

# Responsible Investing: weighing the *impact*

*The trend is positive, but the jury is still out on how much influence activist investors are having on corporate behaviour.*

BY JAMES DAW

Proving you have never invested in the slave trade or a gun maker would be rather simple. More difficult is to prove you sidestepped investing in factories hazardous to workers' health. Hardest of all, though, is to prove you helped alter corporate behaviour to better the world.

That could change as more ethical fund managers make strides at influencing companies. The investment world is changing, with new rankings and corporate disclosures. Support for the United Nations-backed Principles for Responsible Investment (UN-PRI) initiative is rising, with some \$30 trillion in assets committed worldwide and nearly \$900 billion in Canada.

But proving who prompts change is difficult. Most executives and directors prefer to take the credit themselves, says one veteran of socially responsible investments. Sometimes, says another, the prime reason for assessing environmental risks is more to protect investors from financial losses than the world from degradation and inequity.

"It's hard to find quantitative analysis that will give you a hard and fast answer (about

investors prompting change)," says Tessa Hebb, a Carleton University professor who has already helped document the corporate intervention efforts of three fund managers and hopes to document more. "There are so many forces operating in the economy and with companies generally that it is extremely difficult to isolate the environmental, social and governance factors and the pressure of investors on those changes at the companies."

Jane Ambachtsheer of the consulting firm Mercer has been awarded a lifetime achievement award by the Social Investment Organization, which promotes socially responsible investing in Canada. Yet, when asked about the extent that such principles have changed corporate behaviour, she said: "I don't think there is any evidence or research to show that...particularly if you narrow it to the mutual fund field"

A pioneering manager of ethical and responsible mutual funds, the Ethical Funds arm of NEI Investments has had a few victories sponsoring shareholder resolutions – four from 11 attempts in 2009. What it does

not have is much voting power. Ethical Funds runs a Special Equity Fund with the best 10-year performance among its ethical peers. Yet it and the other funds hold only about \$1.4 billion in assets. Total assets reported to Corporate Knights by the socially responsible mutual funds it tracks is about \$5 billion.

"The reality is that there still are structural barriers to the flow of funds (into socially responsible mutual funds)," says Bob Mann, chief operating officer of Sustainalytics. Formerly Jantzi Research, it was chosen by Newsweek magazine to do its 2011 Green Rankings report, and was flooded with questions from 300 corporations hoping to rank highly.

Mann says there is anecdotal evidence that Canadian investors wanting to invest by their values often hit a wall. They "have been discouraged or turned away, or found their broker didn't have the information," Mann says. By contrast, he notes, assets spiked in Australia after the country began requiring brokers and mutual fund advisers to ask new clients if they are interested in responsible funds.

Even if the ethical and responsible investment funds had more in their arsenal than the art of persuasion, Mann doubts they would get full credit for prompting change. “Engagement (with corporate executives on social and environmental issues) has rapidly increased. Investors are more willing to go out there and use their ownership stakes to actively create change,” he says. Large pension funds hire companies like Hermes Equity Ownership Services and the engagement arm of F&C Investments in the United Kingdom to press companies for change. Despite all of their efforts, says Mann, “what companies don’t like to do is to look like they are caving (under pressure). They don’t want to lose face. So companies doing the engagement agree not to go public.”

Large pension funds can put principles into practice through properties and companies they own outright. Stephen Griggs, who became president of the Ontario Public Service Employees Union Pension Trust after three years as executive director of the Canadian Coalition for Good Governance, boasts that his plan managers have taken advantage of government incentives

## *Canadian investors wanting to invest by their values often hit a wall.*

to invest directly in solar, wind and hydro projects. They have also made energy-saving investments in buildings and experimented with ultra-white roofing materials.

On the social side, the pension fund has become a leading provider of low-cost, modular-style housing. Yet, even with assets of \$13.3 billion, Griggs says it would be “naïve to think we can change corporate behaviour.” Instead, the fund employs managers who track environmental, social and governance issues in order to avoid losses, as they managed to do with BP before its Gulf of Mexico oil spill and Sino-Forest before questions were raised about its forest holdings in China.

Daniel Simard has a different story to tell. The managing director of Bâtirente, which manages about \$840 million for multi-employer pension plans in Québec, claims credit for helping to persuade Talisman Energy to develop better community relations strategies in foreign countries.

Bâtirente also helped persuade the Metro supermarket chain to prefer sustainable fish stocks, says Simard. As a member of the advisory council of the UN-PRI initiative, Simard is optimistic the growing list of signatories will also influence corporate behaviour. “Is it going to deliver better risk management?” he asks rhetorically. “I am convinced it will, but it will take time.”

So far, the UN-PRI signatories in Canada hold substantial assets but not the majority of corporate stocks in the country. Caisse de dépôt et placement du Québec, one of the first signatories and the country’s largest pension fund, has only \$17.4 billion (or 8.7 per cent) of the \$199 billion of assets it manages invested in the \$2 trillion worth of stocks traded in Toronto. (The typical Canadian equity allocation for pension funds is 25 per cent, according to Mercer’s Canadian Pension Health Index.)

London Business School professor Ioannis Ioannou says his own research into corporations and performance “runs in the opposite direction” to the theory that investors change behaviour. “We see firms pursuing (corporate) sustainability and being

interested is social responsibility, and investors going to those firms. Their strategy is to go to firms that are better positioned to be sustainable in the future.” He questions why investment funds would even risk investing in order to change behaviour.

Yet Al Gore, the former U.S. vice-president and global warming activist, has greeted with enthusiasm a paper that Ioannou co-authored on the superior financial performance of sustainable corporations. They report much higher investment returns among the 90 corporations judged the most sustainable compared with the 90 least sustainable from a group of 775 U.S. corporations tracked by Asset4, a Swiss company purchased in 2009 by Canada’s own Thomson Reuters.

It’s a positive – if not conclusive – sign that responsible corporations perform better than their peers, and may explain why more investors are tuning into environmental, social and governance issues. But

researchers such as Carleton’s Hebb are convinced that those same investors can nudge corporations in the right direction, or at least keep them on a responsible course.

“Future research will build on our current findings,” concluded Hebb and colleagues in their 2010 paper. The key to successful engagement for investors, they argued, is to bring a strong business case and a reputation for “positive solution-oriented outcomes.”

## Big five bank unveils \$10M impact fund

It may be a small first step, but Royal Bank of Canada’s decision to launch a new \$10 million impact investing fund could spark a new era of social finance, if other Canadian banks follow.

The country’s largest financial institution said last month that its RBC Impact Fund will “help finance projects by organizations and entrepreneurs tackling social and environmental challenges.”

The fund will give priority to projects that promote environmental sustainability, good water resource management and employment opportunities for youth and new immigrants.

RBC president Gord Nixon said his hope is that the fund will “catalyze similar investments from others in the business community.

Will it make a difference? Ilse Treurnicht, chair of the Canadian Task Force on Social Finance, called it a “watershed moment” for impact finance in Canada, but some observers have a more cautious assessment.

“RBC may be playing a leadership role by being the first Big Five bank to set up a dedicated fund like this,” said Doug Morrow, Corporate Knights’ vice-president of research. “But these sorts of funds are often cosmetic.”

Time will tell.

# Are clean capitalism ETFs ready for prime time?

ROB CARRICK

Anything mutual funds can do, exchange-traded funds can do at least as well.

Oh, wait. There's one exception – ETFs just won't cut it for building a socially responsible investment portfolio.

It's not because the ETF options available to socially responsible investors are lacking. Actually, they're attractive from both a cost and performance point of view. The problem is the lack of a well-rounded menu of funds that can be used to build a properly diversified portfolio. Mutual funds offer this to socially responsible investors, but ETFs don't – at least not yet.

According to the Social Investment Organization, an association that promotes socially responsible investing, the amount of money invested in SRI mutual funds at the end of 2010 represented 5 per cent of Canada's retail mutual fund market. There's only one Canadian SRI exchange-traded fund, and it accounts for about 0.5 per cent of total ETF assets.

ETFs, in their classic form, are index-tracking funds that trade like a stock. They're much cheaper to own than mutual funds, and they provide a simple way for investors to buy into hundreds of Canadian, U.S. and international stock and bond indexes. Among them are the Jantzi Social Index, a benchmark for SRI investing in the Canadian market, and the MSCI KLD 400 Social Index, which performs the same function in the United States.

The Jantzi index has been used for the one socially responsible ETF listed on the Toronto Stock Exchange, the iShares Jantzi Social Index Fund (stock symbol: XEN). The management expense ratio (MER) for this ETF – that's the most commonly used

measure of how much it costs to own a fund of any type – is 0.53 per cent. That's a true bargain in comparison to the 2.34 per cent MER of the Ethical Growth Fund, one of the largest SRI mutual funds in the country. Fees are paid out of ETF and mutual fund returns, so lower is always better (note: returns are always shown on an after-fee basis).

The cost of owning the iShares Jantzi ETF also looks cheap compared with the Meritas Jantzi Social Index Fund, a mutual fund that tracks the same underlying index. The Meritas fund has an MER of 1.94 per cent – look no further if you're wondering why it made 8.4 per cent in average annual returns for the three years to Nov. 30, 2011, while the Jantzi ETF made 10.1 per cent.

The Jantzi Social Index draws its companies from among the largest in Canada that have passed through screens for environmental, social and governance factors. Excluded are companies involved in nuclear power, military weapons and tobacco. Returns for the ETF based on this index have been quite solid compared to non-SRI alternatives. Over the three years to early December, the Jantzi ETF outperformed the giant \$10.9-billion iShares S&P/TSX 60 Index Fund (XIU) 39.4 per cent to 37.8 per cent on a cumulative basis. And yet, the Jantzi ETF has attracted just \$19.3 million in assets, a tiny amount. "The assets under management for this ETF tell you the story," said Mark Yamada, a long-time user of ETFs as president of PUR Investing. "I think the pickup by investors has probably been under the expectations of the provider."

This helps explain why ETF providers haven't followed the lead of the mutual fund industry and made a broadly based move into SRI products. There are nine different SRI Canadian equity mutual funds for investors to choose from, plus various options for adding bonds, U.S. and global stocks as well as small-size Canadian companies. There are also many SRI funds to choose from in the balanced category, which has been a favourite of investors in recent years.

Mind you, it is possible for Canadians to invest in socially responsible ETFs built on U.S. companies. One option is the iShares MSCI KLD 400 Social Index Fund (DSI-NYSE), which focuses on best-in-class companies based on environmental, social and governance factors. The other is the iShares MSCI USA ESG Select Social Index Fund

(KLD-NYSE), which sticks to large-size companies and is less strict in terms of what sectors it will avoid (just tobacco, compared with tobacco, gambling, alcohol, firearms, nuclear power and military weapons for DSI).


Investors with a high tolerance for risk – losing money, in other words – might consider a pair of what might be described as honorary SRI ETFs. One is the PowerShares Cleantech Portfolio (PZD), which is based on an index designed to track leading clean technology companies. The other is the PowerShares WilderHill Clean Energy Portfolio (PBW), which invests in companies in the business of developing green and renewable energy sources.

The quickest way to gauge the popularity of an exchange-traded fund is to look at its daily trading volumes. From this point of view, only the PowerShares WilderHill Clean Energy Portfolio can be said to have gained a significant following among investors. The others, including the TSX-listed Jantzi ETF, generate what would be considered low volumes that on a typical day could be as low as a few thousand or even a few hundred shares.

Ironically, it's the PowerShares WilderHill Clean Energy Portfolio that has by far the worst performance of any socially responsible ETF. Over the five years to early December, it lost a staggering 70 per cent of its value on a cumulative basis. As for the largely overlooked KLD 400 and ESG Select Social ETFs, they have both consistently outperformed the S&P 500 index, which is the benchmark for the U.S. stock market.

PUR Investing's Yamada credits the mutual fund industry with doing an effective job of teaching consumers that the fund world offers many options for socially responsible investors. ETF providers have taken the approach of letting SRI investors come to them, which has not proven as effective.

Yamada thinks this could be a generational issue. He said baby boomers have the most money to invest, but they have shown a modest level of interest in socially responsible investing.

"Generations X and Y are a little different, and what is going to drive their investing ethic nobody really knows for sure. I suspect [SRI] issues may be more important to them." 

## R.I. Equity Funds

	1 YR	3 YR	TOR	ASSETS (M)	CKPS	CKSS	FINAL SCORE	SHIELDS
Meritas International Equity	-9.25377	1.35937	61%	20.7401	68	85	75%	
Acuity Social Values Canadian Equity	-12.30435	13.95397	27%	33.713	74	85	74%	
IA Clarington Inhance Growth SRI Port A	-3.63245	N/A	88%	23.80817	51	89	72%	
Ethical American Multi-Strategy	-2.47216	7.42173	38%	41.13176	57	86	68%	
IA Clarington Inhance Gbl Eqty SRI CI A	-7.48184	N/A	62%	6.80438	47	89	67%	
Meritas Jantzi Social Index	-10.48696	10.22338	92%	69.12278	44	85	67%	
Meritas US Equity	1.86918	4.4489	77%	9.29377	46	85	67%	
Ethical Global Dividend	-3.53183	5.25986	27%	16.29232	56	86	66%	
Meritas Monthly Dividend and Income	-5.29415	7.63088	77%	30.28064	42	85	65%	
Acuity Clean Environment Equity	-13.83227	5.39451	16%	35.271	52	85	63%	
IA Clarington Inhance Cdn Eq SRI CI A	-12.13127	N/A	79%	6.78289	33	89	63%	
Ethical Select Conservative Port	1.26541	6.47335	77%	93.72181	33	86	61%	
Ethical Special Equity	-2.89463	12.51926	33%	255.48784	43	86	61%	
Ethical International Equity	-15.383	1.29272	10%	33.82806	47	86	61%	
Acuity Social Values Global Equity	-5.8237	2.56434	66%	10.752	34	85	60%	
RBC Jantzi Canadian Equity Advisor	-8.50791	11.99496	47%	6.16028	68	52	59%	
Ethical Select Global Growth	-5.25495	N/A	0%	7.32051	45	86	59%	
Ethical Growth	-10.66711	6.49364	57%	259.1134	32	86	59%	
Ethical Select Canadian Growth	-4.51645	N/A	0%	18.24476	44	86	59%	
Ethical Canadian Dividend	-4.64231	8.78054	81%	257.65991	18	86	55%	
Ethical Global Equity	-9.90011	3.14205	31%	26.54327	28	86	54%	
PH&N Community Values Cdn Equity D	-9.13659	10.54886	58%	18.87955	54	52	54%	
TD Global Sustainability - A	-13.39757	-3.4641	95%	2.204	4	88	51%	
iShares Jantzi Social Index	-9.17811	12.00168	86%	19.45921	66	18	47%	
Scotia Global Climate Change Advisor CI	-13.31289	-0.57836	42%	0.41071	7	81	44%	
Desjardins Environment	-14.01929	9.68593	0%	179.65636	29	61	41%	
PH&N Community Values Global Eq D	-10.4752	3.39504	46%	5.65501	28	52	41%	
RBC Jantzi Global Equity Advisor	-5.2758	2.1179	0%	0.77595	31	52	37%	
PowerShares Global Clean Energy CI A	-41.34154	N/A	83%	1.18127	0	61	36%	
BMO Guardian Sustainable Opp CI Adv Sr	-7.45434	-0.15862	2%	0.055	19	58	35%	
PowerShares Global Water CI A	-21.77248	N/A	25%	1.22693	9	61	34%	
BMO Guardian Sust Climate CI Adv Ser	-19.42594	-1.4822	1%	0.264	16	58	33%	

	1 YR	3 YR	TOR	ASSETS (M)	CKPS	CKSS	FINAL SCORE	SHIELDS
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## R.I. Bond Funds

NEI Canadian Bond	7.83274	6.20488	38%	293.8092	0.431	86	62%	
PH&N Community Values Bond D	8.15399	7.80508	0%	21.5465	0.792	52	59%	
Meritas Canadian Bond	6.85623	5.47013	0%	45.0752	0.243	85	49%	

## R.I. Balanced Funds

IA Clarington Inhance Bal SRI Port A	-1.35167	N/A	93%	16.67284	0.467	89	70%	
Acuity Social Values Balanced	-5.87116	11.58317	32%	59.983	0.536	85	66%	
Ethical Select Canadian Balanced Port	-2.01292	N/A	0%	21.45331	0.402	86	57%	
Meritas Balanced Portfolio	-0.55989	5.68094	0%	23.60664	0.343	85	54%	
Ethical Select Global Balanced	-2.87651	N/A	0%	6.66472	0.284	86	52%	
Ethical Balanced	-4.65927	5.15866	47%	316.85043	0.179	86	51%	
PH&N Community Values Balanced D	-3.19607	7.525	80%	10.14053	0.426	52	51%	
RBC Jantzi Balanced Advisor	-1.7215	4.26471	12%	1.03238	0.329	52	39%	

### Legend

Shield Score (out of 5) is based on the following weighted scores:

**Portfolio Turnover Rate: 10%**

**Engagement: 20%**

**Integration: 19%**

**Systemic: 6%**

**Performance: 45%**

**N YR:** Compound return for n years

**CK SS:** Corporate Knights Social Score

**CK PS:** Corporate Knights Performance Score

**TOR:** Turnover Rate

**SHIELD:** Quintile Ranking

### Notice to Investors:

The 2012 Corporate Knights RI Fund Ranking is a resource designed to help investors make an educated judgement on which funds have done the best job of fusing the social, environmental, and financial values they bring to the table. Investors can best utilize our chart by making their own assessment based on each fund's characteristics.

### Methodology:

We used a blend of one-year and three-year relative performance (percentile ranking within the final category). For funds with less than three years of history we used the one-year performance. For a full breakdown of our methodology, please visit:

[corporateknights.com/RIranking](http://corporateknights.com/RIranking).

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