Asia Socially Responsible Investment Roundtable Summary Transcript

BSR
March 31, 2011

About BSR

A leader in corporate responsibility since 1992, BSR works with its global network of more than 250 member companies to develop sustainable business strategies and solutions through consulting, research, and cross-sector collaboration. With offices in Asia, Europe, and North America, BSR uses its expertise in the environment, human rights, economic development, and governance and account-ability to guide global companies toward creating a just and sustainable world. Visit www.bsr.org for more information.

On March 31, 2011, BSR, Sumitomo Trust & Banking, and AEGON-INDUSTRIAL Fund Management jointly held the "Asia Socially Responsible Investment (SRI) Roundtable" in Beijing. This was the first roundtable in China convening representatives from three major Asian counties (Japan, Korea, and China) to discuss SRI development and practices. More than 50 representatives, including asset owners, asset managers, ESG researchers, indices, individual investors, government agencies, academics, and NGOs were represented at the roundtable.

The following is the detailed summary transcript of the event.

Welcoming Remarks

MR. JEREMY PREPSCIUS (BSR)

Welcome to the Asia SRI Roundtable on behalf of BSR. Thank you for coming. We would like to start with some reflection and a moment of silence on behalf of what has happened in Japan recently. Today we will be reflecting on the rapidly changing role of business and its impact on society as well as the role of investors. As we look back over the past months and years we can see the impact of business on society and how it can create social and environmental value and have an impact on society. This dialogue has been going for over 200 years since the movement started when some churches decided not to invest in certain companies. This movement has continued to adapt and emerge into a movement that identifies the environmental, social, or governance aspects and impacts of a company on society.

This is clearly being seen in Asia where two of our partners are leaders in this field: Sumitomo Trust & Banking (STB) has had SRI funds for almost a decade, and AEGON-INDUSTRIAL Fund Management (AIFMC) launched the first SRI fund in China. Today's roundtable is meant to facilitate collaboration and share experiences and opinions on SRI and its value. We welcome a conversation based on respectful sharing, open dialogue, and fruitful questions and answers. We thank the sponsors for the event, Sumitomo Trust &Banking (STB) in particular, whose support has made this event possible.

Opening Remarks

MR. SEIJI KAWAZOE (STB)

I would like to thank BSR for arranging this event which will continue to grow and may become a mainstream event in the future. We thank you for your wishes in these difficult times in Japan, and our thoughts go out to those affected. STB is a trust bank and is an investment manager for both public and private pension funds. We began offering Japanese Equities SRI product to institutional clients and then to private clients and have created an investment platform. We have become a market leader and have expanded our product offerings, including a biodiversity fund and a China SRI fund. From tomorrow, after the merger with Chuo Mitusi Trust, we will be even bigger and will continue with this agenda.

"We can learn from what we have done over the last decade, but we know we need to build SRI that reflects our own systems, cultures, and way of thinking that are unique to this region where interest in SRI is growing…"

- *Sumitomo Trust & Banking*

We can learn from what we have done over the last decade, but we know we need to build SRI that reflects our own systems, cultures, and way of thinking that are unique to this region where interest in SRI is growing. However, we are still in the development stage of different products. We need to understand the similarities and differences with other regions, but we also need to embrace best practices. We recognize there is an opportunity to drive SRI and we cannot do this alone.

Today we have participants from China, Korea, and Japan and hope today we can discuss how markets can help build a better global society. BSR, who we work with on our global SRI product, has provided us with this wonderful opportunity, and we want to continue to expand our network and hope this conference can play a role in the growth of SRI in China and the region.

MR. HECTOR XU (AIFMC)

Good morning and welcome to this roundtable on behalf of AEGON and discuss together the development of socially responsible investment in China and the region. We are much honored to be a co-host of this roundtable and hope we can effectively promote the concept and practice of SRI so more people can participate. We want to guide resources so that they flow to enterprises which are more responsible. We see more investors paying attention to this area and believe it can improve the quality of enterprises. It is still a new concept in China but has gained more attention over the last three years with several funds launched and great attention paid to this by the Shanghai and Shenzhen stock exchanges.

When we talk about SRI in China, it is very important, and we hope to grow it in China. We do not doubt the potential for impact, and we hope that with more people being involved, we can make a difference and improve the world.

Session 1: Market Infrastructure and Preparedness

For this topic, there are four important areas that we need to consider:

1. Regulatory support and framing
2. Transparency is required for a market to operate, providing knowledge and information on ESG and financial disclosure
3. Market demand and awareness for SRI products and integration of ESG issues
4. Skilled practitioners, people who understand, operate, and influence the marketplace

We have a great SRI panel today with a fascinating combination of panelists, with both Chinese stock exchanges, one of the largest asset holders, and a respected academic. We hope to blend some of the insights and bring them together, and we welcome questions afterward.

MR. RUYIN HU (SHANGHAI STOCK EXCHANGE - SSE)

Today I will be speaking on what kind of corporate social responsibility (CSR) information disclosure SSE has been promoting. Since 2008, the CSRC and the MEP have required all companies to meet certain environmental protection preconditions before they can list, including information disclosure. After an IPO, there will continue to be requirements on information disclosure if there is further capital raising. SSE has done a lot to promote disclosures related to social responsibility. Since 2000, listed companies have had to abide by their social responsibilities and ensure appropriate corporate governance. We have issued guidelines on good corporate governance and we have worked with China Securities Regulatory Commission (CSRC) to launch the environmental code of conduct for listed companies. In company law it is also provided that all companies must comply with certain specific conditions on corporate governance. In May 2008, we issued a guideline on environmental information disclosure. If a company has been subjected to civil or criminal convictions, it must be disclosed, or if it listed as a serious polluter, it must also be disclosed. Serious polluters must pass environmental assessments before their IPO.

"In recent years we have seen some violations, and the regulatory authorities have stepped up their regulation in observing environmental protection. The media and investors are beginning to recognize the importance of environmental protection. We have been driving legislative improvements in civil liabilities, criminal law, and others such as corporate information disclosure..."

- ***Shanghai Stock Exchange***

In recent years, we have seen some serious violations, and the regulatory authorities have stepped up their regulation in observing environmental protection. The media and investors are beginning to recognize the importance of environmental protection. We have been driving legislative improvements in civil liabilities, criminal law, and others such as corporate information disclosure. For example, with Zijin mining last year, which experienced a serious pollution incident which was highly discussed in the government and led to the MEP fining the company and certain personnel facing sanctions and fines.

Last October, in Shandong, there was a chemical company that also leaked pollutants and the surrounding environment was seriously polluted. So SSE, once we thought there were problems with information disclosure, suspended the company and issued a warning. These listed companies must comply with certain information disclosure requirements. In December 2008, we required companies to issue CSR reports and to have a separate CSR report. There are 241 companies that are defined as *model companies,* and every year these companies will be reviewed and if there are violations, there will be warning and associated punishments, while others that meet the requirements can get on the list if they meet the conditions we have laid out. We notify the public and invite professional companies to evaluate these companies to check if they should be in our list of model companies or if they should be excluded. They will be subjected to a final evaluation, and based on this we will create the corporate governance index and the socially responsibility index. Secondly, there are companies listed elsewhere that have responsibilities to disclose information. Thirdly, there are commercial banks who should disclose certain information.

We are able to calculate companies' social contribution per share. Our disclosure requirements are based on the guidelines I mentioned and the MEP, who has a clear definition of who are heavy polluters. These companies have to meet the criteria in the guidelines. We appoint independent third parties to carry out independent EIAs. Because of a lack of expertise, our requirements on disclosure are not that specific, but we encourage companies to explore and through experience create better solutions.

We are working with the IFC and consultants to study the disclosure reports of the listed companies so that we can have better targeted, more practical, more suitable SRI guidelines and standards. The table shows that in 2008, 390 companies made disclosures. In 2009, 318 did. In 2010 there was further growth in voluntary disclosures. The number of companies inviting auditing from third parties is increasing. Among those who disclose their motivations are economic, and for SRI disclosure, until now, the quality of disclosure is quite poor and reports vary from two pages to 94 pages. They report good news, not bad news, and seldom report minor incidents or problems which should be improved.

Many of these companies have made explorations in CSR, for example Industrial Bank, the first Chinese bank to adopt the Equator Principles. We have developed a corporate governance index, there is an ETF based on social responsibility, and with an Italian consulting company we have established a sustainable development index. AIFMC launched a fund in 2008 and Huiking Fu has also issued such a social responsibility fund.

We need to give more guidelines so that disclosure is better—more quantified, more comparable, and of higher quality. We encourage more voluntary disclosure, more third party verification, and more integration of financial statements and SRI reports. We should strengthen the education of investors and strengthen their awareness. In return we will develop more tools and indexes.

MR. LIYANGJIN (SHENZHEN STOCK EXCHANG - SZSE)

At SZSE, when we have a meeting we always have less to say than our Shanghai colleagues as they always speak first and they have covered most things. I want to cover the background of the SZSE (rules and disclosures are based on this context). We are a multilevel stock market and have more than 480 companies listed on the main board and 556 SMEs on the SME board, and in 2009 we established a NASDAQ-like growth enterprise board with 290 companies. For listed companies we are different from Shanghai, focusing more on growth SMEs—the value is 4.2 billion RMB and growth enterprises and SMEs make up 7 percent and 23 percent, respectively. In 2009, there were 90 IPOs, and 321 in 2010, the largest number in the world. One third of the companies on the exchange have listed in the last two years. As they grow from private companies to public companies they need to have more social responsibilities.

We have more investors in our stock exchange with individual investors growing, as are our institutional investors (refer to the slide for statistics). We pay a lot of attention to the development of SMEs. When they are listed, they have to make more improvements and have to face monitoring and public exposure, so they may face several challenges. In 2001 we established a training center for entrepreneurs to learn about the capital markets and how to be a responsible player. We have provided more and more training since 2005, and in 2010, we trained ten thousand people, including through the internet. SMEs are willing to study the rules of the capital market and be a responsible company with a good reputation. They have the will but need to know how to do it – hence the training platform.

"We only have one fund which is in CCB Principal (JianXinETF) based on an SRI index, which means that we are still in our infancy. When we develop the index we take many things into consideration but we feel we need to pay close attention to the intent of the public, investors, companies, government, etc., when we create index products."

- ***Shenzhen Stock Exchange***

For SRI, we provide rules and guidelines on listed companies—the third worldwide to publish this guide based on Chinese labor and environmental law and governance rules with reference to foreign standards. It is a rough outline emphasizing the responsibilities of listed companies to stakeholders and society. They must abide by the law and take more responsibilities. This was published in 2006. In 2008 we required all SZ100 companies to disclose their social responsibilities and last year ensured they made this part of their annual financial reports. On the main Board, 187 companies last year offered such a report (38 percent) when previously it was only 35 percent, so it is growing.

The number of voluntary disclosures is also growing beyond those on the SZ100 who are required to disclose. Clearly SMEs do have the will to disclose their social responsibility. From 2009, 96 percent of disclosure is independent and compliance with SRI is high—32 percent.

Training—we provide training to Boards and independent directors as well as on SRI trainings. Our challenges are similar to the SSE, for example, third party certifications, quantifiable data, etc.

Regarding the SRI index, the number of those involved is increasing. China's SRI (TEDA Environmental) index was established in 2008 under the Shanghai Securities Index Company. Refer to the slide for a list of indexes established in China, including low-carbon index. The TEDA environmental index was the first and selected 40 companies when it was launched, and its growth has been stronger than the benchmark. For the Shenzhen SRI Index, the preliminary sample calculates net profits, taxes, payment for employees, interest for banks, and contributions to the society. The trend for this index is weaker than a comprehensive benchmark but is stronger than the SZ100. The CBN index excludes certain products (tobacco, military, etc.) and has performed fairly well. The Low-Carbon 50 focuses on companies that provide carbon reduction equipment or use low-carbon. It also has an evaluation system based on a sample and weighting. The market performance is similar to the SZ300.

As Professor Hu said, the SSE established an SRI index based on companies that disclose. This index is quantified but struggles with environmental and social contributions. My two questions for discussion are related to our criteria, which are quite simple and quantifiable: it is good that it is easy to calculate and reflects our market situation (for example, wages are important) but we are thinking how to combine this requirement with social responsibility reports. The company's own disclosure is one thing, but in other countries, third party factors are also taken into account along with industry-specific issues. In our case, so far we do not take these into account.

Secondly, we only have one fund which is CCB Principal (JianXinETF) based on an SRI index, which means that we are still in our infancy. When we develop the index we take many things into consideration but feel we need to pay close attention to the intent of the public, investors, companies, government, etc., when we create index products. Thematic and industrial indexes are important, for example, the environmental protection industry. Investors are very interested in these.

MR. HITOSHI TAKEZUME (JTUC)

RENGO has guidelines on responsible investment of workers' capital. RENGO was inaugurated with the unification of public and private sector trade unions in 2009 with 6.83 million members; 10 million enterprise union members also fall under us. Workers' capital includes workers' pension funds or employers' pension, and today we have distributed pages 19-23 of the guidelines to you. As of December 2010, we have adapted the guidelines and defined SRI (to incorporate ESG issues in to decision making processes and to exercise shareholder rights).

"We considered our substantial influence on companies and the society through workers' pension funds, one of the biggest institutional investors in many countries, including in Japan, and we must recognize our social and environmental responsibilities. We must promote responsible conduct through Responsible Investment (RI)."

- RENGO

Why did RENGO want to do this? We considered our substantial influence on companies and society through workers' pension funds, one of the biggest institutional investors in many countries, including in Japan, and we must recognize our social and environmental responsibilities. We must promote responsible conduct through Responsible Investment (RI). We would like to introduce the principles we have set-up.(Refer to the slide)

What are ESG factors? E is based on various UNFCC laws, S is based on ILO labor standards conventions, and G is based on UN conventions on corruption.

How do our members work on SRI? One example is negative screening to eliminate certain companies from portfolios based on their activities or breach of regulations. Positive screening is another way to include certain companies that place high value on SRI. Another option is to exercise shareholder rights.

In the future, though it may take a long time, we believe that all our affiliates will practice the RI of pension funds and other worker capital. We will also campaign for other public pension funds in Japan to engage in RI too.

MR. ZHIRU CUI (PKU)

I would like to talk about CSR in China and its impacts on SRI. Due to a lack of time I want to share some of our ideas about CSR in China, which has certainly been improving based on some indices, such as those from the stock exchanges and the increase in number of CSR reports. Improvements in CSR have grown rapidly in recent years, with relevant authorities paying attention and companies who have also begun to establish CSR directors even though they are new companies. We also want to encourage Chief Responsibility Officers, but this is very preliminary.

As the other experts said, the scores have also gone up, with MNCs doing better in China, and many are already doing CSR even if they could do more. Secondly, we have very clear issues, for example with the Shanghui incident. Many companies in the leading industries lack strategic management awareness, for example what happened after the dairy problem in 2008. I had spoken with the chairman of Yili about establishing a CSR function, but they were too focused on the Olympics; then the problem came up and they became very involved in crisis management. Their profits would have been 1.7 billion RMB, but instead they lost 2 billion RMB and faced a big crisis throughout the industry. They had not listened to our advice and thought they were doing better than Mengniu; they thought that during the crisis the best thing to do would be to lie low instead of actually attacking the problem head-on. This is worrying as it has to do with food and health.

There is also a lack of administrative intervention and enforcement in terms of disclosure. We have heard about Zijin's problems and the Dalian oil spill, and despite the CSRC and MEP's requirements, we have been discouraged from working with CCTV on highlighting Zijin's problems. The government may intervene in some cases and thus there is not that much focus on CSR or on honest disclosure. We are on a unique road in China. The common feature here is that as we talk to entrepreneurs here they want to use traditional Chinese culture. This is rich and the rules are implementable, for example how to become credit-worthy, honor your commitment, etc. Some SMEs are doing well regarding employee responsibilities. For instance, Hai Di Lau gives bonuses to employees and parents and provides good benefits and decision-making powers to employees.

Though things may not be perfect, we have much in common between companies and investors. However, we also need more legislation as well as just indexes.

SESSION SUMMARY (BSR)

The evolution of marketplaces is following their own cultural characteristics and they all face their own challenges. One challenge is related to information transparency, another is related to the regulatory environment a third is about market demand, and a fourth is related to engagement, impact, and future changes.

QUESTIONS AND COMMENTS

IFC (Zhang Rong): As Jeremy has said, there are these four challenges. Is there a fifth about the role of the different players in the market? Do we have common rules to assess managers? Do investors have rules about what to do? In the banking sector there have been great changes, led by the Equator Principles (EP), to help provide banks with common rules to help them evaluate social and environmental risk. They have used the IFC's Environmental &Social Standards which have common management principles, but they can make their own based on this. Eighty-five percent of project finance is based on the EPs now. The Chinese government has its own Green Credit Principles. In terms of private equity, is there a need for common rules and principles that institutions can base their own on? In China, the green credit guidelines are based on international principles and combine voluntary approaches and mandatory approaches. Can institutional investors also have such rules?

> SSE: In terms of corporate governance, we are moving forward step-by-step, but the asset management community, analysts, and society do not have symmetrical information. Different people have different considerations. With the milk and Shanghui (meat additives) scandals, are companies willing to treat customers well or are they too focused on profit? For example, with these problems, they illegally added things into the products. Also, there are problems with quality inspections and ensuring management systems are well controlled. To make CSR and SRI universal, we need to improve the culture of companies to be “fair” and guarantee investors’ and consumers’ interests. Foreign countries are doing better in this way with ethical investment. In China we need more investors like AEGON-INDUSTRIAL that prioritize their social responsibilities. Corporate Governance is complicated, so public investors lack strong awareness. GDP is worshipped too much at the expense of the environment and fair play.
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> SZSE: We know that almost all listed companies’ CEOs and chairmen want to look good, and some want to be good, but some do not know how to be good. CSR is a vague concept and how a company combines it with their strategy is not easy. For example, with donations: is it just donated, or is it strategic and related to the company that will help the company in the long-run? But many other companies do not know this. Operational rules mean we should integrate these concepts into daily conversations and work and into rules. Who should regulate it—the government or the regulatory commission? I think we need more regulations, such as on public funds, which focus so much on rankings.
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> PKU: In practice your questions are very good. We have recommended to industries that each industry should focus on their own important issues. Different companies face different issues and we need different approaches to each. For the textile industry, for example, it is most sensitive to labor issues and the environment. A standard for all industries will not work or be applicable. The United States or European or Islamic investors all use different systems, voluntary or otherwise. If you go by industry the standards must be varied.
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> RENGO: We hope our affiliates will make their own criteria in the future based on our initial work.
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> Xin Zhuo, BSR: In the banking industry we have the global guideline for project finance, and for equity investments, UN PRI could be a guideline for reference, though investors all adopt their own standards based on different conditions. They choose different companies in their funds. These rules are much broader allowing this variation. Regarding the Shanghui problem—should SRI invest in them? Maybe SRI want to invest and engage and try to change the company’s management and how they deal with supply chain, and thus alter the landscape. For equity investors, this is different from banks. Do we need such rules? This is a great question, especially for Asia and China.

Jeremy Prepscius, BSR: How do you see the dialogue between trade union members, investors, companies? What does it look like?

> RENGO: Each company has a trade union; if a company with our capital is seen to do something unethical, we have to stop this conduct as our responsibility as the owner.

Jeremy Prepscius, BSR: You are doing training, so what does good active owner engagement look like, what does it look like in China, and what roles do the stock exchanges have in this?

> SZSE: Exchanges connect investors, buyers, listed companies, and intermediaries. We are also regulated by the China Securities Regulatory Commission (CSRC), so we feel that when we want to create dialogue, we are in a good position. We are a platform, but we are still exploring how to use it. Our training is good and we bring in listed companies and intermediaries and share best practices with newly listed companies. We also have a platform to allow listed companies to interact with investors, which is required by some of our different boards.

> SSE: We have been working on a few aspects including a CSR forum, where we bring in listed companies who have done well. We have done nine sessions so far. Every year we will give awards to good boards of directors or good companies. Last year we gave awards to various companies and invited some international bodies to participate and academics, institutional investors, etc. We wanted to promote the concept and awareness of SRI. Also we strive to improve our rules and regulations and standards for disclosure so that the listed companies will improve in terms of transparency of information, and we also give them a tool to help them do this. We do not want them to think CSR is just cash donations. Social Responsibility should be very much aligned with stakeholders. We keep improving our disclosure requirements so companies would try to improve their strategies. We try to provide more indices as a platform and tools for investors and to reduce the costs for fund companies who are not as large as other funds internationally that have a large pool of expert researchers. We hope to reduce the cost of research, make it more convenient and simple, and promote CSR. We work with the Ministry of Environmental Protection (MEP) and CSRC on some regulations—we also work with the State-owned Asset Supervision and Administration Commission (SASAC).

Session 2: Market Products and Practices: Eco funds, Green funds, Biodiversity funds, and SRI funds

Despite the recent economic downturn, SRI is expanding. An increasing number of financial institutions are beginning to explore and develop SRI products and services in Asia.

In this session, some pioneering financial institutions will share with us their experiences and lessons learned. What is their approach to SRI? How do they integrate ESG criteria into their investment decision-making process, and what is their business case for doing so? How have the returns for SRI compared to the returns for traditional investments, and how are the returns measured?

MR. SEIJI KAWAZOE (STB)

I want to talk about the evolution of SRI and my thoughts on the future of SRI in Asia. As I mentioned earlier, STB is one of the largest asset managers in Japan —after our merger, we will have over USD 500 billion AUM. We bear a large responsibility for the sector and for our clients' assets in particular. We are very active in international ESG-related programs. We are an active member of UNEP-FI, were the first Japanese signatory of UN PRI, and work with BSR and others.

In Japan, the SRI market has grown steadily. The AUM in the Japanese mutual fund market has not increased much recently due to market conditions, but the number of funds is still growing as there is greater awareness among retail clients. Banks' retail products are expanding. We launched our first Japanese SRI fund in 2003, and in China we have launched a fund as a QFII investor recently too. The group also has green bond funds for retail clients.

The history of SRI is such that it has evolved from a process point of view. In a simplistic view, it started as exclusion-based in charitable organizations (negative screening). After the 1990s, positive screening (or "best in class") began to grow with the idea that investing in good companies will have a positive impact on society. Mainstreaming of ESG is now the common methodology.

SRI has various definitions (refer to the slide) but there are some variations that are important: SRI vs RI. In RI, ESG is one of the extra-financial factors that should be considered. SRI is often linked to a values-based approach. Thirdly, we have Impact Investing, where the evaluation process is more focused on outcomes. These definitions can be categorized into "Core SRI" and "Broad SRI."The latter focuses more on general ESG integration as a whole, whereas the former is looking for specific opportunities from ESG. Broad SRI is dominant in France, Italy, the U.K., etc., and is driven by a high standard in regulatory frameworks and high consciousness from institutional investors. Core SRI is dominant in Switzerland, Germany, and Norway, and is more driven by retail investors. What is happening with the mainstreaming of SRI is a move from Core SRI towards Broad SRI as regulatory frameworks or consciousness evolves.

The strong driver behind RI has been global initiatives, particularly from the UN, a common denominator. The Millennium Declaration in 2000 was the start of gaining agreement on development goals. As the Global Compact focused more on reporting, then the PRI focused on investors. In investment policy itself, universal ownership is an important concept which recognizes externalities can have costs and thus aims to reduce externalities' negative impacts. PRI and Trucost have done some analysis on these impacts. The impacts are largest in CO_2, water, and pollution. By 2050, total environmental externalities' costs may be up to 70 percent of GDP. A large amount of this will be in Asia, so we need to take these externalities into account in our investment management.

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- ***Sumitomo Trust & Banking***

As a long-term investor we need to take responsibility for our investing. We have seen various crises over the last few years that have led to the destruction of companies and can cause environmental or social impacts on society.

(See the slide for examples of the ESG evaluation and criteria that STB uses for its surveys that it provides companies, and then uses positive screening to analyze and rank companies). We then take these issues into account in our stock selection methods and try to integrate the fundamentals (economic returns) as well as extra-financial factors into our analysis of companies. We take many different ESG issues into account. We have to be a whistle blower to some extent and pay attention to what companies are doing. As an ESG analyst, you have to take a different approach to other analysts.

The implications for SRI in Asia and its trends are as follows: with high exposure and awareness, we see growth in thematic products in particular. We see growing needs in monitoring companies and engaging in rules and guidelines. We also feel that investors who lead in this field will be more successful and will benefit from these trends.

Xin Zhuo, BSR: Given these definitions and STB's process we now have a better understanding of SRI. The issue of externalities is important. Companies are using resources and gaining the positive benefits but not paying for them—with others suffering the negative consequences. We need to take these negative externalities into account when we view the overall costs/valuation of these companies. This is important to all asset owners.

MR. WONIL LEE (ALLIANZ GLOBAL INVESTORS)

"From my perspective, SRI is linked to the fiduciary duty that a fund manager has. We need to make profit for our clients and protect our clients' money. We know that the equity market is very volatile. This concept of fiduciary duty is very important and has changed as the market has changed. The behavior of selling is not compliant with this duty. If you sell a company because it gets into trouble, you have to pay a brokerage fee—while you are selling the cost goes down, and then you need to do research on what else to buy; then there is the opportunity cost of investing in another company. This is not in the best interests of clients, so proxy voting has become more and more important."

- *Allianz Korea*

The gentleman with a crystal ball is not me. But as a fund manager we manage other people's money. I have been thinking of SRI for about 20 years. There are some aspects of SRI which I have to say I do not agree with the previous speaker about. I was wondering why our SRI fund has not outperformed the benchmark over time. Each capital markets' stage is different. There are 1,800 listed companies in Korea. Ninety-two percent are still managed by the owner or their sons/grandsons. The biggest problem in Korea may well be the corporate governance issue. In Japan, most companies are owned by labor unions and financial institutions. We have seen some funds fail, for example, and other funds attacking Japanese companies. The process for improving corporate governance in Japan has thus already started. It may still be a long process, though.

Korea is very different, though; we are smaller, with different ownership structures. I decided seven years ago to focus on corporate governance so that SRI would become credible in the market. If we invest in a company, it should behave. The Korean capital market is 60 years old, about the same as Japan, but China's is only 25 years old. The average age of the managers and owners in Korea is very old and they are going to die and the issue of succession is a very big one. There is a50 percent tax in Korea if the father sells his stake to his son. On average the owner's stake holding is 35 percent, but then if he sells to his son, his son will only get 17.5 percent. The Korean economy is number 12 in the world but with limited resources. All the listed companies are concerned about what will be the next area for growth. The fastest growing listed companies are supposed to grow twice as fast as the GDP (4 percent), but what companies will be able to do this or how? Maybe M&A is the solution.

In the US, the growth rate of the GDP was 3 percent but the growth rate of listed companies was much higher. Sixty percent of the reason for this growth was M&A (nationally and internationally) to increase their competitiveness. In Korea this will start to happen, too, as it increases the corporate competitiveness of Korean companies, too. This will help Korea.

I started a Corporate Governance (CG) fund in 2004; it had USD 25 million at the beginning and I was investing in companies with a market cap of less than USD 3 million. In China bamboo grows very slowly to start with then it grows very fast. SRI is the same. We have to wait until the market changes; we have to educate different management, investors, etc. Finally, after the Lehman Crisis, our fund began to grow (more than 10 times). Also, I have a retail fund which is one of the top 10 largest public funds in Korea with USD 1 billion at the moment. Fortunately, though we cannot control our performance, we were quite lucky that we did very well. We invest in companies who are top 5 percent in CG. My CG fund is very different from our competition that looks at social, environmental, and everything, but I only look at CG because of the stage of markets in Korea. I think CG is the most important thing that will drive corporate competitiveness and growth. Because of the issue of owners' control, even though many other shareholders may lose money, the owner may still decide to do something that is not successful. But Korea is not a society where one can be hostile.

From my perspective, SRI is linked to the fiduciary duty that a fund manager has. We need to make profit for our clients and protect our clients' money. We know that the equity market is very volatile. This concept of fiduciary duty is very important and has changed as the market has changed. The behavior of selling is not compliant with this duty. If you sell a company because it gets into trouble, you have to pay a brokerage fee—while you are selling the cost goes down, and then you need to do research on what else to buy; then there is the opportunity cost of investing in another company. This is not in the best interests of clients, so proxy voting has become more and more important.

STB: We have voted 18 percent against company proposals.

In the United States, proxy voting has become a bigger issue after the Enron and WorldCom crises, so SEE has moved on to ESG (a change from ethics to governance). Leaders of companies can dramatically influence the company's performance. The U.K. Pension Minister's SRI Pension Act in 2000, UNPRI in 2009… all point to more active proxy voting. SRI in Korea is less than USD 2 billion. Allianz Global Investors accounts for more than 65 percent of SRI in the retail space at the moment. But even so, SRI is not that popular because clients do not understand the system. Only our fund is popular as it has done well.

I invest in four categories of companies:

1. Asset over-weighters,
2. Chronic Bunglers (management make bad decisions but do not have the expertise and invest shareholders' expertise carelessly)
3. Turn-arounders (invest in these sectors)
4. Value discounters (companies where owners do not want their shares to go up so that they pay more tax to their sons)

In the case of Hyundai, the chairman was voted down by pension funds, as he violated the law. The real success of the CG fund is in its engagement strategy. Engaging with the management is the key to winning. It is not a crusading thing; we need to make returns for our clients and we know that, so we have to have a practical engagement strategy and have to continuously educate society, management, etc. I give public lectures more than 50 times a year. My team has negotiators, CFAs, and more. We need this team with expertise in order to create the right engagement strategy for each company. Each company will require a different strategy on a case-by-case basis and depending on the family's background, ownership structure, etc. I will not buy Hyundai as their political power is too big.

You have to know Korean culture and history to do a proper engagement strategy. That is why there was the case with the U.K.'s Children Fund a few years ago which led to them losing billions. I want to become a credible threat so that owners cannot exploit shareholders' money for their own sake. See the slide for statistics of investments. Allianz aims to become a top three shareholder, averaging around 7 percent ownership of companies. Even so, some people do not listen, and thus, even if I know I will fail, I have felt the need to make shareholder proposals six times so that they know I, as an investor, am a credible threat and should be listened to. Of course, all six proposals failed, but going forward, hostile aggressive CG activism may begin to work in Korea—not now, but maybe in the future. At the moment it is a collaborative, relational approach. Once the market evolves, it might be possible.

> Xin Zhuo, BSR: Bruce Lee told us that SRI is different across markets. However, the common theme is that SRI is for long-term investors and focuses, in the long-term, on contributing to long-term economic sustainability.

MR. HECTOR XU (AIFMC)

Since our establishment in 2003, we have had a culture that wants to have CSR in its mission. Our understanding was very narrow originally as we wanted to plant trees. Then we realized SRI would be something we could do as a professional investor, so we established this SRI fund. We were not sure if it would be successful at the beginning. We rely on ESG as the investment parameter. It was very good and our assets have increased from 700 million RMB to several billion. It is ranked fourth out of all equity funds. Our ROI has exceeded the benchmark SZ and SE 300 indexes by 80 percent. Our foreign counterparts think we have done very well and they are very excited as there are few other such good SRI performers elsewhere. We know we need to do well economically so that the public will be more interested in SRI.

Our greatest concern is that there is that the supply chain has not formed yet. The industry involves regulators, NGOs, media, the public, etc., all of whom monitor companies' performances. There are also a lot of certification bodies. There are now 3 SRI funds, an ETF, and some hedge funds and other products. We are happy to see that many companies are more willing to disclose information voluntarily. In 2007, there were less than 30 reports, but now there are more than 500 reports, which are slowly improving in quality and becoming more standardized and increasingly aligning themselves with international standards.

"We saw the dairy product problems, and since then we have seen the Shanghui incident, so companies are clearly not paying enough attention to their supply chain. Alibaba has also discovered some suppliers that are allegedly fraudulent and is thus sanctioning them. We have seen that the consumers are becoming more important, for example, increasing recycling of batteries."

- ***AEGON-INDUSTRIAL Fund Management***

In 2008 we saw the dairy product problems, and since then we have seen the Shanghui incident, so companies are clearly not paying enough attention to their supply chain. Alibaba has also discovered some suppliers that are allegedly fraudulent and is thus sanctioning them. We have seen that consumers are becoming more important, e.g. increasing recycling of batteries.

The media is also working with us—for example, Southern Weekly's CSR lectures. Other magazines have launched different reports and forums. CDP has promoted carbon disclosure from companies and public awareness has been improving. In recent incidents there has been more awareness among the media and the public. The government drives many things in the market, such as the disclosure guidelines required by the exchanges and the CSRC (more than 360 companies are required by CSRC to disclose CSR reports). There is still a lot to do though with very few third party organizations, such as research organizations, though RUC and PKU now have some social and environmental research institutes. There are some other initiatives, for example, by DNV, ISO 26000, and CDP. We do feel that practices are improving.

We should explore further how we do shareholder advocacy, though, and how we put plans into actions. We are using more positive screening. We do scoring of investment targets. Since the Shanghui incident, we are doing more shareholder advocacy and I think this will expand in the future. That incident began on March 15 with the news of additives being added to the meat. After the news was disclosed, the price fell, the company was suspended on the market, and various reports were issued in the media. This is important in the development of SRI in China. We always get asked if we would have not invested in Shanghui because of our process. But for us, our decisions are based on what information we have, and it is hard for us to know everything or know it all in advance. We also get asked if we should be selling Shanghui's shares. We think it would be better not to sell and lose money. Instead we need to try to help the company improve and to make a return for our investors. We need to influence the management so they can change and then the shareholders can gain value again, and maybe the company can be a leader in the industry and influence others, too.

We have communicated with many companies and experts like Mr. Guo who said that for SRI funds, dealing with companies is an art. They should use the opportunity to help the company in question to improve and increase shareholders' value. We need to do good and be good. This is where we are going. As the other speakers said, China's SRI history is very short compared to Japan and Korea so such opportunities for exchange and dialogue is important. We translated Amy Domini's book and invited her here to share her experiences with us, as well as Wayne Silby from Calvert. Such experience sharing is very important. We have had dialogues with many NGOs that can help us. This includes local NGOs, too. We feel that green investment is becoming a general trend in China. This fits with the government's strategy and is thus an important and large market for the future.

We want to encourage society to support more green industry and thus in one to two months we might be launching a green fund.

Xin Zhuo: AEGON has done a lot of work, is the first mover in this arena, and has a lot to share.

Zhiru Cui: Are you holding Shanghui's stocks? How can you know their risks before a problem happens or what is the long-term solution to avoiding risks. When you select so many stocks surely you cannot guarantee that they might not collapse?

> AEGON: Our analysts do mark companies by ESG and this should filter out many unsuitable companies. For Shanghui we saw a governance problem last year, when the company wanted to sell shares to the management at a lower price without consultation with its shareholders. We and other funds pressured the company on this. We need to consider if an incident is intentional or not and then consider if we can change the behavior of the company and management or not. In some cases we think we might feel we can help companies solve problems and thus hold the shares for a long time. In other instances, companies may be bad and we feel we can do very little with such few shares. We can only "vote with our feet". We may also work with other institutional investors to change the company too and then make more money.

IFC: All you three are pioneers, and at IFC we are similarly a pioneer, with investments in loans, equity, etc. I would like to know as practitioners how can you work together to build the sector? Also, who else needs to be involved to transform the market?

> Allianz: I tried to sell my CG fund to IFC, but IFC said they could not buy as Korea was a developed market! There is a demand among global investors so that if we can develop regional CG funds then maybe this will address the issue of having small markets. Global investors want to have global and diversified portfolios. So I want to launch something like this, but it would be difficult as there are strong cultural differences which need to be understood to engage with companies. Also, each market is at a

different stage of development with proxy voting in particular. It will be difficult but is still possible.

STB: we have to encourage others, especially asset owners, and educate them about the responsibility of their money. As an investment manager we need to bear that responsibility.

AEGON: we have a shorter history of capital markets in China and we try to be innovative and go step-by-step. Also the Chinese market is not that open and is quite closed, so it is difficult for foreign SRI funds to invest in China. It is hard for us to go out and invest elsewhere, though we should do well domestically first before we consider going overseas. We are amazed that few foreign investors have used QFII to launch SRI funds.

SSE: I am an economist and I believe that for improvements in SRI, we need better platforms, such as chambers of commerce. A good market does not repeat mistakes. The Shanghui problem is a supply chain problem. Regarding the due diligence by investors on different industries, it might be possible, but with limited capacity, this is not easy. We may need a platform for more collaboration and sharing and to include ratings agencies and many research agencies to reach consensus and promote know-how. Some foreign fund companies have a lot of researchers and will do a lot of studies worldwide. Can you prioritize your investigations and let others join as well? I think everyone is not down to earth and securities companies and analysts are not interested in good CG. Stock exchanges should have a positive influence and not create a race to the bottom.

AEGON: we know we need to work with others (securities companies, investment companies, and so forth). We do need such a platform. Each year we organize more than 10 such SRI forums and invite more media, and if we talk more there will be less opposition. Originally we rely only on our research teams and require deep scrutiny of the top 10 stocks and exclude them if we see problems.

MSCI: ESG specialists are also very important in the industry chain. Such research analysts are more systematic in evaluating a company's risks and management and quality. There are many KPIs that could be used to anticipate how well they manage product safety, how they treat customers, and past performance, etc. Though we think SRI funds are not that specialized, maybe there needs to be more outsourcing to specialist researchers.

Closing Remarks

MR. JEREMY PREPSCIUS (BSR)
Thank you to the panelists for an interesting and exciting and insightful discussion. Let's think briefly about what we have talked about. We have discussed the whole SRI universe: different asset owners, academics and institutions, and some insights from other players in the marketplace.

What do you take away?

1. Local content and local context matters: Japan, Korea, and the United States are all different economies at different stages of their development cycle. We are talking about the intersection of money and profit and values and ideals and this is different and talked about differently in each country.
2. The importance of people: to have the humility to understand the marketplace and the courage to try new ideas and take the risky next step.

3. The focus on impact: health and safety, clean water, and so on—how do we work together to create change? How we do this?

I hope you have learned something today and we appreciate the comments and the dialogue. We hope you all continue this with each other.