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**THE 7<sup>TH</sup> ACSI ANNUAL CONFERENCE**  
**6 JUNE 2008**  
**Investing for the Future – Leading by Example**

**OVERVIEW**

**MICHAEL O’SULLIVAN, President, ACSI**

For the ACSI 2008 Conference, ‘Investing for the Future – Leading by Example’ was chosen as the conference theme, with an underlying aim to ‘increase understanding of the relationship between change and leadership’.

If it is believed that strong leadership can make a difference, then how can we best equip leaders to make these significant changes? What is it that encourages leadership in relation to governance, environmental and social performance?

Throughout the conference, these questions were incorporated to provoke discussion which resulted in various examples being presented of leaders taking action both locally and internationally.

\* Full transcripts of the conference presentations are available from ACSI upon request.

**ENLIGHTENED SELF INTEREST**

**LOUISE O’HALLORAN, Executive Director, Responsible Investment Association Australasia** 1

“For investors, the 21<sup>st</sup> century has opened the door to issues that are unfamiliar, volatile and complex” comments Louise. As we know climate change is one outstanding example but there are many others as well – such as:

- our urgent need for more water,
- the end of cheap oil,
- human rights issues in emerging nations,
- failures of governance on a massive scale,
- rising rates of obesity; and
- the scarcity of all of our natural resources in the face of a ballooning population.

“For some in the investment world, these issues represent very serious value drivers. But for others, environmental, social and governance issues have no cost, no price, and no value and are irrelevant to company profitability.” Louise said.

Louise’s slideshow looked in detail at how nine key issues are affecting investment portfolios:

- population growth,
- climate change – both the physical impact of a changing climate and the effect of a price on carbon,
- the end of cheap oil,
- water,
- waste,
- obesity,
- corporate governance failures and corporate fraud,
- the sub-prime crisis; and
- human rights and supply chain issues (fair trade) and the rise of civil society activism.

Louise then looked at the various players in the investment cycle and what’s driving them toward considerations of ESG issues in investment analysis.

For companies, successful management of ESG issues results in customer loyalty, brand equity and enhanced reputation. There is also mounting pressure from regulators and civil society for companies to take responsibility for the negative side effects of their activities: that is, to factor in the real costs of pollution, carbon, water, toxicity and of products which cause harm.

For the investment industry, the question is: what are analysts doing with this information? Reports tell us that anywhere between 77% and 85% of a company's value cannot be seen on the profit and loss statement or on the balance sheet. It becomes clear that without good ESG information, analysts are only seeing the tip of the iceberg. Incorporating ESG analysis is a very important shift for fund managers, because once they start to get price signals on ESG issues, they will be incorporated into key investment ratios like discounted cash flow and price to earnings.

For asset owners with a long-term focus, ESG investing is a perfect match. As universal owners, asset owners have a vested interest in the health of the entire economy and that includes the environmental, social and governance structures which support the prosperity of that economy.

Louise then discussed some of the common concerns that are often expressed about responsible investing, including:

- the misconception that ESG issues cannot be quantified,
- the common confusion about ethical investing and considering ESG issues in investing,
- the (changing) perception that ESG analysis is against the law,
- the misconception that the market only cares about the short term; and
- the misconception about performance and considering ESG issues.

Bringing her presentation to an end, Louise then finally discussed the United Nations Principles for Responsible Investment and its rapid growth since its inception in 2006.

Louise encouraged anyone who is interested in presenting the slideshow to contact her at the Responsible Investment Association Australasia.

## UNISUPER'S JOURNEY INTEGRATING ESG CONSIDERATIONS INTO INVESTMENT DECISION-MAKING

**TALIEH WILLIAMS, Manager of Governance and Sustainable Investment, UniSuper**

UniSuper began its ESG journey by articulating investment governance and sustainable investment policies which explain the Funds philosophy and approach to these issues.

*"The Fund is firmly committed to developing its ESG approach and in this regard is placing increased emphasis on the environmental and social factors not just governance" comments Talieh. "In doing so it continually looks at ways to embed ESG across its mainstream investment portfolio. To date the Fund has committed to the Enhanced Analytics Initiative and the UNPRI."*

UniSuper began its investment manager engagement activity by writing to all fund managers, requesting information on the management of environmental governance and social issues within their portfolios.

There are two fundamental external drivers that motivated the Fund to engage with its fund managers. Firstly UNPRI Principle 1 which is to incorporate ESG issues into investment analysis and decision-making processes.

This principle articulates the need to assess the capabilities of the funds investment managers and their ability to incorporate ESG issues, as well as the need to ask their investment service providers to integrate ESG factors into their evolving research and analysis.

The second external driver motivating UniSuper to engage with their fund managers was Section 2 of the ACSI ESG guidelines.

These external drivers make it clear that there is a need to engage with investment service providers in embedding ESG.

The purpose of the correspondence sent was to:

- provide the managers with information on the Funds policies,
- communicate that ESG matters would be receiving greater attention moving forward; and
- to elicit a response from the managers in order to ascertain a baseline in relation to the integration of ESG.

There was a high response rate to the correspondence and three key broad categories of issues were identified. These generally fell under the headings of:

- policy,
- process; and
- membership.

Flowing from this, UniSuper now understands that the approach to ESG adopted by the fund managers was variable. What was clear was that investment managers are largely aware of ESG issues and the potential impact that such matters can have on asset price returns. In addition, also that most managers are at a preliminary stage of incorporating ESG considerations into their respective investment processes.

Since that time UniSuper fund managers have undertaken a range of activities. It is unclear to UniSuper whether these activities were as a result of their process or rather that the fund managers own processes have evolved in response to the market and a raised level of awareness generally.

Today UniSuper's fund managers are:

- factoring ESG risks into their own analysis and this includes thematic considerations such as renewable energy and top down topical considerations such as climate change,
- they are rejecting stocks where they have strong concerns about governance or ethics and;
- they are also actively engaging with company boards and other stakeholders such as wildlife groups and the greens in relation to some assets.

Concluding the project, UniSuper are now confident that almost all of their fundamental investment managers are placing focus on ESG to some extent and are continuing to grow stronger. It was highlighted that some of UniSuper's managers will go as far as taking an activist and in some instances lobby boards quite hard.

*"UniSuper has made it clear to all of our managers that within our investment manager research and monitoring process, we will assess ESG considerations" says Talieh.*

## U.K. GOVERNANCE ACTIVISM

**ALAN MCDOUGALL, Managing Director,  
Pension Investment Research Consultant  
(PIRC)**

Opening his session, PIRC MD Alan McDougal updated conference delegates on the emerging governance trends in the United Kingdom.

During his presentation, Alan spoke about the impacts about the globalization of corporate governance issues.

He noted how the phenomena of dual listings is growing and is resulting in comparisons across jurisdictions on boards, their effectiveness, their election and their accountability. Alan also noted that executive pay remains a permanent feature of shareholder considerations.

Increasingly in the UK and U.S. markets, there is an increasing focus on audit issues. He asked the question - can we as investors rely on the audit report? Is it an adequate view of the company's operations? What is the kind of audit approach that's been adopted in our market?

The debate on Corporate Social Responsibility (CSR) has opened up the opportunity to analyse how companies operate and what makes them valuable and profitable in a way that historic analysis from the financial community has failed to do.

Alan explained that he believed that there was a big challenge for investors in utilising the emerging analysis from the CSR community, or ESG analysis as it is known in Australia. He thought it was significant that an increasing number of investors are concerned about these issues, but could not relate them to their investment strategies and their portfolio construction.

In Alan's opinion, a large number of stocks being held by the average institutional investor are fundamentally at risk. He felt this was because the analysis that has led them to be put into their portfolios has failed to take into account the ESG factors.

Alan's presentation also covered a range of UK corporate governance developments that have emerged since the cornerstone review of pension fund investor responsibilities arising from the Myners Review that was commissioned by the Government and reported in 2001.

Alan commented on what he sees as a fundamental transformation in the way in which the public debate about the role of institutional investors and particularly their fund managers proceeded. The review had identified a series of weaknesses at the level of pension fund Governance (what we call investor governance), namely:

- the lack of focus on investment issues,
- the lack of trustee training on investment matters,
- the lack of time commitment to considering investment matters,
- the lack of scrutiny of advisors reports; and
- the failure to tender properly for distinct services to the pension fund.

Alan then raised the question - why doesn't more shareholder engagement take place in the U.K. market?

A series of conclusions resulted about the role of fund managers and the ways in which they are not geared to shareholder engagement. Alan noted a cultural conflict, he commented: **"You don't get a job in a broking house or in an asset management business in the city of London in order to go beat up the companies you are trying to make money out of".**

Reference was also made to the Higgs report, which involved a fundamental review of the role of non-executive directors. In his opinion it was the most significant review globally.

When the report came out, not only was it very radical - it identified some of the key concerns that investors have to address going forward including questioning:

- the quality of non executive directors?
- have they got enough time to do the job?
- are they remunerated appropriately to do the job?
- have they got the skills to critically review their executive director colleagues in the board room?
- can they stand up to a domineering CEO or chairman?
- do they have enough days in the week to fulfil all the commitments they have got themselves into?

Alan then indicated "that we can't have a discussion about corporate governance these days without talking about the remuneration report vote just developed in the U.K. and within Australia, which is being pushed forward in the US market and in others."

Whilst it has had certain benefits, remuneration has continued to go up and excessive pay for failure has continued to be made. This has been disappointing for those who wished to see a greater transparency, because it leads probably to a lot more confusion. Alan then went on to say however, that one positive outcome so far as he could gather from the evidence, is that there has been an increase in dialogue.

He elaborated by saying that he believes in the UK that they have moved from a situation where corporate governance was really about compliance - compliance with the UK combined code, compliance with international norms and compliance with best practice in various areas, to a situation where that debate is now - how can corporate governance and best practice add value to a company's operations and obviously through the investment process to investors' returns? Subsequently one of the key issues now thought about as investors is board leadership.

Board leadership is fundamental - but now more than ever integrity of a board is being questioned with regards to:

- conflicts of interest,
- the emerging issues of concentration of power (particularly behind currently successful leadership); and
- the whole question of board accountability.

But the debate about the role of the board in a sense continues to keep going back to the first principles and never ends.

A further weakness pointed out by Alan was relevant to proxy agency work in the governance market. That they often tend to focus too much on compliance issues, on remuneration, on board structures and maybe also too much on the high profile issues that we sometimes miss the fundamental issues that are staring us in the face.

He cited Northern Rock and its business model. Whilst PIRC had slated the company on a number of issues in their report in 2007 for its annual meeting, the issue of business risk within the business model was not identified.

Alan believes that some of the crises that we have seen in the corporate world over the last five to ten years must begin to point the finger at the advisory network that both companies use and to a limited extent investor's use. Alan commented "I think Auditors in particular are facing a crisis, I believe there is an intellectual crisis about the value of the actual work they do."

There are conflicts within the existing audit profession and in a sense you're paying two people to give you different advice, In those situations it is difficult to choose.

He also referred to the conflicts of interest credit rating agencies. He went on to explain that the three principal credit rating agencies that dominate the capital markets of the advanced capitalist democracies are fundamentally conflicted because they take fees from the issuer to do their job. He provided one example in the US, where there is only one agency which has recently received SEC approval that does not have that business model, however they are very small in size.

In Alan's opinion, more shareholder value is lost through unsuccessful mergers and acquisitions than probably any other element in the investment firmament that, at least notionally, trustees could do something about.

His explanation for this was because "this isn't about the luck of the market, this is about decisions made by agents of pension funds, the wrong decisions."

There is some evidence that when public pension funds are active on the issue they can mitigate the losses involved in unsuccessful M&A, so that's another reason to be concerned about it. What the forum really wanted to do was to try to provide a framework in which the average trustee could actually ask some very basic questions of their fund managers when a significant M&A occurs to a stock in their portfolio, on the buy side or on the target side.

## LEADING THE WAY THROUGH RESEARCH

**GORDON NOBLE, Principal, Responsible Investment Consulting &**

**HELEN BLOUSTIEN, Executive Manager – Sustainability and Education, VicSuper**

### The sustainability reporting practices of the ASX 100

In the lead up to lunch, Gordon Noble, Principal of Responsible Investment Consulting, spoke about the recent study commissioned by ACSI: "The Sustainability Reporting Journey".

The research was commissioned to identify:

- who of the ASX 100 is reporting and who isn't; and
- the extent and depth of the sustainability reporting carried out.

The study addressed the questions of:

- did the company report on ESG issues at all?
- if yes, how does the company report on ESG issues?
- the timing, reporting boundaries and verification of the reports on ESG issues; and
- did the company report against the Global Reporting Initiative (GRI) framework?

### The key findings of the research were:

- 17% of the ASX 100 does not report on sustainability issues at all,
- 33% report on ESG issues in some limited form (for instance selected OHS statistics),
- 27% provide an increased level of disclosure (through dedicating a section of the company financial report to ESG issues, producing a sustainability report or enhanced website disclosure),
- 7% report on ESG issues by making some reference to the GRI framework and guidelines,
- 16% report on ESG issues according to the GRI framework and guidelines,
- Companies report in a variety of formats, including the annual report, through their website or in a stand-alone sustainability report; and
- 14% externally verify their reporting.

In summary, Gordon then went on to praise the work of those companies who have commenced sustainability reporting. Saying this however, he still stressed that there was always room to make continuous improvements and for those companies that currently do not report - it presented an exciting opportunity to begin.

\* A summary of the Sustainability Research is available on ACSI's Website: [http://www.acsi.org.au/dsp\\_research.cfm](http://www.acsi.org.au/dsp_research.cfm)

**The Enhanced Analytics Initiative in Australia**

Following on from Gordon in the same session, Helen Bloustein, Executive Manager for Sustainability and Education at VicSuper then outlined the recent activities to establish a branch of the Enhanced Analytics Initiative (EAI) within Australia.

Helen firstly explained that the EAI is an investment market initiative involving collaboration between asset managers and asset owners. Its primary aim is to challenge brokers to provide a more complete view of investment opportunities by way of including and integrating ESG analysis in all of their research. As an incentive, members of the EAI commit to paying 5% of their brokerage to the best research on ESG issues.

*"The initiative sends a signal to brokers that ESG research will be rewarded and publicly recognized" said Helen. "Every six months, an independent consultancy assesses and identifies the best broker research according to criteria determined by the EAI."*

At present, HESTA and VicSuper are working to establish an Australian branch of the EAI, in the hope that an EAI in Australia will enable Australian asset owners and managers to:

- measure the quality of Australian research being produced - using the same assessment methodology as Europe,
- provide a direct reward to Australian brokers; and
- more directly influence the growth and development of ESG integration in Australia.

With the conference breaking for lunch, Helen closed by saying that *"the Australian EAI working group would welcome the interest and participation of other Australian asset owners and managers"*.

**LESSONS FROM CENTRO**

**MARTIN LAWRENCE, Risk Metrics & MALCOLM MAIDEN, Journalist**

In this conference session Malcolm Maiden and Martin Lawrence shared their views on some of the lessons to be learnt from the credit crisis. The focus of the discussion was how, and why, the credit crisis has affected a number of Australian companies including ABC Learning, Allco, Centro and MFS (now Octavia).

One of the key themes discussed was that while the repercussions of the current credit crisis may be larger, there are many similarities between current events and past collapses. Comparisons were made with the events which followed the dot-com boom of the 1990s and the takeover boom of the 1980s. Malcolm Maiden commented that in general, the companies at the centre of the dot com boom behaved a lot worse than many of those affected by the sub prime crisis. He added that the current credit crisis has affected some very good companies as well as some very bad companies, mainly because a totally unpredictable event occurred - the complete shut down of the securitised debt markets.

Martin Lawrence then went on to identify the similarities between the current credit crisis and the corporate collapses of the 1980s. He noted that convoluted corporate structures, compliant boards and dominant CEO's were common trends of the well known collapses of the 1980s. He also highlighted that a key feature of the complex structures of companies, both then and now, was a blurring of shareholder and management interests.

Both speakers identified several key features of the some of the Australian companies worst affected by the credit crisis.

These features included:

**A dominant CEO/Management team**

Both speakers noted the governance risks involved where there is a dominant management team. Examples used to highlight this point included MFS, Centro, Allco and ABC Learning. As Malcolm Maiden commented "there is always an entrepreneurial risk factor but it is not always described that way."

Both speakers then qualified this point noting that there are also examples where dominant managers added significant value to a company.

**Companies which are highly geared and 'deal hungry'**

Both speakers identified that, with the benefit of hindsight, high debt is something that we all know that we should be watching more closely. The highly geared structures, and the major acquisitions made by Allco, Centro and MFS were used as examples of this trend.

**Convoluting corporate structures**

One example used within Martin's presentation was Centro's 30 June 2007 Annual Report. This report included 283 controlled entities but did not include the entities that were overseen by those controlled entities and a further 53 associates. Malcolm Maiden then added that "complexity is a feature of the booms that seems less material when the boom is underway and completely material after the event."

Closing the discussion, both speakers emphasised the need for investors to learn from this and past experiences.

They also highlighted the need to identify key indicators from the current credit crisis so that they can be monitored and taken into account in future.

A final warning stressed by both speakers is that investors cannot rely on auditors as they are generally unable to pick the shift from a healthy bull market into excess.

For superannuation trustees, it was suggested by Malcolm that "funds should aim to find funds and fund advisors that can demonstrate that they genuinely understand bottom up analysis and can apply it, and relate it to you."

**LEADING BY EXAMPLE**

**PANEL: ANNE-MARIE CORBOY,  
 CHRIS MCARTHUR, ANDREW SISSON &  
 DR. ZIGGY SWITKOWSKI**

Bringing the programme to a close, the last session featured a group discussion where each panellist was asked to reflect on what they saw as 'leadership' and 'sustainability'.

The highlights of this session were some of the insights the panellists shared based on their own professional and personal experiences. Two of the key themes that emerged were:

**Holding onto your long term strategy in the face of short term pressure:**

- Andrew Sisson gave a candid account of his experience of the campaign around the Qantas takeover bid. He emphasised that during the campaign, despite the obvious short-term pressures, he tried to maintain a clear focus on long-term outcomes.
- Anne-Marie Corboy noted the way in which success is measured in the ESG space. She compared the relevant discussions of the day with those that were had when HESTA developed its corporate governance policy over ten years ago. Many who took a short-term view at that time argued that corporate governance and proxy voting could not be done or would never take off. This highlighted Anne-Marie's point that imposing short-term measures often does not work in this area and this approach fundamentally fails to see ESG as an evolving process.
- From his work as a Senior Asset Manager and Company Director, Chris Macarthur noted that it was possible to maintain short term performance and ignore ESG risks, however, over the long-term there is a real prospect that the risks inherent in this strategy will be realised.
- Using the example of the dot com boom of the nineties, Dr Ziggy Switkowski noted that during that boom short-term investors could make a very good return on investing in what was an unsustainable business model. Ziggy went on to emphasise the point that you have to separate investment appeal from good business.

**A cultural shift on ESG considerations**

- On the issue of ESG and 'corporate sustainability', Chris McArthur commented that he sees ESG as almost a 'generational issue'. In his work as Company Director he has noted that it is now only a minority of his colleagues who do not grasp ESG considerations. Chris commented that "there is often a personal satisfaction in having this ongoing debate and seeing the thinking shift and some of the tangible results around environment and sustainability, which are being achieved with the assets we are investing in."



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As a final point before closing, all panellists commented on the changing expectations of both the general public and corporate Australia in the area of sustainability and climate change. Ziggy Switkowski noted this trend using the examples of the federal election and the growing need for corporations and professional firms to be seen as active and progressive on environmental issues.

**Responsible Investment Conference**  
**24-25 September, Melbourne**

The Responsible Investment Association Australasia (RIAA) is holding its 6th International Responsible Investment Conference.

Issues to be touched on during the conference include Climate change, water scarcity, oil prices, food production, human rights, corporate governance and sustainable development. The conference will look at how these issues affect superannuation funds in the short and long term.

The conference is being presented by RIAA in association with UNEP FI and PRI. For more information please refer to the RIAA website:

[www.responsibleinvestment.org](http://www.responsibleinvestment.org)

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