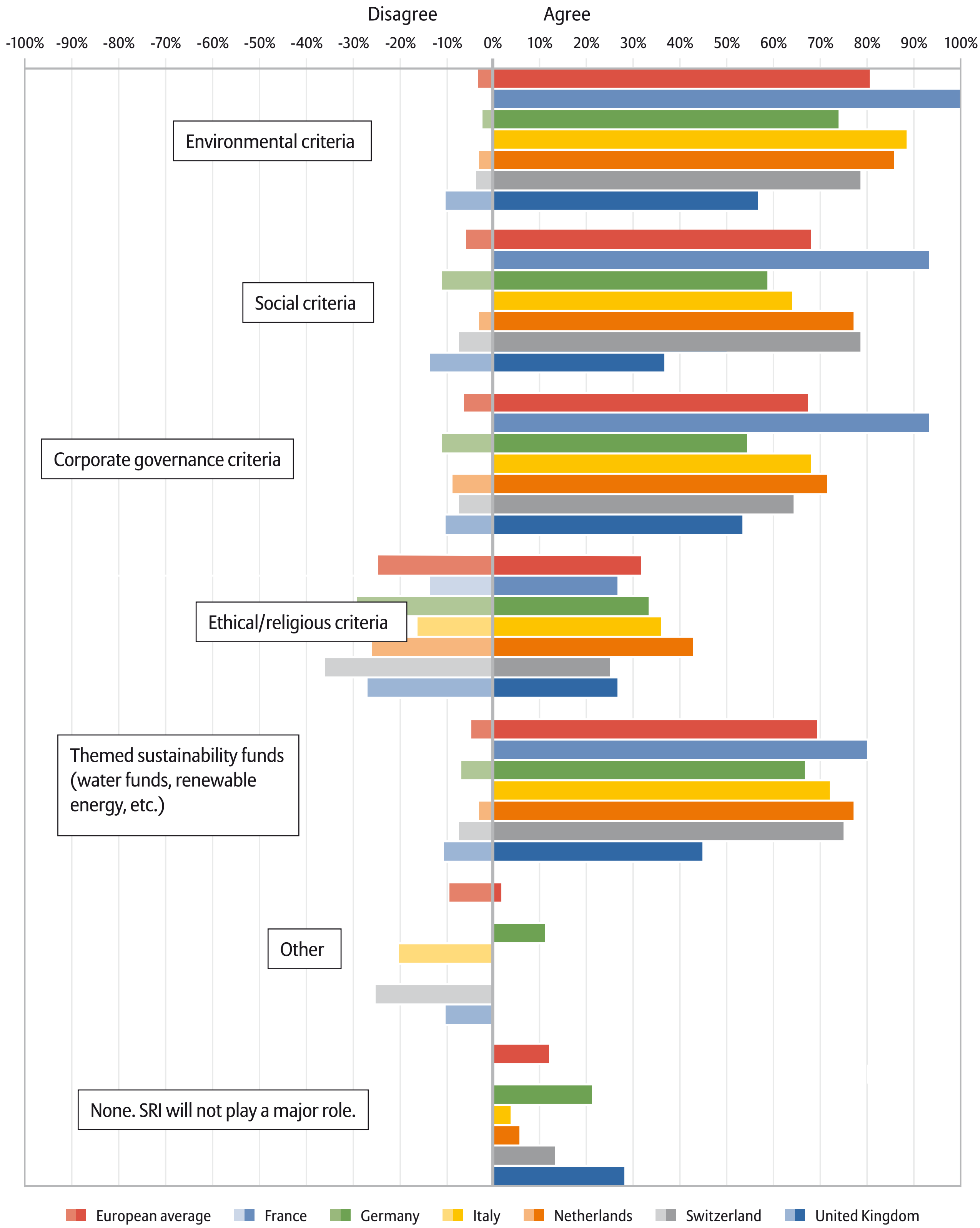
SRI criteria: Experts clearly believe that environmental criteria play the most important role in SRI. On average, 81% believe environmental concerns will play a decisive role in pension fund investments in the near future. Astonishingly, 100% of French experts agree as do 88% of their Italian and 86% of their Dutch counterparts. And even though fewer agreed in the United Kingdom, it was still 57%. Corporate governance and social concerns gave a similar, though not quite as astonishing, picture. On average, almost 70% of the experts surveyed consider both of these criteria important.

Overall, the French respondents were the strongest believers in social and governance criteria; the British were more skeptical. Regarding social criteria, only 37% of experts surveyed in the United Kingdom believe they will play a decisive role in pension fund investments. Other countries showed more positive results. Highest among these were France (93%), Switzerland (79%) and the Netherlands (77%), followed at around 60% by Germany and Italy. As for corporate governance, again French respondents came in strong at 93%, followed by some 70% in the Netherlands and Italy. Other countries, however, were less confident that corporate governance will play a significant part in investment decisions.

Ethical criteria/thematic investments: In most cases, using environmental, social and corporate governance criteria to screen companies provides a more comprehensive picture of the companies under investigation. This in turn may provide an information advantage for selecting investments. The ultimate goal here is outperformance. Ethical approaches, on the other hand, function differently. An ethical approach is oriented towards specific moral values. These investment portfolios exclude any company whose business runs contrary to the moral convictions of its investors. Though socially responsible investing has its roots in such values-oriented approaches, they have lost their importance. Only a third of respondents believe ethical or religious-based investment approaches will play an important role in future pension fund investments.

The outlook is quite different for thematic sustainability funds. On average, 69% of experts surveyed anticipate these types of investments to experience growing importance. France, Germany, Italy, Switzerland and the Netherlands are the most convinced (67–80%). At 45%, the British experts are again the most skeptical.

Figure 3: SRI criteria



Question: From today's point of view, how important do you rate the following criteria of the SRI concept for investment decisions of pension funds in your domestic market within the next 5 years?

Conclusion

The survey results are a double-edged sword as far as the acceptance and future of SRI among pension funds are concerned. On the one hand, European pension experts believe this approach will become increasingly important to pension funds over the next years and will be expanded to other asset classes than equity. On the other hand, this trend seems to be driven by factors most SRI proponents would consider less than ideal. Results show that most pension experts remain wary of the assumed investment advantages and believe SRI is primarily driven by public opinion. This is an interesting result as it suggests that reputation and reputational risk are crucial motivators.

Future financial research needs to determine what can actually be expected from SRI investments. The expectation that socially responsible investing automatically results in better investment performance could be exaggerated. After all, other methods used to screen and select stocks are not able to claim better performance during every phase of every financial market cycle. Therefore, more detailed research into SRI performance during different market phases and the components that drive SRI performance could clarify this issue, leading to a better common understanding of what socially responsible investing actually involves.

Simply reviewing past performance may not give a complete picture. It is possible that the benefits of SRI will be more compelling in the future once foreseeable changes in the business environment take hold, which would then make them even more material for company profitability and security prices. Even so, taking a purely financial approach to socially responsible investing might bypass a key element, which dates back to its very beginning – namely the combination of financial and societal benefit.

Recent Publications

International Pension Studies

http://publications.allianzgi.com/en/PensionResearch/Pages/PensionStudiesandPapers.aspx

Pension Sustainability Index 2009	December 2009
Defining the Direction of Defined Contribution in Europe: Results of an Expert Survey	November 2009
Retirement at Risk II: Challenges for U.S. Baby Boomers Approaching Retirement	October 2009
How the financial crisis affects pension funds: what analysts expect	September 2009
Private household financial assets: the golden days of the past are a long way off	August 2009
Investment Regulations and Defined Contribution Pensions	July 2009
Funded Pensions in Western Europe 2008	February 2009
Retirement at Risk: The U.S. Pension System in Transition	January 2009
Pension Trends in Emerging Markets – The Rise of DC Plans and Its Consequences	November 2008
Funding Unfunded Pensions: Governance and Investments of Asian Reserve Funds	September 2008
Evaluating the Impact of Risk Based Funding Requirements on Pension Funds	May 2008

International Pension Issues

http://publications.allianzgi.com/en/PensionResearch/Pages/Internationalpensionsissues.aspx

Pension funds and the financial crisis	July 2009
Western Europe: Fiscal pressures-ageing costs still on the horizon	April 2009
United States: Severe setback in financial and retirement assets	March 2009
Germany: Household's financial assets dive	January 2009

http://publications.allianzgi.com/en/PensionResearch

Masthead

Publisher: Allianz Global Investors AG, International Pensions, Seidlstr. 24-24a, 80335 Munich, Germany | International.Pensions@allianzgi.com
http://www.allianzglobalinvestors.com | **Author:** Dr. Alexander Börsch, Senior Pensions Analyst, Allianz Global Investors AG, alexander.boersch@allianzgi.com
Editor: Marilee Williams | **Layout:** volk:art51 GmbH, Munich | **Printing:** Christian Döring GmbH, Munich | **Closing Date:** January 15, 2010

www.allianzglobalinvestors.com

Allianz Global Investors AG
International Pensions
Seidlstr. 24-24a
80335 Munich, Germany