

Responsible Investment 2008

An analysis and measurement of the competencies
and practices of leading asset managers

RImetrics

Measuring asset management
competencies and practices



Sir Mervyn Pedelty

Foreword

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It seems a relatively short time since we commenced our first detailed engagements with fund managers with the objective of assessing their policies and practices towards responsible investment. However, in the flurry of work involved not only with our engagement activities but also in ensuring that we have assessment results which are consistently and fairly measured, it is easy to forget that our methodologies have been more than two years in the development and proving.

Consequently, and first of all, let me say that we owe an enormous debt of gratitude to our Policy and Technical Committees. These independent cornerstones of RImetrics' governance have worked diligently on the task of creating a methodology for the assessment of fund managers which is capable of meeting the requirements of the owners of investment assets as well as other stakeholders. The combined results of all of this work are presented in this inaugural report "Responsible Investment 2008".

It is now clear that global investors are increasingly interested in understanding the broader impacts of what have traditionally been non-financial issues – such as environment, social and governance factors – on the investment performance of companies they are, or might be considering, investing in. There is also a growing public interest lobby, which itself appears to be being translating into various legislative actions, around these issues and which many asset owners such as pension funds and other institutional investors are bound to consider taking into account in setting their own policies. However, the synthesis of this growing interest in non-financial issues into rigorous, systematic and integrated research outputs is still a significant challenge for many in the asset management industry. We hope that this is where RImetrics can add both value and objectivity.

This first report analyses many of the world's leading asset managers in terms of how they have responded through their organisations to these changing demands about responsible investment and how they are deploying these within their investment offerings and styles. The evidence we have gathered so far points to some asset managers having already come a long way, whereas others are just beginning to grapple with the new challenges involved.

RImetrics is committed to providing soundly based, independent and transparent ratings analysis and research to the global investment community. As an additional benefit, we also hope that our contribution to this important subject may serve to raise overall awareness and expectations and, over time, raise the standards of practice across the industry.

Next year's report should give us an indication as to whether we are on course.

1. Executive Summary

The acceptance that environmental, social and corporate governance ('ESG') performance can influence investment returns and risk continues to gather momentum within the mainstream asset manager community. 'Responsible Investment 2008' provides evidence that global asset managers are beginning to integrate ESG knowledge within their investment policies and processes. Nonetheless, the report also shows that the industry as a whole is a long way from best practice, with competencies and practices varying greatly from manager to manager.

As interest in responsible investment grows globally, those managers able to demonstrate these competencies can expect to be better placed to win new business mandates and to retain those that they currently have.

Rimetrics conducted detailed research among global asset managers representing over \$12 Trillion of AUM, and including over half of the world's leading 20 managers, examining their approach to responsible investment in relation to active management styles.

Key Findings:

- The study reveals significant inconsistencies across five key responsible investment themes of strategy, engagement, integration, voting and transparency and accountability.
- Competencies and practices vary markedly, not just across the industry but within individual organisations.
- Clients are rarely consulted on the development of responsible investment strategies.
- Global engagement with invested companies is rarely achieved.
- Many asset managers are unable to successfully integrate ESG knowledge and research into their investment process.
- Despite industry progress on proxy voting, the survey reveals a mixed picture in execution.
- Few managers demonstrate any formal training and human resource planning necessary to deliver responsible investment strategies.

Key Conclusions:

- The industry as a whole is a long way from best practice: although asset managers increasingly accept that ESG factors can influence investment returns and risk, most have yet to develop the corresponding competencies systematically across their organisations.
- Mainstream asset managers are increasingly coming to apply research skills previously more typical of SRI specialists.
- A lack of measurement of responsible investment activities and their costs means that many managers are not able to manage these effectively.

2. Introduction

RImetrics' ratings were created in response to the increasing level of institutional investor interest in the integration of environmental, social and corporate governance (ESG) information into the investment management process, and in particular the practices of mainstream asset managers in discharging these responsibilities on behalf of their clients.

RImetrics conducted assessments of global asset managers, representing over \$12 Trillion of AUM, to examine their approaches to responsible investment. The managers assessed included over half of the world's leading twenty managers, plus a significant number of mid-ranking managers, specialists in fields such as emerging and environmental markets, and also managers with an orientation towards corporate engagement and stewardship services.

Data was gathered predominantly through face to face interviews with key investment staff, including portfolio managers. A questionnaire, verified using written supporting documentation provided directly by managers, and a review of the public information available from each manager's website, supported the process.

Each asset manager was assessed against a series of Best Practice Principles developed by a Technical Committee including leading practitioners and reviewed by a Policy Committee of leading asset owners (collectively representing over \$2.5 Trillion of assets.)

The assessment examined 22 aspects of each manager's responsible investment competencies and practices across five key themes: the manager's strategic orientation in relation to responsible investment; their approach to engagement; the degree to which responsible investment activities are integrated with their investment management processes; their proxy voting processes; and their own transparency and accountability.

This rich set of data for each manager provides a unique insight into the position of each asset manager relative to their peers, and a detailed view of the overall state of the industry regarding the adoption and integration of responsible investment practice.

For asset owners, responsible investment is no longer simply an issue for those who have a strong sustainability or stewardship approach; it has become a central concern in relation to investment risk and return. However, asset owners are still often unclear as to what responsible investment objectives to set, how these can be met, and how they will measure whether they have been achieved.

For asset managers, there is still a wide variation in the interpretation of what constitutes good, responsible investment practice. Although many accept that their clients are increasingly interested in ESG issues, many managers are struggling to establish how best to respond to this interest.

In addition, there is a lack of recognition as to how managers can most effectively leverage their investments in ESG resources. On a strategic level, many managers do not have a clear view as to where they currently stand in comparison to their peers, nor where competitive advantage may best be gained in the future.

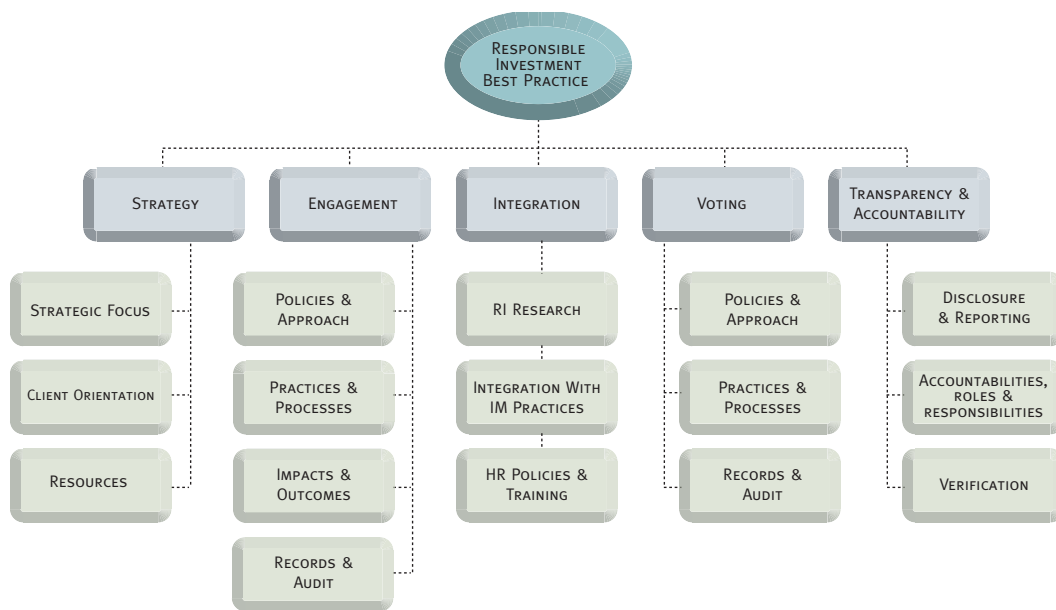
The biggest issue for asset managers however, is the lack of clear, strong signals from their asset owner clients.

The shift towards a greater acceptance of the 'materiality' of ESG in relation to both investment performance and client demand has had the effect of increasing the demand for credible, independent and reliable responsible investment data and information, both at an organisational and at an industry level. It is clear that the maxim, "If you can't measure it, you can't manage it" applies in this field just as much as in any other.

Responsible Investment 2008 highlights a number of opportunities facing the industry, from both the asset owner and the asset manager perspective, which are central to raising standards in responsible investment practice across markets.

It is against this background that Rimetrics continues to research asset management responsible investment competencies and practices. This report will be repeated annually providing an insight into the changing responsible investment landscape.

Fig. 1 Analysing 22 Elements of Responsible Investment Best Practice



3. Key Findings

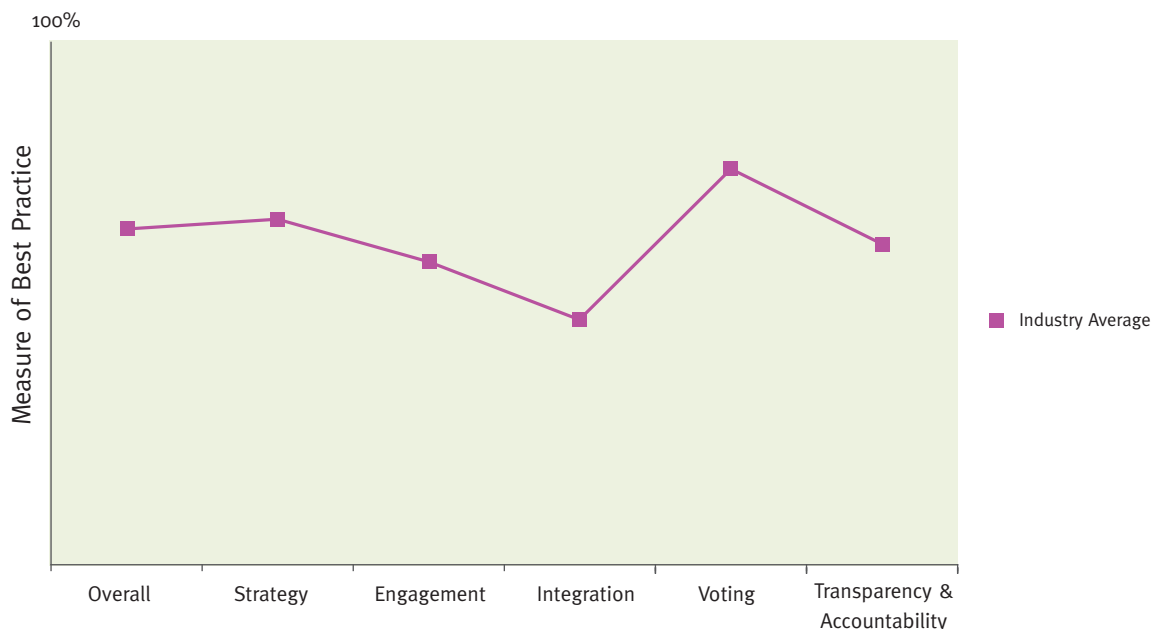
The key findings include:

3.1 The study reveals significant inconsistencies across five key responsible investment themes of strategy, engagement, integration, voting, and transparency and accountability.

When the total scores for all asset managers are aggregated (Fig 2), a picture emerges, highlighting where the industry has made the most progress in developing best practice and where there are still deficiencies.

Unsurprisingly, the strongest practices are to be found in proxy voting execution, while the weakest are in the integration of ESG information and analysis. The decline of average practice between the development of policy and strategy, and its execution via corporate engagement and integration, underlines the challenge in delivering a consistent level of responsible investment practice for many asset managers.

Fig. 2 Asset Management Industry Average Competencies



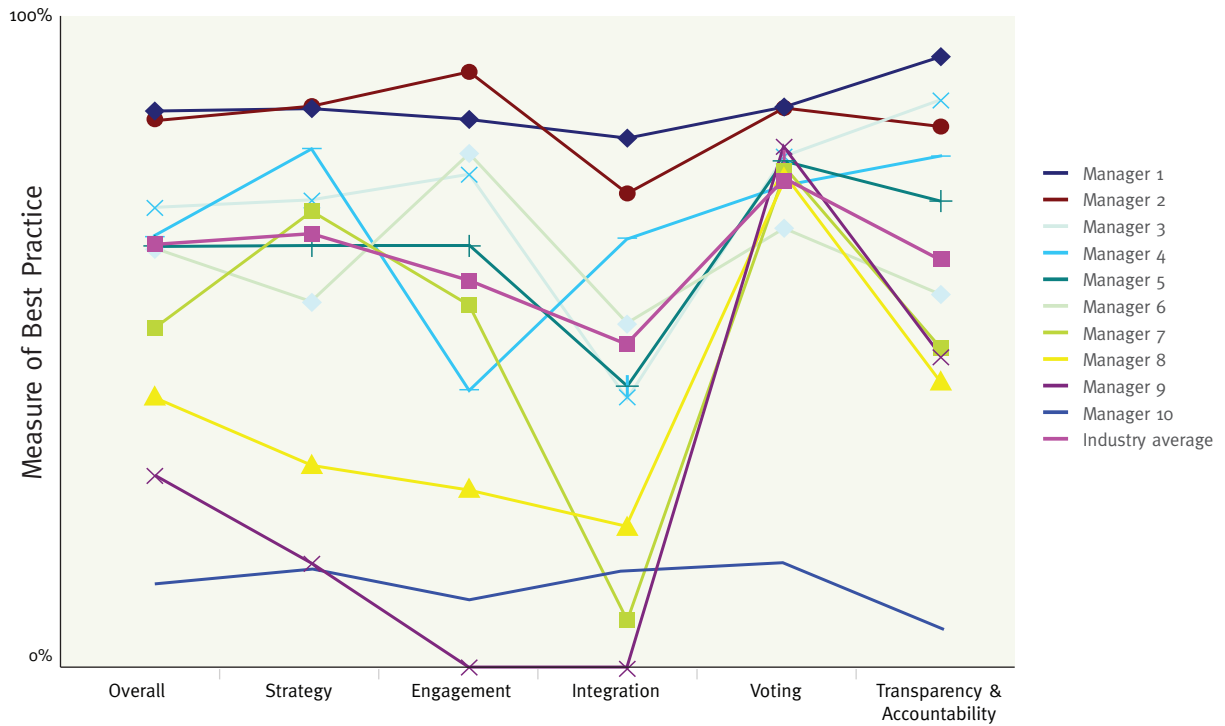
The Assessment Process

The assessment process gathered more than 130 different data points from each asset management organisation, most during face to face interviews, or conference calls where respondents were based outside the UK. Interviews were conducted with a range of investment professionals across the various functions related to corporate governance and other responsible investment activities within the asset management organisation. The process also included a series of verification measures to ensure data accuracy including, wherever possible, a review of both public and internal documentation.

3.2 Competencies and practices vary markedly, not just across the industry but within individual organisations.

It might appear to pension fund trustees that all asset managers have similar competencies and practices. The reality can be very different. Even amongst the world's largest asset managers there are enormous variations in approach. Few managers have consistent strengths across all aspects of responsible investment; many show relative strengths in just one or two areas at most. (Fig 3)

Fig. 3 Competencies of 10 Sample Asset Managers



This variability is, for example, illustrated by differing approaches to responsible investment policies, where only a third of managers indicated their engagement policies covered all the markets in which they were invested.

Figure 4 shows ratings achieved by three global asset managers: Manager A achieving a low score versus best practice, and Manager C a high score. Manager B achieved a high rating for its strategic orientation but a lower rating for its engagement competencies.

Fig. 4 Three Sample Global Asset Manager Ratings

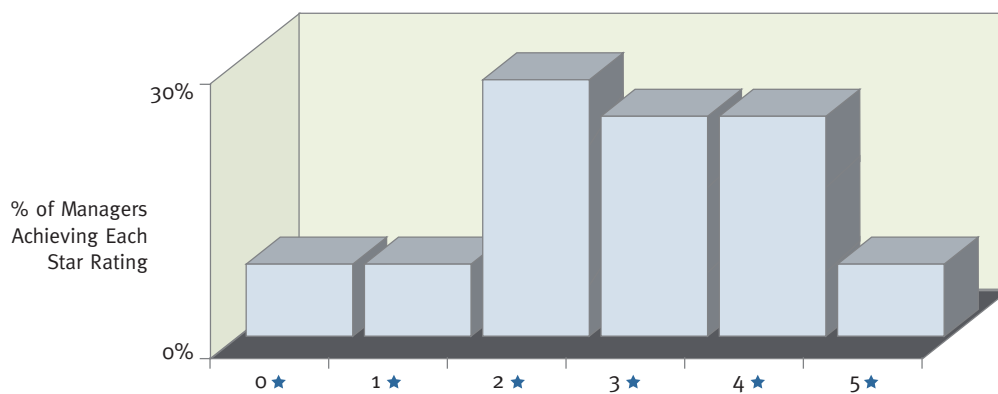
	MANAGER A	MANAGER B	MANAGER C
Headline AMR	★☆☆☆☆	★★★★☆	★★★★★
Strategy	★☆☆☆☆	★★★★★	★★★★★
Engagement	☆☆☆☆☆	★★★☆☆	★★★★★
Integration	★☆☆☆☆	★★★☆☆	★★★★★
Voting	★★★☆☆	★★★★★	★★★★★
Transparency & Accountability	★★★☆☆	★★★★★	★★★★★

The Rimetrics Rating System

Rimetrics' star rating system provides 'at a glance' summary assessments of asset managers' competencies and practices. Managers are rated between zero and five stars, with a five star rating representing the highest level of manager competence.

Figure 5 shows the distribution of headline ratings amongst the assessed asset managers. Amongst the global top twenty managers assessed, four rated at two stars or less and only one at four stars or above.

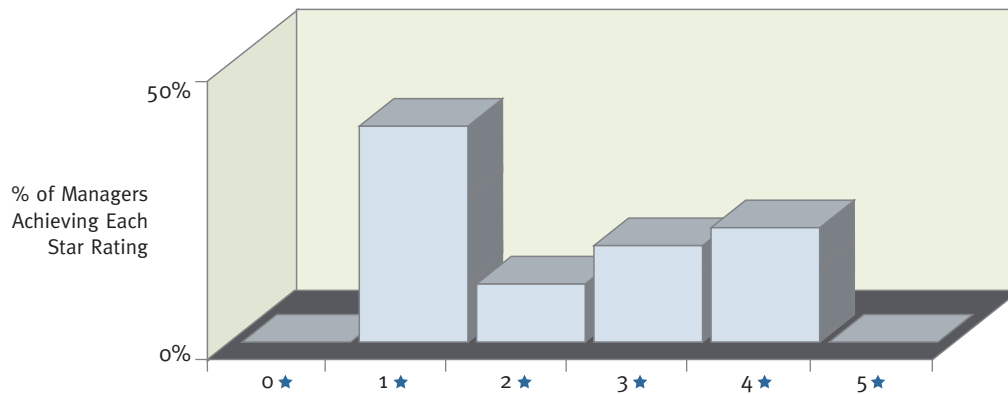
Fig. 5 Distribution of Headline Ratings



3.3 Clients are rarely consulted on the development of responsible investment strategies.

This research shows that whilst a high proportion of asset managers had responsible investment strategies, only half (56%) had strategic policies that were action orientated and relevant across the organisation. Only 44% of managers achieved a 3 star rating or higher for client orientation. (Fig 6)

Fig. 6 Distribution of Client Orientation Ratings



A majority of asset managers (60%) did not consult their clients when developing their responsible investment strategies. Instead, these strategies typically reflect what asset managers assume to be their clients' priorities. In many instances this has led to responsible investment strategies being selectively applied, for example in the asset managers' or the clients' home market only.

Reporting and communication between managers and clients on other aspects of responsible investment policies and practices is, in many cases, also limited. One sixth of managers (16%) do not report their voting record to clients, few managers agree written performance goals for engagement programs and, of those managers that undertake engagement, one third (34%) do not report to clients on the results.

3.4 Global engagement with invested companies is rarely achieved.

Amongst the managers assessed in this research, a large proportion engaged solely to build ESG knowledge; some engaged both to build knowledge and engender change; and some managers did not typically engage at all on ESG related issues. The majority of managers did not specifically recognise the costs associated with their engagement activities. Of managers who engaged, 30% did not maintain any audit trail of their engagement activity.

Fig. 7 Engagement competencies of 10 sample asset managers

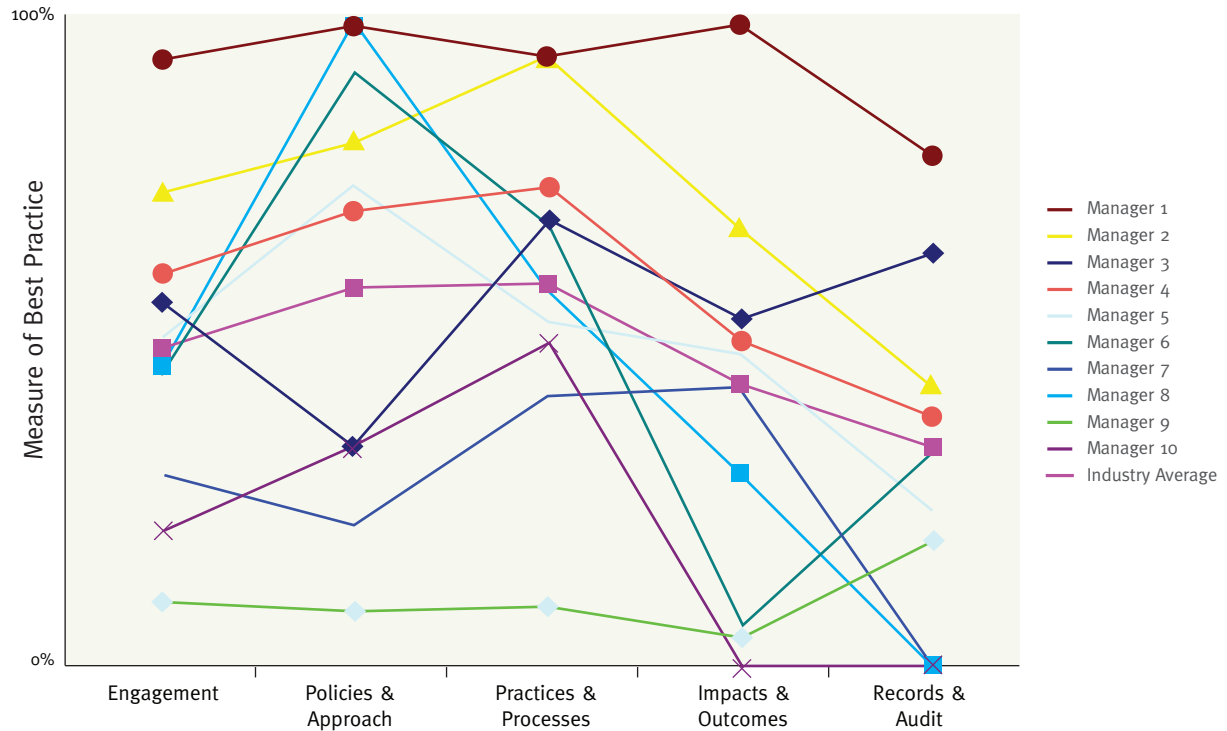


Figure 7 shows example profiles of ten assessed managers. In this sample, eight out of ten managers rated more poorly on engagement impacts and outcomes than might have been expected from an assessment of their practices and processes.

Most managers' engagement efforts did not match the geographic distribution of their AUM. Many engaged mostly or exclusively in their home market, or the market where their specialist team was based. Only 32% of managers assessed stated that their engagement policy covered all the markets in which they managed assets.

Attitudes to engagement in emerging markets illustrate this variability: some managers with significant AUM in emerging markets claimed that engagement was simply too difficult or too expensive to undertake, while others in a similar position stated that engagement in emerging markets was not only feasible but indispensable, since this is where ESG issues pose the greatest risks.

3.5 Many asset managers are unable to successfully integrate ESG knowledge and research into their investment process.

The research shows the integration of ESG knowledge into investment processes is well executed by only a minority of managers. 80% of assessed managers create, obtain, or sponsor research on ESG issues; however 70% of managers do not carry out any post-event analysis to determine whether this information is taken into account by investment managers.

Business models that rely on analysts or investment managers to gather ESG information have inherent advantages, in that this information is directly available to the investment process. However, although 44% of managers assessed in this research favoured this model, none had made any effort to assess the degree to which ESG factors were successfully identified by analysts or investment managers. Conversely, the 48% of managers who employed specialist ESG engagement teams were often able to demonstrate effective engagement, but fewer could show that the knowledge gained from this engagement was systematically integrated by analysts or investment managers.

Fig. 8 Investment Process Integration Measured



Fig. 8 illustrates the degree to which managers leverage their engagement activities. The horizontal axis plots engagement scores versus best practice and the vertical axis plots integration scores relative to engagement scores. A manager demonstrating strong competencies in engagement and effectively integrating the knowledge gained from engagement and research into its investment management processes would occupy the upper right hand quadrant of the chart. Such a manager could be confident that they were maximising the benefits of the cost associated with their ESG engagement programs.

3.6 Despite industry progress on proxy voting, the survey reveals a mixed picture in execution.

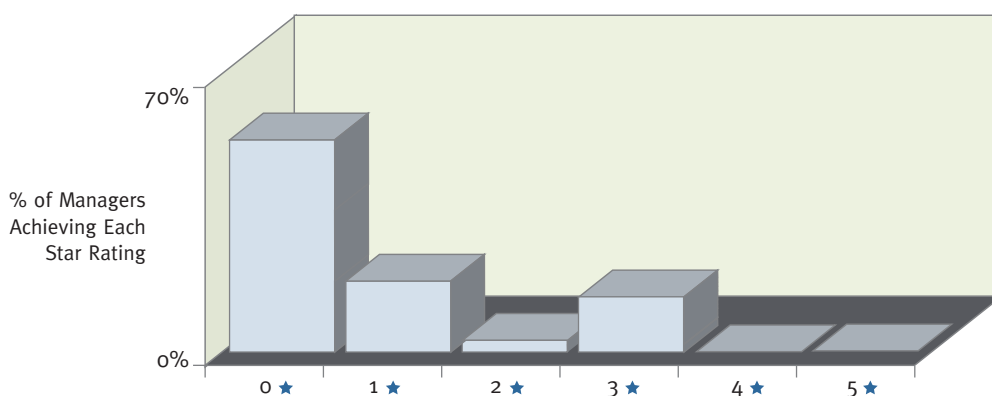
Although corporate governance has become a key industry issue, proxy voting practices are not as consistent across asset managers as trustees might expect, and within the overall picture there are significant variations. For some managers, responsibility for voting decisions rests with the appropriate sector analyst or investment manager; for others it is the responsibility of specialist teams. Some managers delegate authority completely with an individual analyst's decision subject to minimal checks or analysis. Some managers produce a significant amount of proxy research, while 28% produce none and 8% rely wholly on the recommendations of a service provider.

In the assessed group, 32% of managers operated stock lending programs and a quarter of these suggested that they did not disclose the returns gained from these activities to their clients.

3.7 Few managers demonstrate any formal training and human resource planning necessary to deliver responsible investment strategies.

In-house training of investment professionals, such as investment or portfolio managers or analysts, rarely focuses on the development of ESG-related skills. Some managers suggest these skills are embedded in their corporate culture and are promoted by the interchange between specialists and generalists. Nonetheless, this research found that less than a third of managers provided structured ESG training to investment or portfolio managers, and only one in ten conducted this training regularly and included new employees. Figure 9 shows the distribution of ratings for HR policies and training. Only 1 in 5 assessed managers achieved a rating of two stars or above.

Fig 9 Distribution of HR Policies and Training Ratings



This finding is of particular concern given the evolution of knowledge development in areas such as reputational risk, governance and particularly climate change. Few asset managers were able to describe any formal training of investment or portfolio managers on climate change impacts. Some managers clearly felt that such training would be entirely unnecessary.

4. Conclusions

4.1 The industry as a whole is a long way from best practice: although asset managers increasingly accept that ESG factors can influence investment returns and risk, most have yet to develop the corresponding competencies systematically across their organisations.

This research provides evidence that, for increasing numbers of mainstream asset managers, responsible investment is beginning to drive core elements of thematic, sector, and company research, premised on the belief that ESG factors can be material to financial performance and should therefore be integrated into investment analysis and decision-making. As a consequence, there is increasing demand for credible, reliable data and information that is accessible to those making investment decisions.

Few organisations are able to demonstrate high levels of competence in all aspects of responsible investment policies and practices. No assessed manager applied responsible investment competencies systematically across their whole organisation, and as a consequence none show outstanding competencies simultaneously across all relevant areas of their business (ESG research, engagement programs, HR and remuneration policies, training of investment professionals, and measurement of the integration of ESG knowledge into the investment process).

The next step is to develop a truly integrated approach to leverage the costs inherent to all responsible investment activities. Capacity building is still a challenge for asset managers, with no clear consensus as to the best approach or the most effective way of ensuring that investment managers are kept apprised of current and material ESG information and have the skills necessary for its interpretation.

4.2 Mainstream asset managers are increasingly coming to apply research skills previously more typical of SRI specialists.

Whilst 'SRI' is still seen as a specialist investment approach, some mainstream asset managers are beginning to adopt the techniques and approaches long used by SRI specialists in assessing companies' 'extra financial' profiles.

The knowledge associated with the development of first and second generation SRI products is now beginning to be applied to mainstream investment portfolios in a 'value' driven, as opposed to a 'values' driven way. Some managers are starting to develop trading strategies and products that exploit this knowledge, although this is still in the very early phases of implementation.

4.3 A lack of measurement of responsible investment activities and their costs means that many managers are not able to manage these effectively.

Excellence in responsible investment costs money. Asset managers are doing many good things but, because they do not have ways of recording or measuring them, that investment is not always being maximised. They often fail to appreciate and communicate to their clients inherent ESG strengths of their organisation. Benchmarking provides the opportunity to both develop clear competitive strategies and to audit the costs associated with all aspects of responsible investment. Responsible investment activities and their costs need to be subject to more rigorous assessment. Chief investment officers should demand more objective measures of both absolute and comparative responsible investment competencies and consider the strategic implications on both investment performance and client retention. Drucker's famous maxim "If you can't measure it, you can't manage it" should guide both asset managers and asset owners in this key area.

5. Implications for Asset Owners

5.1 Trustees should be clear about the responsible investment competencies they expect their managers to possess.

Asset management competencies and practices are both divergent and evolving, and often they are not apparent to trustees. Some managers have demonstrably stronger competencies than others; some are working hard to develop them.

Those responsible for the administration of pension funds should ensure they have a clear view from their trustees as to what responsible investment related characteristics they are seeking before engaging a manager. To enable this, a detailed evaluation of managers' current practices and future capacities is critical.

5.2 Asset owners can promote the development of managers' responsible investment practices.

ESG competencies are beginning to emerge within mainstream asset management organisations. However, stronger signals of demand from asset owners will catalyse this process for the majority of managers and incentivise further and more rapid capacity building within their organisations.

Asset owners should also encourage a more constructive dialogue with asset managers. Many managers would respond positively to client requests for a review of, and dialogue regarding, their responsible investment practices. From a fiduciary good practice standpoint, management selection decisions should incorporate a rigorous evaluation of environmental, social and governmental competencies, practices and capacities.

5.3 Asset owners with internal managers should review their own approach to responsible investment.

It is important that asset owners with in-house investment management capacity show leadership in employing best practice in responsible investment internally, as well as externally. Holding external managers to a commitment to deliver best practice in responsible investment, while not moving to adopt this internally, will send unhelpful and misleading signals.

Acknowledgements

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About RImetrics

RImetrics is an independent company founded by Will Oulton (former Deputy CEO, FTSE Group), Jonathan Horton and Sir Mervyn Pedelty (former CEO, The Co-operative Bank).

The company's technical and policy committees include individuals from organisations including AP3, AXA Investment Management, BT Pension Fund, Capital International, F&C, Hermes, PGGM, Railpen, Schroders, the TUC, USS, Joseph Rowntree Charitable Trust and the Wellcome Trust.

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Important Information

The asset management data in this analysis has been compiled from questionnaires completed with asset managers and from other information provided. RImetrics has analyzed and summarized this information in order to present what RImetrics believes to be a comparable assessment of the key responsible investment practices and policies of these organisations as a whole. We aim to update this non-financial responsible investment data as appropriate.

RImetrics strongly recommends that users of this data take independent financial advice from a qualified adviser before entering into any investment decision or relationship with the asset managers reviewed in this analysis. The information presented in this analysis should be seen only as providing information in relation to some of the many considerations that should be taken into account in that process. No prospective investor should take any action on the basis of this information alone. It is intended to assist an investor or manager in moving to sources of more specific and detailed information for further investigation, advice and analysis.

Whilst RImetrics has used all reasonable endeavours to ensure the accuracy of the information contained in the report, RImetrics does not accept any liability in respect of the investment decisions of investors nor any loss arising from such decisions.

If a prospective investor wishes to apply responsible investment criteria to their choice of investment this should not be, wholly or partly, to the exclusion of a full consideration of their investment needs and of all relevant financial and other non-financial factors and the full range of alternative investments in the same (and other) classes.

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