A C S I
Australian Council of Super Investors Inc.

THE ESG SURVEY REPORT

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1. Background

During December 2006 and January 2007, ACSI conducted a survey of its members to find out their knowledge and activities relating to environmental, social and governance (ESG) issues generally, and the United Nations Principles for Responsible Investment (PRI) in particular.

The purpose of the survey was twofold: to assist ACSI in identifying activities it can undertake to best support its members in integrating ESG issues into their investment decision-making; and to provide participating members with a "snapshot" of their ESG and PRI related activities to date.

The survey was divided into three sections. The first section explored how (or if) member funds and their service providers use information about ESG issues in their investment decision-making, selection of fund managers and or in any other way. The second section asked a series of detailed questions about each of the six the Principles for Responsible Investment. The final section looked at a number of existing ESG industry initiatives and asked for members' views on services that ACSI may provide on ESG issues in this area in the future.

24 funds participated in the survey.

2. General Observations

2.1. Funds showed a lot of interest in ESG issues and had good intentions to do more to consider ESG issues in investment decision-making. All respondents to the survey saw the consideration of ESG risks as an important area, and recognized that it will grow in importance in the future, even if they were not factoring ESG into their investment decision-making in a systematic way at this stage. Many funds felt that they did not yet have enough skills or resources to consider ESG issues in their investment decision-making.

2.2. There was broad range of responses about how funds are considering ESG issues.

At one end of the spectrum, some funds declined to participate in the survey because they had not yet considered ESG issues at all and did not feel that they had anything to contribute.

At the other end of the spectrum, some funds are already working to fully integrate ESG considerations across all aspects of their operations. However, even these funds pointed out that they still had much more to learn and do in this area. These funds found the PRI to be a particularly valuable resource as a place to collaborate with, and learn from, others in Australia and internationally.

2.3. Factors that would encourage funds to consider ESG issues include:

- If there were research or evidence that demonstrates a positive correlation between considering ESG issues and investment returns or at the very least that returns would not be eroded.
- The philosophy that ESG provides as big a risk (if not bigger) than other financial factors that the fund is exposed to.
- The fund's asset manager recommending that ESG factors should be taken into consideration.

- Receiving positive feedback from service providers and managers.
- It is within the fiduciary duty of trustees and is not detrimental to member returns.
- Increased awareness in the community about environmental, social and governance issues and corresponding increased member interest in this area.
- Successes such as the News Corp action, in that they show that acting collectively funds can make a difference.
- A greater range of available products and managers that considered ESG issues.
- Increased member demand, which then leads to considering these issues becoming beneficial from a marketing perspective.
- "The fund wants to be a good community citizen".
- Competitors are already considering ESG issues in investing.

2.4. Factors that might discourage funds from taking ESG factors into consideration include:

- “A strong bull market means that ESG factors are not on the agenda because the market is doing well.”
- Approaches from specific interest groups, as they tend to take a very black-and-white view.
- If it limited the way the fund managed or invested its money.
- If there were conflicts with the fund's fiduciary responsibilities.
- Small funds have limited resources to deal with extra issues, and would not want consideration of ESG issues to distract them from its core business objectives.
- If the costs were prohibitive, or outweighed the benefits.
- If considering ESG factors were proved to be detrimental to member returns.
- If the board took the view that ESG is not critical or directly relevant to enhancing investment performance.

2.5. Funds holding their investments through pooled trusts were more likely to say that they were unsure how they could integrate ESG considerations into investment decision-making, since they have less ability to direct how fund managers vote or undertake other activities. However, these funds showed a lot of interest in exploring how they could “make more of a difference”.

A number of the smaller funds also indicated that they did not have the resources to consider ESG issues, as they felt they had to concentrate their resources towards focusing on member returns.

2.6. Some funds are already working to fully integrate ESG considerations across all aspects of their operations. Examples of activities undertaken by those funds include:

- Appointing fund managers in part specifically for their ESG capabilities.
- Aligning investment mandates with long-term ESG considerations.
- Participating in and supporting Australian and international collaborative initiatives on ESG themes.
- Using an engagement service to discuss ESG issues of concern with companies.

- Holding member education seminars on issues such as climate change and its potential impact on member returns.
- Considering the environmental impacts of directly-held property investments.
- Considering their own operational environmental footprint.
- Producing a sustainability report on their own operations.

2.7. Funds factor in ESG issues into investment decisions in the following areas:

- In their dealings with fund managers and asset consultants.
- In their active ownership activities (including proxy voting, applying the ACSI guidelines and seeking to engage companies, either directly or indirectly).
- In direct investments, including investing in sustainable property, clean-tech and bio-fuels.
- In SRI options.
- In developing responsible investment and corporate governance policies.
- Participating in collaborative initiatives.

3. Asset consultants and fund managers and ESG issues

3.1. Generally speaking, funds do not request ESG information from brokers, fund managers or other service providers in any systematic way, although some plan to do so going forward.

3.2. More than half of the respondents said that they do receive some information about ESG issues (mostly governance information) from fund managers and brokers who are developing expertise in the area.

3.3. 71% of respondents said that they do take ESG matters into consideration when selecting and approving fund managers or said that they are likely to do so in the future.

3.4. Some funds appoint fund managers for their SRI investment options partly on the basis of their ESG capabilities.

3.5. Some respondents observed that asset consultants are starting to consider these issues, mainly at the request of funds.

3.6. As many funds have not yet formally communicated ESG expectations to investment service providers, they acknowledged that it would not be fair to revisit relationships on the basis of their ESG performance. A preferred approach is to engage and encourage service providers rather than terminate relationships.

4. The funds' members and own organisational footprints

4.1. Aside from considering ESG issues in their investment decision-making, some funds are starting to consider their own environmental impact, and are focusing on reducing their carbon emissions, water usage, waste and energy consumption. One fund produces an audited sustainability report. Apart from the potential environmental and cost saving benefits, one fund observed that it needs to focus on its own organisational footprint, since "if the fund is going to ask companies about their environmental and social performance, the fund should also start to consider its own organisational practices and environmental footprint."

4.2. Some funds also observed that there has been strong member interest in ESG issues, although this may manifest itself in different ways: for example, asking funds about their environmental performance or showing interest in SRI investment options.

5. The Principles for Responsible Investment

5.1. All respondents said that they were aware of the Principles for Responsible Investment and considered that the PRI was a useful and valuable initiative. 75% of respondents have either signed the PRI, or are intending to do so within the next 12 months.

5.2. Factors that encouraged funds to sign to the PRI included:

- It offers a policy framework to deal with ESG issues which is relevant globally.
- It provides a credible place to start and has attracted large, high calibre and reputable signatories.
- It is backed by the UN.
- It is a forum where signatories can learn from others as well as contribute their experiences.
- The Principles are voluntary and aspirational, so there is scope for the fund to define for itself how it will implement them.
- "The more funds that sign on, the more momentum the PRI will have. This increased momentum will give a framework within which funds can have a conversation with their investment managers about ESG issues. Supporting a global framework will give a more mainstream agenda to considering ESG issues."
- The guidelines are clear and concise.
- Signing the PRI is consistent with the fund's wish to be an aspirational institutional investor.
- The Principles are consistent with the fund's overall philosophy.
- The ACSI letter supporting the PRI sent to all member funds in 2006.
- Seeing Al Gore speak on a global CMSF study tour.

5.3. Where funds talked about factors that might discourage them from signing the PRI, these could generally be characterised as an indication that the fund took Principles seriously, and funds would not wish to sign up to something they could not live up to.

Some funds also expressed reservations about signing the PRI if:

- There was a negative impact on member returns as a result of considering ESG issues.
- Signing was in conflict with APRA requirements.
- There was negative publicity about the PRI.
- Signing the PRI attracted liabilities or significant costs.
- The fund could not live up to the Principles.

The voluntary and aspirational nature of the Principles, the flexibility in being able to implement the Principles, and the relatively low cost of joining and allayed many of the concerns expressed.

5.4. Overall, respondents noted their most significant activities were under Principle 1 (we will incorporate ESG issues into investment analysis and decision-making processes) and Principle 2 (we will be active owners and incorporate ESG issues into our ownership policies and practices). This is encouraging, as the first two Principles are key Principles.

Even so, the highest-ranking scores for activities under PRI 1 and PRI 2 were in the "to a small extent" category.

5.5. The highest scores for undertaking activities under the Principles overall were in PRI 2, where 67% of funds said that they undertook and activities "to a small extent" or "to a large extent". The most significant activity undertaken by members was proxy voting or actively monitoring proxy voting. This is not surprising, given the funds surveyed are members of ACSI, whose services have focused on corporate governance to date.

5.6. For Principle 3 (we will seek appropriate disclosure on ESG issues by the entities in which we invest) the majority response was "not at all".

5.7. For Principle 4 (we will promote acceptance and implementation of the Principles within the investment industry), Principle 5 (we will work together to enhance our effectiveness in implementing the Principles) and Principle 6 (we will report on our activities and progress toward implementing the Principles), the majority of responses were either "not at all" or "not applicable" or "to a small extent". This is not surprising, given that the Principles are in their infancy, and we would expect this to increase in the future.

6. Acknowledgements

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