

Responsible Investment – Global Drivers

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Outline

Sustainability, climate change and investment (CSRI - Robert)

Sustainability, global drivers of change, implications for investment (SANZ - Wayne)

Small group discussion



Hopeful Outcome

Both CSRI and SANZ have been thinking through the implications for investment based on a common understanding of the major drivers that are threatening human life on earth. This is work in progress.

We are seeking interest from other individuals and organisations who want to join us, and a successful outcome would be the identification of interest.



Part 1

Are investments in New Zealand and the world based on sustainable fundamentals?



SRI (social and environmental factors) = exclusion and/or engagement

Examples:

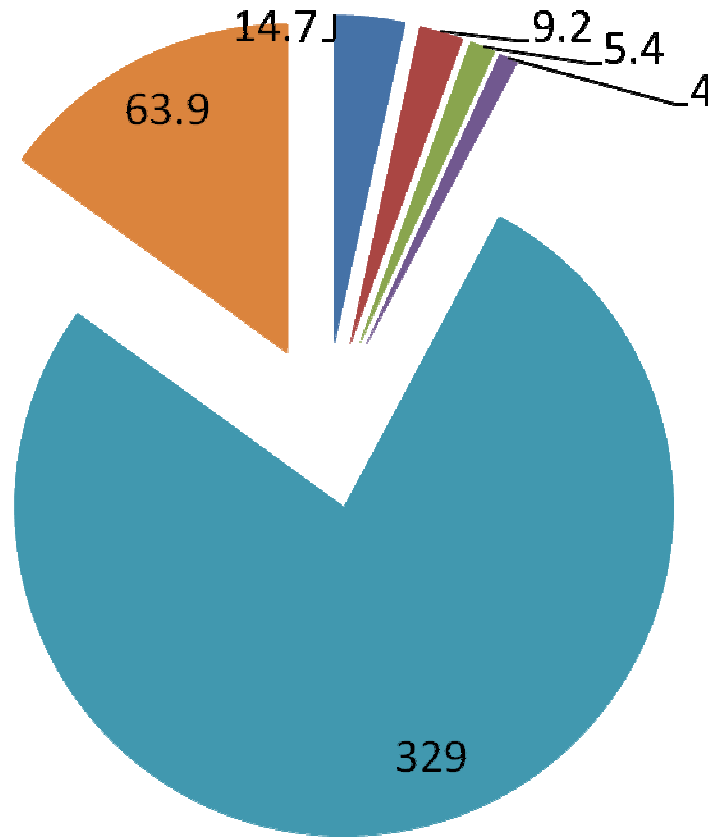
Apartheid

General Electric

Interfaith Centre for Corporate Responsibility



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- NZ Superfund (109 by 2025)
- ACC
- Earthquake Commission
- Govt Super, NPF
- Banks (44% residential mortgages)
- Fund Management (Dec 06 over 50% in residential property)

Investment by New Zealand

NB Government capital expenditure such as roads, schools, is not included.

CFI Criteria *“to avoid prejudice to New Zealand’s reputation as a responsible member of the world community”.*



New Zealand (1)

Government

NZ Superfund

- Adopted UNPRI, UN Global Compact, Carbon Disclosure Project
- Divested from companies involved with cluster munitions, whale meat, tobacco.
- Have engaged with other UNPRI signatories with 103 companies in reporting progress on UN Global Compact.

ACC

- Divested tobacco.
- Maryan Street's enquiries identified that they have been investing in the nuclear weapons industry.



New Zealand (2)

Kiwisaver SRI Option

ABN Amro, Asteron, Superlife, ASB, Fidelity Life, Anglican Church Pension Fund, ING.

Problems with Codes of Conduct

Sethi: *Setting Global Standards*

Rosett: Global Compact

Schepers: Equator Principles

www.csri.org.nz



Sovereign Wealth Funds (SWFs)

UAE	\$875 billion	Algeria	\$42 billion
Singapore	\$489	Australia	\$40
Saudi Arabia	\$300	US Alaska	\$38
Norway	\$380	Russia	\$32
China	\$200	Brunei	\$30
Kuwait	\$250	South Korea	\$20
Lybia	\$50	Malaysia	\$18
Qatar	\$50	Taiwan	\$15



Comparative Transparency

Total Sovereign Wealth Funds - \$2876 billion

Global Hedge Funds - \$1500-2000 (inc some SWFs)

“In terms of disclosure on performance, investment strategy or even basic philosophy, many SWFs rank below the most secretive hedge fund” - Financial Times 25 May 2007 / Economist 19 Jan 2008



Socially Responsible Investment

Social Investment Forum USA (9.4% of \$24.4 trillion)

- tobacco 88%
- alcohol 75%
- gambling 23%

EuroSIF (10-15% of €1 trillion)

- simple screens 6%

USA 2-3%?

Europe 4-9%?

Simple screens / Best of Class inadequate for sustainable fundamentals



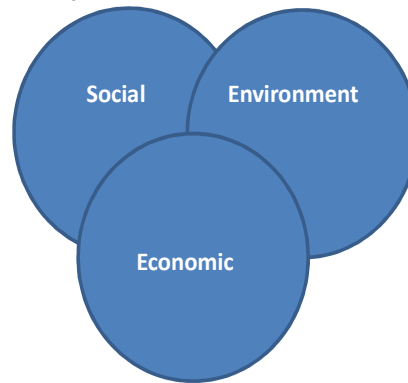
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Despite financial returns to support climate change solutions (eg wind farms, solar energy) the financial incentives under the business-as-usual model always dominate over environmental and social factors.

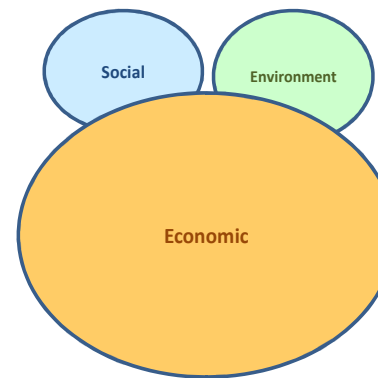
The current economic model will not deliver solutions to the threat of environmental degradation. [“Globalization and the Good Corporation: Whither Socially Responsible Investment?” in *HSM 27 (3)*

2008 243-254]

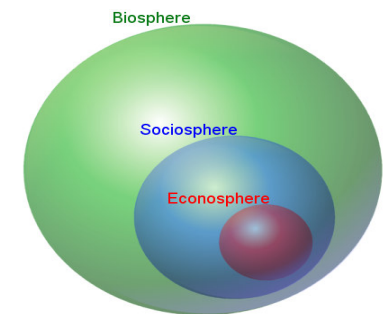
Triple Bottom Line Model



Mickey Mouse Model of Triple Bottom Line



Strong Sustainability Model



Wall Street Crisis : What went Wrong

- Economist 22 March 2008

Inevitable consequence of the laissez-faire philosophy that allowed financial services to innovate and spread almost unchecked.

Complex, interdependent system prone to conflicts of interest - fraud has been rampant in the sale of subprime mortgages.

Pay that was geared to short-term gains, bankers and fund managers stand accused of pocketing bonuses with no thought for the longer-term consequences of what they were doing.

If disaster struck, someone else (borrowers, investors, taxpayers) would end up bearing at least some of the losses.



Wall Street Crisis : What went Wrong

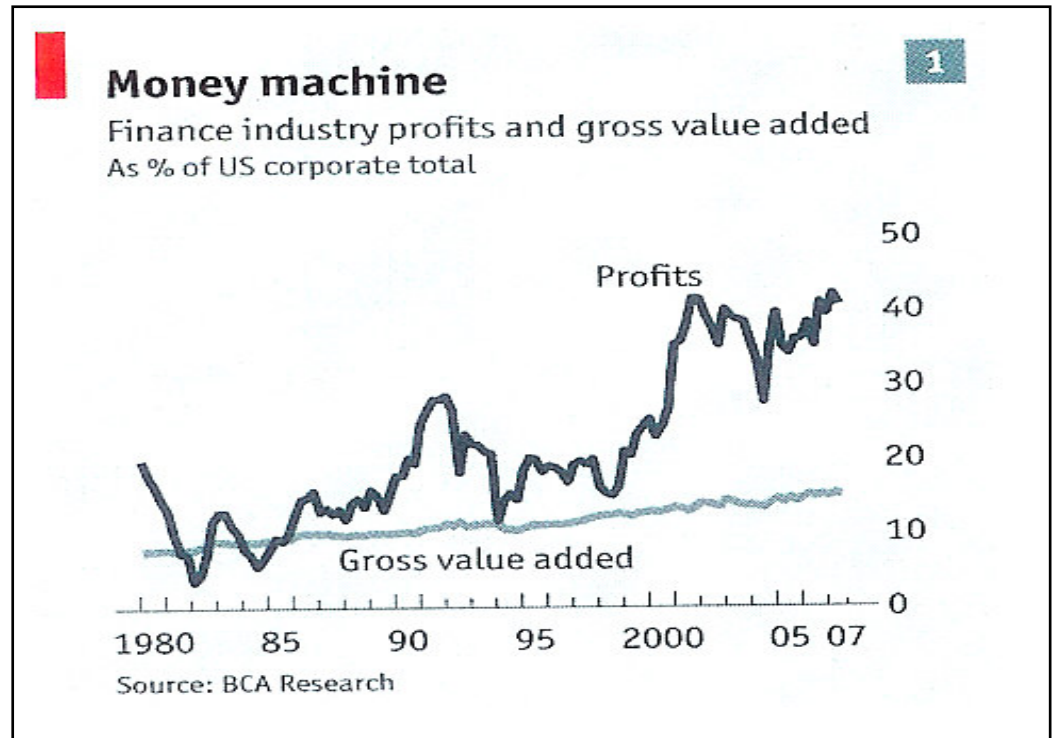
- Economist 22 March 2008

Share of corporate profits 10%
to 40%

Stockmarket value 6% to 19%

Gross value 15%

5% of private sector jobs



AllianceBernstein : Abating Climate

US\$5 trillion would be spent globally through 2030 on power plants and factories.

Billions more would fund efforts to improve the efficiency of energy-intensive equipment, eg automobiles, industrial motor systems, motor systems for various large consumer appliances (refrigerators).

The earth will continue to warm despite the aggressive emissions-abatement scenario outlined.

The consequences would be adverse, rather than catastrophic.

Adapting to changes in sea levels, weather and water availability will likely impose significant social and economic costs.

“The simplest option is do less by cutting back on activities that require burning fossil fuels for energy. This would reduce the standard of living in developed countries. Clearly no country would agree, so we crossed this off our list of options.”

This is walking north on a south bound train

Part 2

SANZ - Global Drivers



Background about SANZ and the Think Tank Project

Sustainable Aotearoa New Zealand (SANZ) is a non-profit NGO

With support from UNESCO and the Tindall Foundation SANZ has completed a Think Tank Project that addressed issues around strong sustainability

Part of the analysis considered future insight into Global Change Drivers

These Global Change Drivers, and the implications of them for investors, are the focus of this presentation



Major Global Drivers of Change

A complex sequence of global changes has *already begun* that will take human civilisation outside the range of prior experience in terms of magnitude, speed of arrival and simultaneity. All are subject to uncertainty about timing.

These changes will cause abrupt and radical shifts in human living, work and recreation.

These statements are not intended to be alarmist. Instead, they should be interpreted as a challenge to become prepared and as an invitation to face the future with hope, resilience, and the required knowledge and skills.



Major Global Drivers of Change (2)

- 1. *Degradation of global ecologies* caused by population growth and human economic activity, further reducing the already grossly overloaded capacity of these ecological systems to ‘clean up’ pollution from human industry and consumption, and to continue to have the ability to contribute food, fibre, and energy.**
- 2. *Rapidly accelerating global climate change*, with associated extreme weather, with both direct impacts and the further effects of policies of mitigation and adaptation. Irreversible ‘tipping points’ may occur.**
- 3. *Radical upward trends in the prices of hydrocarbons (oil, coal, natural gas) and wider variations around the trend*, caused by increasing costs of extraction, internalisation of carbon gas emission costs, and recognition of ‘peak oil’. Substitution of renewable energy will increase, but it will be insufficient to avert major economic and social disruption as whole sectors of global and local economies fail.**



Major Global Drivers of Change (3)

4. ***Poor and declining regional supplies of water (volume and quality) with consequent negative impacts on human health and agricultural food production and an increase in mortality. Regional conflicts will arise.***

5. ***Critical global food supply deficit as population growth further outstrips the ability of both subsistence and commercial food and fibre production to feed humanity, resulting in widespread starvation.***

6. ***Atmospheric and water-borne toxins from industrial sources having much more direct serious affects on the health and mortality of humans and many other species.***



Major Global Drivers of Change (4)

7. ***Geopolitical shifts and disruptions***, as nations and blocs suffer adverse conditions, adjust to change, advance their ideologies, compete for critical resources, and attempt to exercise shifts in relative economic and military power.
8. ***Wide swings in economic activity including widespread market failures*** as economic and financial institutions struggle (with declining success) to operate in a world that is shifting and changing beyond their ranges of competency.
9. ***Advances in computers, information technology, global connectivity, robotics and other technologies***. Some of these will assist in mitigating aspects of the changes listed above, but none will be a 'magic bullet'.



Implications: Adjusting Investors' Expectations about Returns

1. Pricing of securities will be on expectation of no resumption of long-term rapid global economic growth - on average, no price component based on growth
2. Increasing variation in economic output, resulting in average security prices reflecting more risk.

Reasons

- Ongoing disruption of credit/money systems and financial markets, and the long period required for design and implementation of effective new/modified systems.
- Heightened perception of the business risks inherent in reliance on both continuous risks in capital goods markets and service sectors.



Reasons continued

- **Radical upward trends in the average costs of using hydrocarbons (coal, oil and natural gas) and wider variations around these trends**
- **Increasingly steep upward trends in the costs of doing business arising from natural feedback processes that are part of the accelerating degradation of ecological systems**
- **The disruptive effects on trade and shipping of increasingly frequent regional conflicts caused by disputes over access to water and oil, and by political instability in some economically important countries**



Implications: Mitigating New Emergent Sources of Risk

Mitigate medium/long term risk by reducing their positions in businesses that are exposed – either directly, or through their supply chains, or through their distribution channels and markets - to:

- Dysfunctional aspects of banking and financial markets
- The direct costs of hydrocarbons, plus carbon gas emission imposts
- Major impacts of climate change and weather events
- The cost-enhancing natural feedback processes of degrading ecological systems
- International shipping that is exposed to conflicted regions
- Political instability in major supply countries or major market regions



Implications: Investing in Emergent Opportunities

Substantial growth opportunities will arise in supplying products or services that help consumers, businesses and institutions to mitigate or adjust to the new sources of risk discussed previously

These will probably utilise new technologies and/or innovative approaches, but not all such innovations will succeed

These opportunities will shift rapidly over time

Each opportunity will carry the usual risks associated with innovation and new ventures in competitive market environments



Implications: Desirable Attributes of Investee Businesses and Institutions

As the highly risky, low-growth and challenging future unfolds, investors should favour businesses and institutions that have attributes that provide them with strengths in these business environments.

These attributes differ somewhat from those currently thought to be critical: Managers and directors have a clear understanding that their enterprises must strive to minimise their impact on degradation of ecological systems, and they have information systems, strategies, and operational controls in place to achieve this. Businesses that do not have these perspectives, skills and systems will increasingly be at risk of both negative natural feedback processes and regulatory costs and penalties.



Attributes contd.

Investors have engagement with businesses through direct governance processes, so that investors have a sense of real responsibility for the actions of the business, and managers know and respect this.

Investors, and their directors and managers believe in the merits of 'patient money'. They know that the needed strategies of change and transformation are likely to take time. They acknowledge that the achievement of desired outcomes should not be compromised by investors' demands for short-term cash returns.

Directors and managers have a deep understanding of global change drivers and the implications of these for the business



Small Group Discussion

Feel free to discuss any aspects of the presentation: comments, criticisms, suggestions. To assist here are some specific questions:

Do the global change drivers of change seem valid to you? Why or why not?

Do the proposed implications for investor's expectations about returns make sense to you? Why or why not?

What are the implications of these expectations for your organisation?

What is your response to the suggestions for mitigating risk, taking opportunities, and desirable attributes of investee businesses?

To what extent would your organisation be capable of taking up these suggestions?

