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Gaining ground

Integrating environmental, social and governance (ESG) factors into investment processes in emerging markets



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IFC, a member of the World Bank Group, creates opportunity for people to escape poverty and improve their lives. We foster sustainable economic growth in developing countries by supporting private sector development, mobilizing private capital, and providing advisory and risk mitigation services to businesses and governments. Our new investments totalled \$16.2 billion in fiscal 2008, a 34 per cent increase over the previous year.

The Environmental and Social Sustainability Business Line of IFC works for the large-scale adoption of business models that are profitable, good for the environment and promote social development. Its projects address the market barriers to a sustainable private sector by demonstrating practices that can generate green profits across an entire sector.

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Contents

Foreword	1	2. Global survey on emerging market managers	13
Executive summary.....	2	2.1. Growth in Assets	14
Global survey.....	3	2.2. ESG Practices at a glance	14
Country level ESG research of emerging market investment managers	3	2.3. Survey results	15
SI-labelled EME strategy research.....	4	2.4. Development of ESG integrated EME products globally	18
Key themes.....	4	2.4.1. Key findings	18
Key research findings: ESG practices of emerging market investment managers	5	2.4.2. Data analysis background	18
Recommendations	6	2.5. Product split.....	19
1. Introduction	7	2.6. Significant products	20
1.1. Key concepts.....	8	3. Sustainable investment practices in China.....	21
1.2. Methodology	9	3.1. Key findings	22
1.2.1. Overview of the global survey.....	9	3.1.1. Overview of the investment industry in China	22
1.2.2. Research meetings in China, India, South Korea and Brazil.....	11	3.2. ESG integration capabilities of investment managers in China	24
1.2.3. Research into best practice SI-labelled strategies	12	3.2.1. Highest ESG rated managers in China	25
1.2.4. Industry research	12	4. Sustainable investment practices in India	27
1.2.5. Other relevant standards and sources.....	12	4.1. Key findings	28
1.3. Structure of the report	12	4.1.1. Overview of sustainable investment in India	28
		4.2. ESG Integration capabilities of investment managers in India.....	29
		4.2.1. Highest ESG rated managers in India	30

Contents

continued

5. Sustainable investment practices in South Korea.....	32
5.1. Key findings	33
5.1.1. Overview of sustainable investment in South Korea.....	33
5.2. ESG integration capabilities of investment managers in South Korea	36
5.2.1. Highest ESG rated managers in South Korea.....	36
6. Sustainable investment practices in Brazil	39
6.1. Key findings	40
6.1.1. Overview of sustainable investment in Brazil	40
6.2. ESG integration capabilities of investment managers in Brazil.....	42
6.2.1. Highest ESG rated managers in Brazil	42
7. Development of SI-labelled investment.....	45
7.1. Global overview	46
7.1.1. Key findings	46
7.1.2. Overview of SI-labelled funds in emerging markets	46
7.2. Research on leading SI-labelled funds	47
7.2.1. Key findings	47
7.2.2. Research on SI-labelled emerging market strategies.....	48
7.2.3. Highest ESG rated SI-labelled emerging market managers	48
8. Conclusion and recommendations.....	49
8.1. SI is a growth story in emerging markets.....	50
8.2. Governance is a well-understood concept in major emerging markets....	50
8.3. The environment and climate change—a trend	51
8.4. Social issues are addressed better by local emerging market managers.....	51
8.5. Emerging market ESG research is lacking	51
8.6. Global standards are beginning to influence emerging markets.....	52
8.7. Recommendations	54
Selected bibliography.....	55
Appendix 1—Acronyms and abbreviations ...	60
Appendix 2—Investment data analysis	61
Appendix 3—Managers interviewed.....	62

Foreword

Since 2002, IFC, the private arm of the World Bank Group, has supported sustainable investment initiatives in the financial industry. IFC sponsors publications, tools, training and dialogue to raise awareness and advance the investment materiality of environmental, social and governance (ESG) issues, with the goal of mobilizing substantial and sustainable capital flows into emerging markets to create stronger and more resilient economies and reduce poverty.

The recent financial crisis reveals the critical value of global economic sustainability and underscores the importance of transparency and accountability in all markets. While asset managers in developed markets are often credited with being a step ahead in factoring ESG issues into investment decisions, this latest research from Mercer and sponsored by IFC reveals that emerging market asset managers are beginning to take ESG issues seriously. In fact, this latest research suggests that sustainable investment in emerging markets has grown to over US\$300 billion in assets under management.

To continue this momentum, it's critical to engage asset owners and managers to ensure their awareness not only of ESG-related risk exposures but also growing investment opportunities in this area. To that end, IFC and Mercer produced the first-ever rating on ESG practices of fund managers in China, India, South Korea and Brazil and identified best-practice ESG examples to pre-empt potential risks and enhance returns.

IFC is convinced that the financial industry can and should play a major role in addressing environmental and social sustainability challenges and mitigating the effects of climate change by encouraging responsible investment.

We strongly believe that better integration of ESG issues into investment markets is essential for continued progress, and that asset owners and managers should strongly consider implementing the recommendations set forth at the end of this report.

Gaining Ground: Integrating environmental, social and governance (ESG) factors into investment processes was sponsored by IFC in partnership with the Netherlands, Norway, Luxembourg, Italy and New Zealand and launched 31 March 2009.



Greg Radford

IFC Environment and Social Development Director

A hand is shown from the top, gently holding a small green plant seedling with several leaves. The background is a soft, light-colored gradient. The overall image conveys a sense of care, growth, and sustainability.

Executive summary

Over the past five years, phenomenal economic growth in emerging markets has increased the speed of the depletion of natural resources and created tensions with sustainable development. Despite these tensions, sustainable investment (SI), which entails integrating environmental, social and corporate governance (ESG) factors into investment processes, has gradually evolved in emerging markets. IFC, the private arm of the World Bank Group engaged Mercer to conduct this study to identify leading investment managers, pursuing sustainable investment in emerging markets, their AUM and their capacity for integrating ESG into investment processes.

There are three parts to this study:

1. Global survey of investment managers of emerging market equities (EME) responding to questions about their ESG capabilities
2. Country level research of ESG capabilities of mainstream investment managers based in Brazil, China, India and South Korea
3. Research on Sustainable Investment (SI)-labelled equity investment products across the emerging markets region.

Global survey

Mercer conducted a global survey among 514 equity managers through Mercer's Global Investment Manager Database (GIMD). Of this group, Mercer focused its research on 177 managers that invest via 328 strategies in EME. Based on the global survey, Mercer identified leading investment managers who have taken a more integrated approach towards sustainable investing in their *mainstream* EME products.

Top 10 ESG-ranked managers based on responses to Mercer's global survey

- Colonial First State Global Asset Management (8 strategies, including the Global Emerging Markets Sustainability Fund, the top scoring fund)
- Threadneedle Asset Management (Latin American Fund & Global Emerging Markets Equity)
- Newton Investment Management (Asia-Pacific Ex Japan Equity)
- Dexia Asset Management (Emerging Markets Sustainable Equities)
- Investec Asset Management (Pan Africa)
- Robeco Group (Emerging Market Equity)
- Baillie Gifford & Company (Emerging Markets Leading Companies & Emerging Markets)
- Scottish Widows Investment Partnerships (Core)
- F&C (6 strategies including Indian Equity, Latin American Equity, Global Emerging Equity and 3 strategies on Asia-Pacific Ex Japan)
- Lloyd George Management (Global Emerging Markets Equity & Asia Ex Japan)

Country level ESG research of emerging market investment managers

In addition to the global survey, Mercer conducted 40 research meetings with investment managers on-site in China, India, South Korea and Brazil, to evaluate the managers' capabilities with respect to ESG integration and active ownership. Managers were rated on ESG factors using Mercer's ESG four-factor framework, namely:

- The extent to which ESG issues feature in investment idea generation as part of the alpha generation process
- The extent to which ESG factors are considered as part of the portfolio construction process, including active over/underweight positions held in the fund
- How ESG policies are implemented, including the length of the investment horizon and the level of voting and engagement activities, and
- The fund management firms' commitment to ESG integration, such as the adoption of ESG related policies, staff training and participation in collaborative initiatives.

Top 3 ESG-rated mainstream strategies in China, India, South Korea and Brazil (based on Mercer's proprietary research)

China

- China Asset Management Company Chinese Equity—Segregated Accounts
- Bank of China Investment Management (BOCIM) Chinese Equity—Sustainable Growth Fund
- Harvest Fund Chinese Equity—Growth

India

- Kotak Mahindra Asset Management Co. Ltd. Kotak 30 (Indian Equity)
- HSBC Global Asset Management HSBC (Indian) Equity Fund—Growth
- JPMorgan Asset Management Indian Equity Fund

South Korea

- Rexiter Capital Management Korean Equity
- RCM Active Korean Equity
- Samsung Investment Trust Management Korean Leading Group Fund

Brazil

- ABN Amro Fi Ações Ativo II
- HSBC FIA Multi Ações
- Rio Bravo Fundamental FIA

Sustainable investment in emerging markets has grown considerably in the past five years, to over \$US300 billion...

SI-labelled EME strategy research

Mercer researched 10 SI-labelled EME strategies internationally, following the same ESG research four-factor framework methodology used for the country level research discussed in the previous section.

Top 3 ESG-rated SI-labelled EME strategies

1. Colonial First State Global Emerging Markets Sustainability Fund
2. Industrial Fund Management Company (IFMC) – China Equity SRI Fund
3. Lloyd George (LG) Asian Green Fund

Key trends

- **Sustainable investment is a growth story in emerging markets**
Sustainable investment in emerging markets has grown considerably in the past five years, to over \$US300 billion, according to Mercer's survey of EME managers described in this report. Mercer's research revealed that the growth of sustainable investments was primarily driven by investors in developed markets investing in EME to achieve diversification benefits. Some \$50 billion of this reflects funds which are specifically branded as socially responsible or sustainable. The remainder represents mainstream managers who identify themselves as taking ESG issues into account.
- **Global investment managers who invest in EME products lead ESG investing**
According to Mercer's research, EME products that use SI approaches are mainly managed by global managers. Since major investors of global managers are asset owners based in developed markets, this indicates that asset owners based in developed markets who have taken an ESG integrated approach in their equity mandates, are currently driving the growth of sustainable investment in emerging markets.
- **The managers with the largest EME mandates are not actively pursuing engagement**
Following on from the point above, Mercer's research found that engagement on ESG issues is not commonly pursued by most EME managers. Whilst a good proportion of the managers with the largest mandates tend to vote proxies where they can, more active engagement with investee companies does not necessarily follow such practices. In fact, less than one third of the managers surveyed have a policy or practice of engagement with investee companies.
- **Short-term investment horizons inhibit ESG integration**
One of the key differentiators between the leaders and laggards on ESG integration and active ownership was the investment horizon adopted by the portfolio managers. Indeed, our research found that managers with shorter horizons (with portfolio turnover in excess of 100% pa) were less concerned with ESG issues and less able to articulate or demonstrate how these might feature in their investment process. A longer investment horizon is therefore more conducive to pursuing long-term goals and behaving as an active, long-term responsible investor.
- **Corporate governance is a well-understood concept in major emerging markets**
Corporate governance is a well-understood concept, compared with environmental and social issues, in major emerging markets such as China, India, South Korea and Brazil. While corporate governance is regarded as important by investment managers, they may struggle to obtain clarity on companies' governance structures in emerging markets. Many investment managers Mercer interviewed tend to actively investigate governance standards in their meetings with, and appraisals of, investee companies, and considered it material at a stock selection stage.

While governance is seen as an important issue, *active ownership is not yet a high priority*, as stated above.

- **The environment and climate change are on the radar**

While it may take a few years for environmental issues to be fully and formally integrated into investment processes, many managers interviewed noted that environmental issues were already of significance to them. This was particularly emphasised in the research meetings Mercer conducted in China and South Korea. Mercer also found that managers in China and India were aware of the potential impacts of a carbon-constrained economy.

- **Social issues are best addressed by local emerging market managers**

Compared with global emerging market managers, local emerging market managers saw social issues as an important indicator of the quality of management and a source of insight into a company's outlook. Labour standards for example in 'dirty industries' were cited by local managers as issues of potential concern. This was especially true for investment managers Mercer interviewed in South Korea and Brazil.

- **Global standards are beginning to influence emerging markets although gaps remain**

Global initiatives promoting ESG and corporate social responsibility (CSR) are beginning to influence some of the factors in the investment supply chain. Asset owners (primarily based in developed markets) and global managers have signed up to voluntary global standards such as the Principles for Responsible Investment (PRI) and the United Nation's (UN) Global Compact (GC). Companies in emerging markets have also started to sign up to the Global Reporting Initiative (GRI) and the Carbon Disclosure Project (CDP). Despite these standards, our research identified gaps in the ESG capabilities of investment managers compared with demand from asset owners.

Key research findings: ESG practices of emerging market investment managers

- **ESG awareness as a risk management tool**

Mercer's research suggests that most of the investment managers included in the country level research (China, Brazil, South Korea and India) demonstrated some level of awareness of ESG issues—but primarily as a risk

management tool. In contrast, only a few managers were pursuing active ownership policies or considering the integration of ESG as a driver of long-term value.

- **Compliance and governance dominate ESG thinking in China**

In China, the approach to ESG was more about compliance than pursuit of opportunities. The highest ESG rated strategy of all the 40 managers included in this study was a Chinese based investment manager. Generally, integration and awareness of governance issues was higher than environmental and social factors.

- **South Korean managers scored highest on integrating ESG into active positions**

In South Korea, on average, the investment managers scored better than the other countries in terms of how they implemented ESG into the portfolio construction process. Specifically, Mercer found some evidence of active ESG positions being taken by portfolio managers.

- **Brazil led on promoting high corporate governance standards**

Brazilian based investment managers demonstrated active involvement in pursuing some ESG related value drivers, particularly in the promotion of corporate governance standards. The investment managers have also developed specialist SI-labelled products in response to asset owners' high level of interest in SI.

- **India demonstrated awareness of local social issues but notable absence of active ownership**

The Indian EME investment managers scored relatively well in terms of the level of firm-wide commitment to ESG integration, mainly through links with the international parent/holding company where a commitment to ESG had been made at the global organisation level. We also observed a natural tendency for some of the investment managers to consider the implications of local social issues in their appraisal of investment opportunities, particularly on the issues of poverty reduction, access to clean water and sanitation. Where specialist ESG research staff existed at the organisation wide level, they are yet to extend their coverage to Indian companies. Many managers demonstrated a reluctance to utilise voting or engagement as tools for pursuing SI, with most managers opting to sell a stock if they identified a risk, rather than choosing to engage.

Mercer recommends that asset owners send a clear signal to the market by including ESG integration and active ownership into the selection criteria of EME investment managers.

Recommendations

- **Asset managers improve training and awareness of ESG issues**

One of the important aspects of integrating ESG into investment research and investment decision-making in EME is to ensure that ESG training and tools are promoted across the organisation and amongst investment analyst teams.¹ Mercer recommends that asset managers improve understanding of ESG throughout the firm by developing a SI policy and promoting existing policies consistently, and by providing training regardless of location.

- **Local EME managers consider using active ownership tools**

Managers in local firms interviewed by Mercer demonstrated a keenness to better understand whether ESG was material to investments. Accordingly, Mercer recommends that local asset managers would benefit from raising awareness and educating their investment staff via available resources and tools designed to encourage asset managers to better incorporate ESG research and investment considerations into their processes. Tools such as the implementation options associated with active ownership offered through the framework of global collaborative networks, for example, could provide a useful starting point for managers.

- **Asset owners refine policies with respect to ESG in EME**

One of the first steps that asset owners can take to promote improved ESG and active ownership standards across their emerging market investments is to clarify their expectations with respect to investments in the emerging market region. This would ideally distinguish itself from the broad investment policy and recognise the unique characteristics of emerging markets, paving the way for the establishment of more focused policies that can be easily understood by investment managers, and therefore more likely to be implemented across the investment process. Such policies should also specify asset owners' expectations regarding ESG integration into mainstream mandates versus SI-labelled products, as well as their preferred approach towards active ownership.

- **Asset owners incorporate ESG into EME selection criteria and mandates**

Mercer recommends that asset owners send a clear signal to the market by including ESG integration and active ownership into the selection criteria of EME investment managers. For existing mandates, asset owners could integrate ESG criteria into their Investment Manager Agreements and monitor how managers are integrating ESG factors across their investment processes and reporting framework. In addition, asset owners should incorporate an assessment of investment managers' voting and engagement capabilities, and set minimum standards for activities and disclosure.

- **Asset owners and managers consider joining collaborative networks**

Emerging market asset owners and managers should also consider joining collaborative networks such as the Emerging Market Disclosure Project, co-chaired by Calvert and the US Social Investment Forum, or initiatives such as the PRI and the Carbon Disclosure Project (CDP). Joining collaborative networks provides benefits such as learning from peers on best practice with respect to ESG activities in emerging markets, as well as providing a framework for engaging with global and local emerging market managers and investee companies.

¹ ESG training should not just be provided in the head office, but rather should be provided across all offices of investment managers.

1. Introduction



The International Finance Corporation (IFC), the private arm of the World Bank Group, has been promoting sustainable investment in emerging markets since 2002. Its 2003 report “Towards sustainable and responsible investment in emerging markets”², provided the first comprehensive review of sustainable investing in emerging markets and recommended that IFC support regional sustainable investment associations in order to promote sustainable development in emerging markets.

² Commissioned by IFC and prepared by Enterprising Solutions Global Consulting

In addition to this, Mercer has been actively involved in assessing the capabilities of investment managers in integrating ESG into their investment decision making processes, both in developed and developing economies across all asset classes. Since 2005, Mercer has developed a proprietary ESG rating framework and started assessing asset managers' capacity for integrating ESG into investment processes. Mercer's ESG rating helps increase awareness of ESG, as well as provides an input into the search and selection of new investment mandates in EME on behalf of its clients³.

Building on these foundations, IFC commissioned Mercer to prepare this report to provide an update on the development of sustainable investment in emerging markets in 2008. In particular, the aim of this report is to:

- Develop a deeper understanding of the market for sustainable investment products, including major players and recent trends
- Identify existing markets for sustainable investment products and raise awareness of those products amongst all investors
- Provide the wider market with information on the capabilities of local and global investment managers in emerging market listed equities to manage sustainability-oriented investment strategies. This includes analysis on both sustainability labelled funds and mainstream investment funds
- Identify the higher-ranked global emerging market managers in responding to the demand for ESG integrated solutions, the top ESG-rated emerging market managers in China, India, South Korea and Brazil and the higher-ranked sustainability branded investment products in the emerging markets region
- Increase awareness of ESG issues amongst emerging market investment managers and provide information on the tools employed by their peers, including both local and global managers

³ In 2007 Mercer identified high-performing emerging markets equities managers that have ESG at the core of their strategy on behalf of PGGM (a Dutch pension fund). See

Mercer 2007, "Mercer conducts search for world's first major ESG-driven emerging markets mandate", available at <http://www.mercer.com/summary.htm?siteLanguage=100&idContent=1285435>, accessed 25 February 2009.

1.1. Key concepts

The terms "**Sustainable Investment**" (**SI**) and "**Socially Responsible Investment**" (**SRI**) are used differently across the world. In some countries, SI and SRI are viewed as being one and the same thing, whilst in other countries they represent distinct investment approaches.

Mercer uses the term **SI** throughout this report. Evolving out of the ethical, socially responsible investment (SRI) waves, SI involves taking a long-term horizon and integrating environmental, social and corporate governance (ESG) factors into investment analysis, stock selection and active ownership practices in the belief that these factors can help improve long-term risk/return management. In terms of investment practices, it places an emphasis on the integration of ESG factors into investment decisions and active ownership via voting and engagement, rather than negative screening techniques.

At Mercer, our assessment of investment managers' ability to integrate ESG factors into the investment process has a number of facets, such as the competencies and skills of the team members, their access to and use of appropriate data for evaluation of ESG risks and opportunities, and the extent to which these metrics are embedded into their alpha generation process. Active ownership as a tool for beta enhancement is also a key part of this evaluation, and Mercer would not only look for evidence of voting and engagement policies and activities, but also consider how these are implemented, on what issues and the transparency in reporting and sharing outcomes with others. These considerations are assessed against a four-factor framework incorporating idea generation, portfolio construction, implementation and firm-wide commitment. The first three factors focus on ESG integration and active ownership at the strategy (product) level, whilst the fourth factor—firm-wide commitment—focuses on the fund managers' organisation-wide commitment to ESG integration and active ownership.

Mercer uses the term **SRI** to mean an investment process that balances an investor's ideals with performance considerations, and typically seeks to achieve a trade-off between social and financial objectives.⁴

⁴ For further details, refer to Mercer 2008, "The ABC of ESG: environmental, social and corporate governance", available at: <http://www.mercer.com/referencecontent.htm?idContent=1315220>.

Emerging Markets are those included in the MSCI emerging market index and the S&P and IFCI emerging market index.

For the purpose of this report, an investment in EME was defined by the MSCI emerging markets index and the S&P/IFCI emerging market index. The make-up of these indices in terms of country exposure is outlined in Table 1.

Table 1. The makeup of the MSCI emerging markets index and the S&P/IFCI emerging market index by country exposure

Region	Countries Included	Weight ⁵ % at 30 June 2008
Emerging Asia	China, India, Indonesia, South Korea ⁶ , Malaysia, Pakistan ⁷ , Philippines, Sri Lanka, Taiwan, Thailand	50%
Latin America	Argentina, Brazil, Chile, Columbia ⁸ , Mexico, Peru	25%
Emerging Europe	Czech Republic, Hungary, Poland, Russia, Turkey	16%
Middle East & Africa	Egypt, Israel, Jordan ⁹ , Morocco, South Africa	9%

Source: MSCI emerging markets index by country exposure

ESG integrated investment funds: mainstream funds that have integrated ESG factors into their investment processes possibly through their valuation metrics, risk analysis and/or voting and engagement activities.

SI-labelled funds: specialist funds that have been marketed as sustainability themed or SRI branded products. They include funds which employ negative screening and/or positive screening, corporate engagement and/or pursuit of a specific investment theme related to E, S or G factors.

Investment product / strategy / fund are used interchangeably in this report.

⁵ According to the MSCI Emerging Markets Index

⁶ Mercer notes that South Korea will reach a major turning point in its transition from classification as an emerging market to a developed one in September 2009

⁷ MSCI Emerging Markets Index only.

⁸ MSCI Emerging Markets Index only.

⁹ MSCI Emerging Markets Index only

1.2. Methodology

There are three main components to the project:

1. A global survey of EME managers to evaluate general industry standards with respect to ESG policies and practices
2. Research on local emerging market investment managers in China, India, South Korea and Brazil via a survey, meeting and research note with 40 fund management teams
3. Research on sustainability branded emerging market products via a survey, follow up interview and research note with 10 fund management teams of SI-labelled EME strategies.

1.2.1. Overview of the global survey

The global survey of EME managers was designed to evaluate general industry standards and trends with respect to ESG policies and practices. The survey was conducted using Mercer's Global Investment Management Database (GIMD)¹⁰ and was comprised of two parts:

Part A: Nine general questions relating to the degree of commitment and integration of ESG factors across the investment management firm. These "organisation wide" factors are designed to assess the extent to which policies exist on ESG integration, voting, and engagement and participation in collaborative initiatives.

Part B: Thirteen specific questions related to the integration of ESG factors for a specific emerging market strategy that the fund management team manages. These questions are designed to assess the extent to which the organisation wide commitment filters through to the actual investment teams making the investment decisions.

For Part A, 514 equity managers completed the nine questions on the organisation wide level of commitment to ESG. These include investment managers with EME strategies and developed market strategies, as most managers offer many products and strategies across regions and asset classes. Of these respondents, 177 represented EME managers who provided details of 328 strategies that were specific to EME, and completed the 13 questions of Part B.

¹⁰ GIMD is a proprietary, Internet-based database on investment managers for institutional investors. As at 31 December 2008, GIMD held data for over 3,286 managers covering in excess of 19,349 strategies.

The survey asked managers about a range of investment issues related to ESG factors. At the firm level (which is covered in Part A of the global survey), some examples of the issues investigated are as follows:

- Whether the firm has made a commitment to ESG issues through participating in relevant collaborative initiatives
- Whether the firm has a policy on integrating ESG into the investment process
- Whether the firm has a policy on voting and engagement and if that policy is made publicly available, including details on how it is implemented and its effectiveness evaluated and reported
- Whether the firm has asked its brokers or investment research providers to adapt their services to include ESG issues

The survey questions were categorised into two types, open-ended questions and multiple choice questions. The multiple choice questions were allocated a score to quantify how Mercer regarded the importance of the question to ESG integration. The higher the score, the higher the importance of the question to ESG integration. We allocated scores to three questions of nine for Part A.

At the strategy level (which is covered in Part B of the global survey), some of the issues that were examined are set out below:

- The way the fund management team thinks and their beliefs with respect to the relevance of ESG factors in their core process
- The investment horizon typically adopted by the investment management team, where a short term horizon (i.e. 12 months or less) makes ESG integration more challenging
- Access to, and utilisation of research that might inform the investment management team on ESG issues
- Commitment to training and educating investment staff on how ESG issues might impact on the alpha generation process
- Implementation and reporting of voting and integration of ESG into the conversations they have with management of corporations
- Collaboration with other investment managers when engaging with companies
- Future plans for improving internal processes to better integrate ESG factors into their investment and active ownership practices

Four of the 13 questions in this part of the survey were multiple choice questions and each choice was allocated a score. Each manager that answered Part B of the global survey therefore also received a total score for that part. For managers that answered both Part A and Part B, a total score was calculated by adding the scores for the two parts. Based on each manager's aggregated score from Part A and Part B, Mercer is able to identify strategies that scored higher than others, which are categorised as high ESG-**ranked** strategies. This is clearly distinguished from Mercer's proprietary ESG-**rated** strategies, which are based on Mercer's proprietary four-factor framework and involves a follow-up research meeting, as discussed in detail in the next section.

For mainstream strategies (not SI-labelled strategies) that responded to the global survey and indicated that they have integrated ESG factors into their investment processes, Mercer was unable to ascertain the date from which they commenced taking ESG factors into account, and in most circumstances there is no clear date. Therefore, while data about their current assets was collected, Mercer was unable to track their ESG capabilities historically. Having established the methodology, future surveys could provide a comparison of how processes change in future years.

The survey respondents have been categorised according to whether they invest **all** or only some of their assets in emerging markets. For strategies investing all their assets in emerging markets, they have been further grouped into regions including Asia, Latin America, Central and Eastern Europe, and Africa. Based on their ESG practices, the funds are further separated into those having ESG-integrated mainstream strategies and those with SI-labelled strategies. While this report includes all managers that answered Mercer's survey and who claim to make efforts towards mainstream ESG integration, Mercer found that the level of ESG integration varies considerably across managers.

1.2.2. Research meetings in China, India, South Korea and Brazil

Mercer met with 40 investment managers to evaluate their capacity to integrate ESG factors into investment and ownership practices through the survey questions, follow-up interviews, a written research note and ESG rating. The research meetings were conducted with portfolio managers and their teams in these four countries between April and September 2008.

Following the research meetings with investment managers on their EME strategies in China, India, South Korea and Brazil, the investment strategies were assigned an ESG rating using Mercer's proprietary four-factor framework, namely:

- The extent to which ESG issues feature in investment idea generation as part of the alpha generation process
- The extent to which ESG factors are considered as part of the portfolio construction process, including active over/under weight positions held in the fund

- How ESG policies are implemented, including the length of the investment horizon and the level of voting and engagement activities
- The fund management firms' commitment to ESG integration, as represented by factors such as the adoption of ESG related policies, staff training, availability and use of data, and participation in collaborative initiatives

The first three factors focus on the strategy level of ESG integration, while the fourth factor (firm-wide commitment) focuses on evaluating the manager's organisation-wide commitment to ESG integration. The same framework was applied to the research of the 10 SI-labelled EME strategies.

The selection of funds to research was influenced by a number of factors. The first step was to draw up a list of all the equity managers in each country based on Mercer's GIMD and our network of consultants based in each region. Initial research was undertaken to determine basic details about possible managers for inclusion in the research, and those prioritised for research by the Mercer researchers in each country were influenced by the following factors:

- Fund management firms with strong local presence in the respective countries and a willingness to participate in a survey of this kind
- Managers with strategies that Mercer had previously rated highly from a financial performance perspective or thought were of high quality for institutional investors
- Products within the fund management firms that represented the flagship fund of each firm, namely the largest (mainstream) equity fund in terms of assets under management

In addition, the target list was designed to include a range of both local and global managers, with the specific strategy chosen for research being that with the largest assets under management (AUM) for each manager locally. This was to ensure that Mercer rated a process that was most representative of the majority of the fund management firms' mainstream investment teams. During the course of the project, Mercer became aware of newly launched products and managers, often smaller managers or sustainability-branded products, some having approached our team following the project launch. The final list of managers researched was a result of all of these considerations plus, critically, the willingness of the manager to participate in the research process.

The fund management firms included in this analysis were:

- Managers that offer single- or multi-country emerging market equity strategies
- Managers that are local¹¹
- Managers that are global
- A combination of global managers that have formed joint ventures with local managers.

1.2.3. Research into best practice SI-labelled strategies

A further 10 strategies were researched that focused on SI-labelled funds. In other words, EME funds that were either sustainability-themed funds, ethical or socially responsible investment branded.

Managers were selected based on the same criteria used to identify managers in each of the four countries, as outlined in section 1.2.2. The only difference is that the opportunity set was restricted to SI labelled funds rather than mainstream strategies.

1.2.4. Industry research

Industry associations such as the European Social Investment Forum (Eurosif) and Association for Sustainable and Responsible Investment in Asia (ASrIA), research firms and other practitioners (including Mercer) have released studies, reports and thought pieces on the SI market around the world. This work was also informed by the trends and experiences Mercer sees across its client base.

1.2.5. Other relevant standards and sources

Industry sources, media searches and Mercer's network of contacts were consulted for comment on the development of ESG-investment strategies and markets.

1.3. Structure of the report

The structure of this report is as follows:

- **Section 2** discusses the result of the global survey and the size of the SI market in the emerging market region
- **Section 3** presents data on the growth of ESG integration and active ownership into mainstream EME products globally
- **Section 4** shows the results of detailed ESG research on 10 mainstream fund managers in China
- **Section 5** highlights the results of detailed ESG research on 10 mainstream fund managers in India
- **Section 6** describes the results of detailed ESG research on 10 mainstream fund managers in South Korea
- **Section 7** gives the results of detailed ESG research on 10 mainstream fund managers in Brazil
- **Section 8** summarises the growth of SI-labelled funds in EME and research findings on the practices of 10 SI-labelled EME funds
- **Section 9** outlines the major research findings and provides recommendations for further promoting sustainable investment across the emerging markets region

¹¹ The term local means a manager that invests in emerging markets and is not owned by a global manager.

2. Global survey on emerging market managers

The global survey received 514 responses from equity managers with 177 of these representing EME managers. These EME managers provided details of 328 strategies that were specific to emerging market equities.

Part A of the survey focused on the organisation wide commitment to ESG and Part B focused on the implementation at the strategy level.

In addition to ESG related information, Mercer gathered statistics on the size of the funds in terms of assets under management, in order to estimate the size of the SI-labelled strategies in emerging markets, and also those mainstream strategies that have made a commitment to integrate ESG into their core investment processes.

The survey response suggested that over US\$300 billion in assets under management represents either an SI-labelled fund or a mainstream fund that has made some commitment to integrate ESG into the core investment process.

2.1. Growth in Assets

The survey response suggested that over US\$300 billion in assets under management represents either an SI-labelled fund or a mainstream fund that has made some commitment to integrate ESG into the core investment process.

The table shows that the majority of the sustainable assets identified in this survey were mainstream funds with a commitment to ESG integration and that most of these represented funds with full exposure to EME rather than partial allocation.

Table 2. Total AUM of SI equities in emerging markets

	SI Labelled (\$US million)	ESG Integrated (\$US million)
Products investing all their assets in emerging markets	37,712	200,843
Products investing a portion of their assets in emerging markets ¹¹	14,275	57,200
Total	51,987	258,043

Source: Mercer GIMD Global Survey results

It is important to note that the mainstream ESG integrated fund statistics are based purely on managers' response to the global survey and their claim to integrate ESG into their core process. The data does not reflect our ESG research on the actual strategies. In other words, the global survey data results are aspiration on the part of the investment managers rather than a true reflection of the ESG integrated investable universe for asset owners.

¹¹ Data included in this table is only the emerging market-invested portion of their assets.

2.2. ESG Practices at a glance

At the organisation wide level:

- According to Mercer's global survey, almost half of the managers investing in emerging markets (46%) had a policy regarding the integration of ESG issues in their investment processes. This compares with around 34% of all equity managers who answered Mercer's survey on GIMD. Since EME managers surveyed in this study are dominated by global managers, this suggests that global managers are driving the development of SI in EME investment. This could be due to two reasons: global managers are managers with large AUM and have more resources to deal with ESG issues; and asset owners in developed countries are driving sustainable investment through managers (usually global managers).
- A large proportion of managers investing in emerging markets have a voting policy, with two-thirds of these managers making their policy public. However, less than a third of these managers have a policy on engagement with investee companies. Managers suggested that compared with voting, engagement is either more difficult to pursue as it requires specialised skills or is not regarded as a priority.

At the investment product level:

- ESG issues are taken into account in almost half (47%) of the EME products offered by the managers. (This compares to around a quarter of all managers across all asset classes and outside of EME on Mercer's database). Managers of two-thirds of these strategies saw ESG factors as a means of identifying investment opportunities, with many of the remainder seeing it as a risk-management tool.
- With respect to engagement on ESG issues, only 21% of the strategies surveyed raised corporate governance concerns with management of their investee companies, and only 18% of strategies researched raised broad ESG concerns. However, some collaboration amongst investment managers on engagement related to ESG concerns is apparent, with only 20% of strategies stating that they did not collaborate at all.

Of the 177 managers investing in EME surveyed, almost half (46%) have a policy regarding the integration of ESG issues into their investment process.

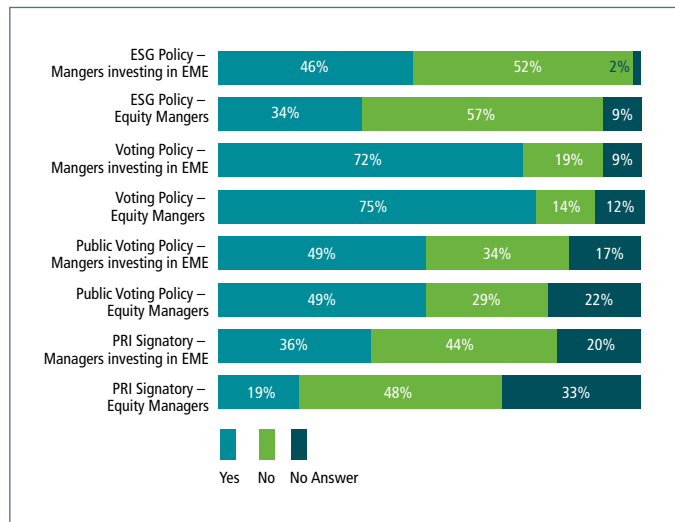
2.3. Survey results

Organisation wide commitment—Policies and collaborative initiatives

The following questions were designed to better understand the extent to which investment management firms have made a commitment to develop ESG capabilities at the organisation wide level. This is demonstrated in the initial stages by the development of a policy on ESG issues, as well as a policy on voting and engagement and participation in collaborative initiatives. Having a policy indicates that the investment manager has taken the time to consider the issue and formulate a response.

The chart below highlights the survey responses of the 177 managers that invest in EME and compares this to the responses from all 514 equity managers who completed Mercer’s survey.

Figure 1. Survey responses of managers investing in EME vs. all equity managers surveyed



Source: Mercer GIMD Global Survey results

Some key observations regarding organisation wide commitment:

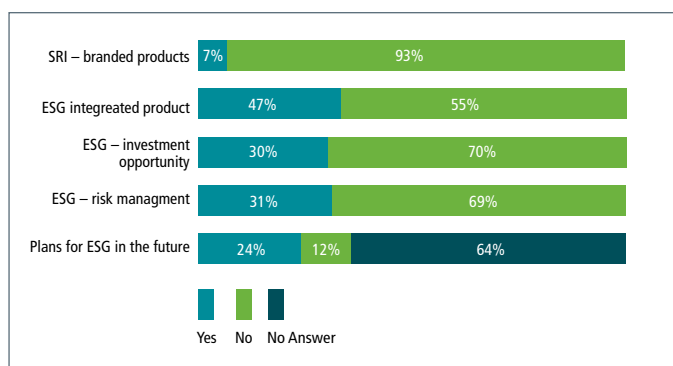
- Of the 177 managers investing in EME surveyed, almost half (46%) have a policy regarding the integration of ESG issues into their investment process
 - This compares with 34% of all equity managers surveyed, indicating that managers investing in EME have been more proactive in developing ESG policies
 - The EME managers surveyed by Mercer tended to be global managers with larger AUM the results could therefore indicate that deeper resources and capacity of larger managers to smaller is a factor that supports ESG integration, although the sample size is too small to conclude that this difference is statistically significant. This could be an interesting focus for future research
- On voting policies, there were similarities between EME and the total sample, with 72% of EME managers having developed a written voting policy compared to 75% of all equity manager respondents to the survey. Likewise, around half claim to make their policies public
- Around a quarter of EME managers that had a written voting policy did not have an ESG policy, suggesting that active ownership standards are the first area for development before developing a wider policy and approach to integrating SI into their processes. This is quite typical of how investment manager practices evolved across other regions
- Interestingly, more EME managers had collaborated via joining the PRI or other initiatives with 36% of EME respondents having collaborated with other investors compared to 19% of the total sample. This likely reflects the fact that the sample of Mercer’s EME managers tends to be biased towards large, global managers who have been amongst the first movers in joining the PRI and other sustainable investment initiatives

Strategy level implementation—ESG integration and active ownership

Whilst having a policy on various ESG factors is an important starting point, sustainable investment practices will only occur if these policies are implemented. The survey investigated the extent to which the investment managers had integrated ESG factors into the management and active ownership practices of actual EME products. The survey asked this of all investment managers and not just those who had explicitly stated that they had an ESG policy. Altogether, the respondents provided details for 328 emerging market equity strategies.

Because investment managers may have more than one emerging market product (for example they may have a “mainstream” product and an SRI branded product), the survey asked how various ESG issues were being implemented in respect of their individual products. This is important as some teams, especially specialist SI-labelled teams, might be well versed in ESG issues but represent only a small part of an investment firm’s assets under management. By focusing at the strategy level, Mercer was able to distinguish between the practices of investment managers within an SI-labelled investment product and how a regular mainstream investment management team invests.

Figure 2. How ESG is applied in EME products



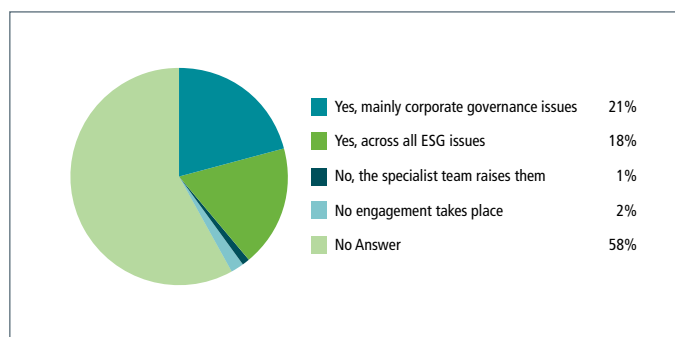
Source: Mercer GIMD Global Survey results

Some key observations regarding strategy level implementation:

- A very small proportion of the EME products are branded “SRI” (7%). To some extent, this underestimates the true number of SRI funds available to investors, as there are a significant number of funds available which are not branded as SRI, but which do follow socially responsible practices. For example, in Malaysia, a large proportion of equity products will be Shariah-compliant—however, managers would not typically identify these as “SRI”
- Whilst only a small number of products are marketed as SRI, almost half of the products take ESG issues into account within their investment process. This corresponds to the 46% of managers who have a policy on ESG. Anecdotally at least, it appears that managers who have a policy on ESG are implementing the policies they have devised
- Of the managers integrating ESG factors into their investment processes, around one third of them do so to identify investment opportunities and manage risk. Some managers implement ESG factors into their processes for other reasons. For example one manager stated that “...responsible behaviour is an indicator of sound management”
- Looking forward, less than a quarter of managers with EME equity strategies are expecting to make changes to improve their ability to integrate ESG issues into the investment process. A large number do not intend to, or remain undecided. So the jury is still out as to how fast practices will improve

The following chart highlights the extent to which the managers with EME strategies raise ESG issues when they meet with the management of the companies that they have exposure to in their portfolios.

Figure 3. Do managers raise ESG issues with management of the investee companies?



Source: Mercer GIMD Global Survey results

Over half of the strategies included in this survey did not answer the question as to whether they raise ESG issues with managers when they meet them.

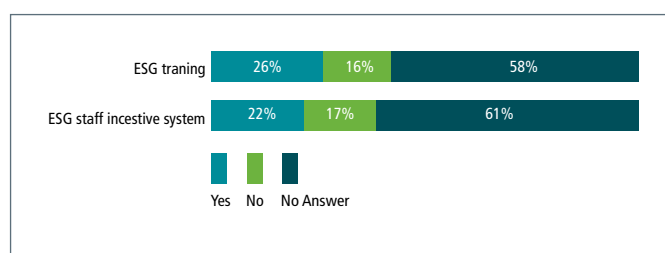
Of those that did respond, 21% claim that they raise corporate governance issues with company management, while 18% claim to raise all ESG issues. Only one fund management firm, with two EME products, had a specialist ESG team that led the engagement activities on these issues (currently with five staff members). The remainder claim to undertake the engagement with companies directly themselves.

The EME managers were also asked about the extent to which they collaborate with other investment managers when engaging with investee companies. The responses to this question varied, with a relatively small proportion claiming to participate in regular collaborative activities:

- No collaboration at all (20%)
- Limited collaboration (45%)—“Not many other investment managers are actively engaging with emerging market companies on ESG issues and so to date there have not been many opportunities”
- Regular collaboration (35%)—“If there is a corporate governance issue which we feel strongly about, we will canvass the opinion of other asset managers and stock holders in order to provide a united group. This enables us to influence the management of a company through collective action to ensure that our views and those of other like-minded investors are respected”

The final set of questions focuses on capacity building and expertise at the strategy level with respect to ESG factors, both through undertaking appropriate training and implementing incentive systems that might encourage investment teams to embrace extra financial factors and longer term investment horizon.

Figure 4. Investment manager staff development on ESG



Source: Mercer GIMD Global Survey results

As the chart illustrates, there is significant potential for improvement amongst investment managers to better train and incentivise their investment staff with respect to ESG factors. Of the managers surveyed, less than a quarter had provided their investment staff with training on ESG. Slightly under a quarter of managers also link long-term issues and ESG factors to incentives for staff. The take out from this is that the majority of managers surveyed do not prioritise ESG in the development and reward of investment staff.

Top ESG-ranked managers in the Global Survey

Based on the global survey, Mercer have also identified top ESG-ranked managers¹³. Some top ESG-ranked managers are listed below.

Top 10 ESG-ranked managers based on managers' answers to the global survey

- Colonial First State Global Asset Management (8 strategies, including the Global Emerging Markets Sustainability Fund, was the top scoring fund)
- Threadneedle Asset Management (Latin American Fund & Global Emerging Markets Equity)
- Newton Investment Management (Asia Pacific Ex Japan Equity)
- Dexia Asset Management (Emerging Markets Sustainable Equities)
- Investec Asset Management (Pan Africa)
- Robeco Group (Emerging Market Equity)
- Baillie Gifford & Company (Emerging Markets Leading Companies & Emerging Markets)
- Scottish Widows Investment Partnerships (Emerging Market Leaders (Core))
- F&C (6 strategies including Indian Equity, Latin American Equity, Global Emerging Equity and 3 strategies on Asia Pacific Ex Japan)
- Lloyd George Management (Global Emerging Markets Equity & Asia Ex Japan)

2.4. Development of ESG integrated EME products globally

2.4.1. Key findings

For investors looking for managers that claim to offer an ESG-integrated mainstream fund, there are more than 130 EME funds potentially available for further analysis. This includes almost 50 global EME funds. These funds account for more than \$US200 billion in assets under management.

Note that these figures were compiled based on survey responses only and do not reflect Mercer's ESG research ratings on the strategies or constitute a recommendation.

2.4.2. Data analysis background

Our data analysis started with identifying the types of funds which would be invested in EME. The analysis included both local and globally managed EME funds that are available to investors based in either emerging or developed countries.

Additionally, both retail-focused and institutional products were included. Where an investment manager offered both an institutional and a retail/mutual fund(s), these were aggregated to one "product" for the purposes of this analysis, i.e. Mercer did not separately survey retail funds.

The analysis included EME products that invest in specifically:

- Strategies investing all their assets in emerging markets
- Single country and regional emerging market equity funds, e.g. a South African equity fund or a BRIC (Brazil, Russia, India, China) fund
- Global emerging market funds, e.g. funds benchmarked to the S&P/IFCI emerging market index

¹³ Refer to section 1.2.1 on how the ranking is determined.

In addition to EME products, strategies that invest all of their assets in emerging markets and a portion of their assets in emerging markets were also included in the analysis, namely:

- Asian equity funds where a large proportion of the assets are invested in emerging markets
- Other equity funds with investments in emerging market countries, e.g. a global equity fund with exposure to emerging markets
- Other balanced/multi-asset funds with exposure to emerging markets

For each of these types of products, the strategies were classified into funds that were either:

- Mainstream ESG integrated—the fund is not promoted as SI, but ESG factors are apparently integrated to some extent into the investment process, based on the unverified response to the survey questions
- SI labelled—this includes sustainability themed products and Socially Responsible Investment (SRI) products where the respondent indicated that the product represents a branded fund of this type in their survey response.

2.5. Product split

The table below highlights the split of emerging market assets identified by Mercer's GIMD survey, as at June 2008 by the type of product invested. A detailed breakdown of the number of products in each region from the survey and their AUM is provided.

Table 3. ESG integrated emerging market assets at June 2008 by product type

	SI Labelled (\$US million)	ESG Integrated (\$US million)
Products investing all their assets in emerging markets:		
Total Emerging Asia	1,136	18,683
Emerging Europe	1,729	5,305
Latin America	–*	5,045
Middle East & Africa	–	397
Global Emerging	34,846	171,413
Products investing a portion of their assets in emerging markets:		
Regional Asia	7,494	13,483
Regional Europe		
Global	6,781	43,716
Total	51,987	258,043

Source: Mercer GIMD Global Survey results

***Note:** There are SI-Labelled mutual funds available to Brazilian retail investors, however, they did not participate in Mercer's GIMD Global Survey ESG questions.

The significant majority of both SI-labelled and mainstream ESG-integrated funds are global emerging market products, investing against a benchmark of the MSCI Emerging Markets or S&P/IFCI emerging markets index. There is also a healthy amount of emerging market assets invested via regional Asian mandates (e.g. Pacific ex Japan products) and global equity mandates. In most cases, our data suggested that the majority of assets invested in these types of products will come from asset owners domiciled in developed countries.

In comparison, the proportion of assets invested in single emerging markets SI equity products is low. This likely reflects two factors. Firstly, these markets are smaller and therefore lower investments would be expected. Secondly, SI appears to have been taken up to a greater extent by investors in developed markets than investors situated in emerging markets.

Significant products

The following table lists the mainstream ESG-integrated products with the largest investment in emerging equity markets.

It is important to note that these statistics and the funds listed below are based purely on the managers' response to the global survey and their claim to integrate ESG into their core process. They do not represent recommendations from Mercer or reflect our ESG research on the actual strategies. In other words, the global survey responses are not validated by Mercer and do not represent our ESG ratings. These are provided later in the report for 40 strategies in China, Brazil, Korea and India and 10 EME SI-labelled funds.

Table 4. ESG—integrated products with the largest AUM—EME

Manager name	Product	Product type	Assets in EME (USD M)
Capital International	Emerging markets	Global emerging markets	24,500
Lazard	Emerging markets	Global emerging markets	16,600
Morgan Stanley	Global emerging markets	Global emerging markets	15,200
Aberdeen	Emerging markets	Global emerging markets	9,400
Mondrian	Global emerging markets	Global emerging markets	8,000

Source: Mercer GIMD Global Survey results

The table above highlights that there are a number of managers reportedly making efforts to invest large sums of money in a way that also integrates ESG factors. The investors in these products span a number of different countries.

3. Sustainable investment practices in China

This section presents the key findings of SI practices of 10 investment managers based in China. It includes an overview of the investment landscape in China and examples of the most highly rated products in terms of ESG integration and active ownership.

3.1. Key findings

- Rapid economic growth has caused current and impending ESG challenges for Chinese companies and investors. Many stakeholders are becoming more aware of the potential impact of these issues on their investments and most investment managers acknowledge that ESG issues are not something that can be ignored.
- The Chinese government is taking steps to address ESG concerns with various new regulations starting to come into effect, for example, the Green Securities Policy requiring companies to undergo environmental assessment before being listed on the Chinese Stock Exchanges.
- Corporate governance is regulated by the China Securities and Regulatory Commission through Code of Corporate Governance.
- At the company level, responses to ESG concerns are more a function of the fear of sanction due to non-compliance with regulations, rather than a true belief in good ESG practices enhancing profit. High people and portfolio turnover were some of the barriers to integration of ESG factors into investment processes across firms.
- Engagement and active ownership is at an early stage of development in China where the dominance of state ownership is a challenge for implementing engagement activities.
- The three equity managers with the highest ratings on integrating ESG factors and active ownership into their investment process were **China International Corporation, Bank of China Investment Management and Harvest Fund.**

3.1.1. Overview of the investment industry in China

China has experienced phenomenal economic growth in the past 30 years. Along with its economic expansion, China's stock market has developed from being virtually non-existent in the 1990s¹⁴ to becoming one of the major components of the S&P/IFCI emerging market index in recent years.

By 2008, the investment management industry in China had 60 mutual fund investment managers and 422 products, with AUM reaching US\$286 billion¹⁵, down from US\$440 billion in 2007¹⁶. Of the 60 mutual investment managers, approximately half of these were joint ventures between Chinese entities and foreign entities.

Major institutional investors in China include mutual investment managers¹⁷, insurance investment management companies, the National Council for Social Security Fund (NCSSF) and Qualified Foreign Institutional Investors (QFIIs). To become QFIIs, foreign investors need to apply for a licence and a quota to trade in China's domestic A-shares market. By 2008, there were 59 QFIIs and their quota to invest in the Chinese A-shares market reached US\$10.67 billion.¹⁸

Sustainable investment in China

While ESG integration into mainstream investment strategies is still at an early stage of development in China, our research found that there is growing concern that the rapid economic development of China has brought about environmental degradation and social inequality and that this could hamper China's long-term economic development¹⁹.

Environmental degradation and social inequality are also being acknowledged as challenges to redress by the Chinese government. For example, in a white paper published in December 2007, the government noted that

¹⁴ Shanghai and Shenzhen Stock Exchanges were established in 1990 and 1991 respectively.

¹⁵ <http://www.csrc.gov.cn/>, and using exchange rate 1USD = Yuan 7.27

¹⁶ <http://in.reuters.com/article/asiaCompanyAndMarkets/idINPEK19673720080103>

¹⁷ Including local investment managers and managers which are joint ventures between global managers and local managers.

¹⁸ http://www.safe.gov.cn/model_safe_en/index.jsp

¹⁹ JPMorgan 2008, 'ESG in China: the issues, the effects and the cost to development'. See also OECD 2007, 'The cost of pollution'.

Policies require companies that could possibly cause heavy pollution and consume a lot of energy undergo environmental assessment before they seek listing on stock exchanges in China.

it is facing a significant challenge in balancing economic development (to improve domestic living standards) with the need to reduce energy usage and tackle climate change.²⁰ In January 2006 and August 2007 respectively, the government promulgated a Renewable Energy Law, and Renewable Energy Long Term Development Plan to encourage development and investment in renewable energy sources. In addition, the government is targeting a 20% reduction in energy consumption per unit of GDP by 2010.²¹

In addition, IFC has been working closely with the Chinese government on setting up a proper framework to promote sustainable finance in China. With the support of IFC, China's Ministry of Environmental Protection (MEP), China Banking Regulatory Commission (CBRC) and the People's Bank of China (PBOC), has developed and implemented a "Green Credit Policy", which is modelled along the Equator Principles and mandates financial institutions assessing environmental risks and integrating environmental considerations in their investment evaluation process.²² Other initiatives that support the Green Credit Policy include the Green Insurance, Green Taxation and Green Securities Policies.²³ Among these three policies, the most relevant one to this report is the Green Securities Policy. Developed by China Securities and Regulatory Commission (CSRC) and the MEP, these Policies require companies that could possibly cause heavy pollution and consume a lot of energy to undergo environmental assessment before they seek listing on stock exchanges in China.²⁴ Since the launch of Green Securities Policy in February 2008, about 38 Initial Public Offerings (IPOs) were reviewed under the requirement of this policy, roughly 20 companies were also refused IPOs because they failed the

environment review in accordance with the policy.²⁵ IFC is also working with China's State Environmental Protection Agency (SEPA) to help them develop environmental guidelines for the Green Credit Policy.²⁶

Corporate governance

The China Securities and Regulatory Commission (CSRC) introduced its Code of Corporate Governance for listed companies in China in 2001. Listed companies are required to comply with this code and report on their compliance in their annual reports. In January 2008, the Chinese Government State-owned Assets Supervision and Administration Commission (SASAC) issued an official policy to facilitate and encourage State-owned enterprises (SOEs) to implement Corporate Social Responsibility (CSR) in order to achieve sustainable development of SOEs.²⁷ Most large-cap Chinese listed companies are SOEs and are controlled by SASAC. This move by the SASAC signalled that promoting CSR will be one of the major focuses of SASAC in 2008.²⁸ A few leading listed companies in China disclose their social and environmental practices along the lines of the Global Reporting Initiative (GRI).²⁹

20 Information Office of the State Council of the People's Republic of China 2007, 'China's energy conditions and policy', <http://www.ccchina.gov.cn/WebSite/CCChina/UpFile/File229.pdf>

21 AllianceBernstein 2008, 'Abating climate change: what will be done and the consequences for investors', p. 57, sourced from: China's national Climate Change Programme (June 2007), p. 26.

22 IFC 2009, "China EPA, IFC to develop guidelines for groundbreaking national Green Credit Policy", available at http://www.ifc.org/ifcext/sustainability.nsf/content/Highlights_January2008_ChinaGreenCredit, accessed 7 January 2009.

23 IFC 2008, "IFC convenes China Green Credit Policy delegation seminar series", available at http://www.ifc.org/ifcext/sustainability.nsf/Content/Highlights_June2008_ChinaGreenCredit, accessed 8 January 2009.

24 ChinaDaily 2008, "Green Securities", available at: http://www.chinadaily.com.cn/bizchina/2008-02/26/content_6485411.htm, accessed 8 January 2009

25 Zhang, X. 2009, "Green securities policy presses forward in China", available at <http://www.greenlaw.org.cn/enblog/?p=726>, accessed 17 March 2009.

26 IFC 2009, "China EPA, IFC to develop guidelines for groundbreaking national Green Credit Policy", available at http://www.ifc.org/ifcext/sustainability.nsf/content/Highlights_January2008_ChinaGreenCredit, accessed 7 January 2009

27 Ho, Brian, CSR as "No. 1" issue for State-owned enterprises in China, available at <http://www.csr-asia.com/upload/csraasiaweeklyvol4week02.pdf>

28 Ibid.

29 SIRAN 2008, Sustainability reporting in emerging markets: an analysis of the sustainability reporting in selected sectors of seven emerging market countries, available at: http://www.siran.org/pdfs/SIRANKLD_Report_for_EM_Transparency_2007.pdf

3.2. ESG integration capabilities of investment managers in China

Mercer conducted research meetings with 10 Chinese based equity managers in their local offices. The managers Mercer interviewed included both global and local managers (all managing the Chinese assets from within China).

The key themes and insights that emerged from this research are as follows:

- Although the level of ESG integration in China's asset management industry is variable, **most of the managers acknowledged that ESG is a significant trend in the industry**. As one interviewee stated:
- *"It is just something you can't ignore nowadays...part of the pressure is from our government, who is looking for sustainable growth now. You can see how it is taking gradual steps towards controlling pollution, working against various social problems and advocating business ethics and transparent financial disclosure and reporting. Managers who ignore those changes would inevitably face more risks and lose investment opportunities."*
- Additionally, the increasing competition in China's asset management industry urges investment managers to find new investment themes to attract assets and satisfy growing demand from asset owners for sustainable investments.
- At the same time, **there are conflicts between China's economic growth and ESG advancement at a business level**. As a "world factory" with incentives to pursue profits at any cost, corporate management may elect to operate in the "grey areas" or take legal risks that would not be tolerated in other emerging markets. The research evidence suggests that corporate management compliance with various government policies and regulations is driven more by fear of sanction than by a genuine belief that good ESG practices enhance profits and shareholder value. As a result, investment managers in China face many challenges in assessing ESG issues in their process in a pro-active way.
- While anxious to know how their international peers integrate ESG into their investment processes, **investment managers in China have developed their own approaches to ESG assessment**. While company visits are the most straightforward way, some innovative managers check a company's upstream and downstream

business counterparties and neighbouring communities to develop an in-depth understanding of ESG issues along the supply chain. Score sheets and rating systems are used to quantify ESG considerations amongst some investment managers in China, but it is still more of an "art than science". Pollution disposal costs, contributions to communities, labour relationships and corporate management structures have been creatively and reasonably factored into valuation metrics.

- **A high churn rate—for both managers and assets—has implications for the implementation of ESG ideas**. At investment management firms, staff turnover is high and managers are incentivised to focus on short-term performance. Due to the immaturity and volatility of the market, nearly all the Chinese equity strategies Mercer researched had portfolio turnover above 100%. The average portfolio turnover was closer to 200%. Mercer expects both these types of turnover to be detrimental to the integration of ESG factors—which are predominantly long-term considerations—into portfolio exposures.
- **Active ownership and engagement are still in their initial stages in China**. The government's dominant share ownership of most large-cap listed companies makes it difficult to practice active ownership and engagement.³⁰ The view of one manager—*"We do active voting and, if things are getting disappointing, we 'vote by feet' finally,"*—was shared by nearly all 10 managers participating in the research project. While there are initiatives such as voting alliances underway at several investment managers, active ownership is still at an early stage of development. Nevertheless, new developments on corporate governance such as the recognition of minority shareholders who can vote on certain issues might help encourage active ownership in the future.³¹

30 Wei, G. and Geng, M. 2008, "Ownership structure and corporate governance in China: some current issues", *Managerial Finance*, Vol. 34, No. 12, pp. 934 – 952.

31 Tang, X. 2009, 'Protecting Minority Shareholders in China: A Task for Both Legislation and Enforcement', In (forthcoming) Curtis Milhaupt (ed.) *A Decade after Crisis: Transforming Corporate Governance in East Asia*, Taylors & Francis, London, available at: <http://www.law.umich.edu/centersandprograms/cicl/workshop/workshopseries/Documents/Paper%20-%20Tang%20Xin.pdf>, accessed 2 March 2009.

3.2.1. Highest ESG rated managers in China

Among the 10 managers interviewed, three managers: China International Capital Corporation, Bank of China Investment Management (BOCIM) and Harvest Fund (Harvest); received the highest rating on integration of ESG factors and active ownership activities across their investment process.

As the summaries below highlight, both China International Capital Corporation and BOCIM have developed certain models/guidelines aiming to incorporate ESG ideas into the whole process in a systematic way, and Harvest is believed to consider ESG ideas on a more case-by-case basis. While China International Capital Corporation and Harvest embrace ESG considerations only in certain sectors, BOCIM has issued clearly articulated ESG guidelines for portfolio construction.

While active ownership and engagement is still at a very early stage in China's investment industry, there are some encouraging movements from investment managers such as Harvest, particularly in regard to pursuing active ownership activities.

China Asset Management Company Chinese Equity—Segregated Accounts

Established in 1995, **China International Capital Corporation** is the first joint venture investment bank in China. It formulated a strategic partnership with domestic and foreign financial institutions, including China Jiayin Investment and Morgan Stanley, and has expanded its business quickly to become one of the biggest local names in asset management.

The China International Capital Corporation strategy researched is its China A-share Equity Fund (segregated accounts). Generally, ESG factors play an important role in both passive stock screening and active stock picking. China International Capital Corporation has also developed an internal manual to guide ESG research. The manual covers nearly all the key issues and provides thorough and effective guidance to analysts' ESG research. Interestingly, the manager gives a 10–20% target price premium to stocks with ESG-related “catalysts”. While the methodology looks arbitrary to us, it is a positive sign that this manager tries to reflect ESG ideas into stock valuation.

Their portfolio construction is a combination of top-down views from the investment committee and bottom-up stock selection from the research team. Like many other managers, “economic factors” dominate the portfolio construction process, and it is underweight to certain industries with potential negative ESG issues.

China International Capital Corporation has a formal proxy voting process. While the research team provides opinions, the investment committee is responsible for decision making. Some examples were provided to show that the manager communicates with invested companies actively and, as such, selling or reducing a holding would be the final result in most cases where the manager disagrees with company management.

The senior management team has a thorough understanding of ESG issues and is keen to incorporate ESG issues into the investment process. Their model is largely based on qualitative analysis and thus lacks adequate “science”. They also demonstrated an eagerness to learn more about best practice amongst European and US investment managers on ESG integration. On the downside, similar to other investment managers based in China, Mercer didn't see much evidence of active ownership policies, particularly a formulated policy and approach towards engagement on key issues.

Bank of China Investment Management (BOCIM) Chinese Equity—Sustainable Growth Fund

Established in 2004, **BOCIM** is a joint-venture fund management company between Bank of China (83.5% of shares) and BlackRock (16.5% of shares). The manager offers five funds with the suitability growth funds focusing on ESG themes. Both the portfolio manager and the researcher appear to have developed a good understanding of ESG ideas.

The BOCIM “Sustainable Growth Fund” is targeted to embrace the investment theme of sustainable growth, which is closely connected to ESG ideas. Through a combination of top-down and bottom-up analysis, the manager incorporates ESG ideas into the investment process in a systematic way.

The investment team evaluates five factors at macro level and five factors at the company level, including business strategy, financials, corporate governance, social and environmental issues (pollution disposal and social activities)

as well as talent/employee reserves. These are the key parameters for the investment team's scoring system on potential investee companies. Valuation models are also used to identify the "long-term economic value".

The whole process is a reasonable combination of quantitative and qualitative analysis. In terms of portfolio construction, the manager insists that stock holdings shall be no less than 60% of total assets, and stocks with a "sustainable growth" theme shall not be lower than 80% of total stock holdings in the portfolio.

Although emphasis is placed on identifying ESG factors which could affect a company's share price within a two year timeframe, high turnover is inevitable given the high volatility level in China's A-share market. However, the strategy includes several stocks since the inception of this fund and makes efforts to withstand short-term pressures.

BOCIM has a formal process for proxy voting. The research team provides inputs to portfolio managers as well as the investment committee to make a final decision on proxy voting. The manager would also communicate with investee companies. However, if the voting result is disappointing, selling or trimming related holdings might be the final solution.

To sum up, through a combination of top-down and bottom-up views, BOCIM incorporates ESG ideas into investment process in a systematic way. The portfolio manager has a reasonable level of discretion to reflect "sustainable growth" ideas within the basic asset allocation framework. The investment professionals possess a good understanding of ESG factors and are keen to integrate ESG into their process. On the downside, Mercer didn't see a lot of evidence regarding a formulated policy towards active ownership and engagement activities, which was a common theme across Chinese-based investment managers.

Harvest Fund Chinese Equity-Growth

Harvest is another manager that received a high rating on integrating ESG factors into the investment process. It implements ESG issues not only through stock screening techniques, but also to some certain extent, in its active stock picking. Environmental protection, industrial upgrades and sustainability are some of the investment themes the manager targets to embrace bottom-up analysis and selection.

Several examples in the healthcare and green energy industries showed that ESG standards have been considered as key elements for triggering value. Except for those specific sectors, however, evidence of the incorporation of ESG into pro-active bottom-up selection in a systematic way is yet to be implemented across all sectors.

The proxy voting process is thoughtfully disciplined; and the manager is relatively active in voicing their opinions and pursuing engagement, which we view favourably. In terms of the investment horizon, the investment managers identify investment opportunities with a 2 year horizon in mind. For some stocks with foreseeable long-term competitiveness and business sustainability, the manager would hold stocks for longer with some examples of companies held in the fund since 2004.

To sum up, it appears that the investment team has developed a good understanding of ESG concepts and believes that ESG could help, not only in risk control and stock screening, but also in the discovery of value.

4. Sustainable investment practices in India

This section presents the key findings of SI practices of 10 investment managers based in India. It includes an overview of the investment landscape in India and examples of the most highly rated products in terms of ESG integration and active ownership.

4.1. Key findings

- Within the investment management community in India, ESG is in its infancy.
- At a company level, Indian companies are not well-represented in global sustainability funds, and overall, India lags behind other emerging markets in attracting sustainable investment.
- Although there are a few regulations around corporate governance, for example, the Confederations of Indian Industry (CII) Code of Desirable Corporate Governance, few firms have embraced them.
- The Mercer research meetings with investment managers pursuing Indian equity strategies found evidence of some awareness of ESG issues at the global parent company level, but this typically did not translate to ESG policies or practices locally.
- There was some evidence of managers demonstrating a natural propensity to think about some ESG issues, particularly local social issues, without necessarily classifying them as such.
- The standards of ESG integration in India, when considered against the backdrop of wider market evolution, are comparatively lower than the other emerging market regions included in this research, both in terms of ESG integration and active ownership practices.
- Most of the managers rated quite closely to each other and did not generate very high ESG ratings overall. The three Indian equity managers with the highest ratings of the sample were Kotak Mahindra, HSBC Global Asset Management and JPMorgan.

4.1.1. Overview of sustainable investment in India

There has been substantial growth in the Indian stock market, institutional investor assets and the mutual fund industry in the past few years³² As with all emerging economies, this has brought with it social and environmental pressures, as well as the need to raise standards in terms of corporate governance in the wake of India's own Enron experience, aka Satyam. Whilst there is a growing awareness of sustainability issues across the Indian investment community, it is still very much in its early stages and our research indicated that it is the least progressed of the four country reviews included in this research project, in terms of what the actual investment managers are doing with respect to ESG issues.

A recent report from a Delhi-based European affiliate, the Energy and Resources Institute (TERI) Europe, is a guide to how Indian-based companies are dealing with ESG issues. The report examines some of the practices adopted by the Indian investment management industry³³; it indicates that high levels of compliance with ESG investment principles would likely assist in differentiating Indian stocks from stocks of other emerging markets which will help attract high-quality investors with a long term focus.

The report also revealed that:

- Indian companies, such as Cipla, ICICI, Infosys, and Suzlon, are already among those included in specialised global sustainability funds. There are currently 72 Indian companies which have passed The California Public Employees' Retirement System (CalPERS) ESG criteria and are on its approved list for investment
- The majority of Indian companies are still not well-represented in global sustainability funds
- India lags behind other emerging markets (such as Brazil) in terms of attracting sustainable investment and building domestic markets

Since the publication of the TERI report, India has witnessed some further developments within the sustainable investment industry, for example, initiated and sponsored

³² See further Siddy, D. and Kumar, R. 2007, "Sustainable Investment in India", TERI Europe.

³³ Ibid.

by IFC³⁴, CRISIL, together with Standard and Poor and KLD Research & Analytics, has launched the S&P ESG India Index, the first investable index of companies whose business strategies and performance demonstrate a high level of commitment to meeting ESG standards. The S&P ESG India Index links a company's ESG score to its index weightings such that companies with higher scores carry higher weightings.³⁵

Corporate governance

In 1998, the Confederation of Indian Industry (CII) developed the CII Code for Desirable Corporate Governance, with the aim of developing and promoting a framework for corporate governance within Indian companies. However, the adoption of the Code was voluntary and few firms embraced it.³⁶

In December 1999, the Securities and Exchange Board of India (SEBI) set up the Kumar Mangalam Birla Committee on Corporate Governance, whose recommendations formed the basis for Clause 49 of the Listing Agreement. SEBI revised Clause 49 in late 2004 on the recommendations of the Narayana Murthy Committee on Corporate Governance, with the revisions coming into effect on 1 January 2006.³⁷

One of the largest corporate governance events of recent times, in the form of Satyam, could help to quicken authorities' and investors' response to raising corporate governance standards in India. In one of the biggest frauds in India's corporate history, Raju the founder and CEO of Satyam Computers, India's fourth-largest IT services firm, announced on January 7 that the company had been falsifying its accounts for years, overstating revenues and inflating profits by \$1 billion. This has been dubbed as India's Enron by many market commentators and has brought renewed and critical focus on improving the governance framework through the role of independent directors, auditors, company management, the CFO and other key persons involved in corporate activities³⁸.

Climate change

The Indian government's response to climate change has been rather mild to date. The prime minister appointed an advisory committee to develop a national action plan on climate change in 2007. The plan was released in June 2008, and is more aspirational with a repackaging of initiatives already underway and a notable absence of targets or timetables.

Despite the lack of hard targets set by government, there has been a focus on solar energy and a proposed domestic emissions trading scheme for the most polluting industry sectors—which could improve standards going forward. India's private sector is making major investments in solar energy and potentially could be a leading force in this area.

4.2. ESG Integration capabilities of investment managers in India

The managers that were interviewed as part of this research process included global managers, local managers and joint ventures between global managers and local Indian managers. Based on these research meetings, Mercer found that in those cases where there was ESG awareness at the organisation level, this did not translate into an ESG policy or integration into investment managers' activities locally.

Another notable observation was the **lack of appetite for active ownership practices**, where most of the investment managers interviewed showed a reluctance to engage with companies when they became concerned about particular aspects of their activities. Rather, the most common response to any concerns that may arise is to sell down the stock holdings. In regard to voting, our research suggested that none of the managers had an active voting policy in place that was implemented across their Indian equity holdings.

34 KLD 2008, "Standards and Poor's India ESG Index launched", available at http://www.kld.com/newsletter/archive/press/pdf/S&P_ESG_India_Index.pdf, accessed 12 January 2009.

35 <http://www.csrwire.com/News/10867.html>

36 <http://www.seattleu.edu/asbe/abei/papers%20for%202006%20conference/Iti%20Bose.pdf>

37 <http://www.sebi.gov.in>

38 <http://knowledge.wharton.upenn.edu/india/article.cfm?articleid=4344>

On a positive note, some (a minority) of the managers displayed a limited awareness of **local social issues as a backdrop for evaluating investment opportunities and risks**. Admittedly, the managers did not see this as a particularly strong area of their skills. When the investors were making an overall assessment of quality of management in terms of corporate strategy and behaviour, the investor might look at how a company deals with government policies or measures that could impact on business models. Notwithstanding the awareness of local social issues (as a preference), this issue would not be explicitly scored as part of an assessment of corporate management. At least, the awareness had some influence on the investment process. This finding is somewhat encouraging as it shows that there is some inclination for local managers to think about some ESG issues.

On the other hand, some managers Mercer interviewed did not think that investing with an ESG focus (amongst other issues) was a valid part of the investment process.

Overall, the practices and level of awareness of ESG issues amongst Indian investment managers included in this study was comparatively low and, on average, the managers were rated the lowest on ESG integration and active ownership compared to the other three regions included in this report.

4.2.1. Highest ESG rated managers in India

The ESG ratings of the top three strategies in India were only marginally ahead of the other seven managers included in this research. Mercer has reviewed the top three strategies below in any case.

Kotak Mahindra Asset Management Co. Ltd. Kotak 30

Kotak Mahindra is one of India's largest financial services conglomerates, employing more than 17,100 people across its various businesses. In its offshore funds, Kotak has a Shariah fund. A strategy based on an ESG platform is also being developed.

For the Indian equity strategy (Kotak 30) that Mercer researched, Mercer found that whilst there is no formal ESG policy, corporate governance is considered in the portfolio management process. Idea generation and portfolio construction are being synergised for the entire equities team in the Kotak group. The global head of equities for the Kotak Mahindra group meets with the portfolio

managers across businesses every month. This helps in getting market insights for the portfolio manager. Serious governance concerns can also come up in these meetings. When governance concerns do arise, the investment managers follow a practice of having an informal chat with the company management rather than voting or active engagement. In extreme cases, the investment managers will sell stock holdings.

The group has a 'green fund' in the separate Portfolio Management Service business (as part of a retail fund offering). Hence they have information about ESG factors, but no scorecard or process is used to evaluate companies against ESG issues. The investment team's view was that integrating ESG into investment processes could restrict their potential opportunities and may not be desirable. The manager's attitude is that ESG analysis is a specific skill set and that they would need to invest in additional resources with expertise in this area if they were to elect to include these matters formally in the investment process.

The preference to develop a specific SI-labelled fund over ESG integration was a trend that prevailed across all managers interviewed in India. This likely reflects the retail based environment that they operate in, with a still small institutional investor client base locally in existence. The notion of ESG integration is unlikely to develop in Kotak given the management's attitude towards these issues, although new product developments and potential engagement actions could be interesting to watch in the future.

HSBC Global Asset Management

HSBC Equity Fund—Growth

HSBC Global Asset Management invests in Indian equity and often assesses environmental issues such as eco-systems, food inflation, environmental challenges, wind power, energy conservation and supply chain risk, as the portfolio manager believes these factors can have a material impact on the Indian business environment. The manager of this strategy also held a leading wind-energy company in the investment portfolio.

The investment team looks at energy conservation as a theme and the portfolio manager commented that a few mid-cap cement companies in India were not included in the portfolio, as these companies were inefficient in

their power consumption, which was a negative factor in forecasting the prospects for these companies. The energy theme has also helped them identify an electronics company as an investment candidate.

Governance is taken seriously as they have avoided investing in companies where there is a lack of information disclosure. While the portfolio manager has made a formal request to its brokers to include ESG issues in their investment research, there is still a lack of direct integration of ESG factors into the investment process. Nevertheless, there are indications that the level of integration of ESG into the investment process could improve over time as HSBC makes efforts to implement the PRI more effectively globally.

HSBC has been an active and vocal participant in collaborative initiatives such as the PRI, and has dedicated 7 SRI team members to this area globally (although they are not based in India). The firm wide level of commitment to ESG integration is a challenge as there are many distinct parts of the business for which SRI does not naturally fit. For example, the absence of a proxy voting policy and approach to engagement specific to India is an example of the lack of global 'link-up' across HSBC Global Asset Management.

One encouraging development is that from quarter 2, 2008, all investment teams will have access to a global ESG dedicated database. A local analyst in India has also had some training on the PRI. Overall, there is still a lack of direct integration of ESG into the business operations in India but there are indications that this could improve over time, as HSBC makes efforts to implement the PRI more effectively globally.

JPMorgan Investment Management Indian Equity Fund

JPMorgan Investment Management (JPMIM) signed the PRI. JPMIM's senior management team globally supports this initiative and is confident that its focus on ESG issues provides an appropriate framework for investor practices. Despite the level of commitment at the firm-wide level, Mercer found little evidence that this is feeding through to investment practices in India or, indeed, this particular strategy that Mercer researched.

For example, corporate governance specialists routinely attend scheduled one-to-one meetings in the UK and Europe alongside analysts and portfolio managers, as well as convene dedicated meetings, to discuss areas of concern. These processes do not exist in India.

At the global organisation-wide level, risk management and control systems provide oversight, coordination and a consolidated view of risks and controls. Operational and fiduciary risk are the primary focus with research and recommendations provided by two third-party proxy voting advice vendors to assist in researching and implementing their proxy voting activities. This practice has not been applied to India yet. Rather than voting and engaging with companies in India, the manager of this strategy would be more likely to sell out of a position where they perceive major issues (such as governance) that would negatively impact on long-term shareholder value.

JPMIM has established a proxy committee and appointed a proxy administrator in each global location where proxies are voted but has yet to include India as one of these locations.

5. Sustainable investment practices in South Korea

This section presents the key findings of SI practices of 10 investment managers based in South Korea. It includes an overview of the investment landscape in South Korea and examples of the most highly rated products in terms of ESG integration and active ownership.

5.1. Key findings

- There is a reasonable recognition within the investment community of the importance of ESG issues. The South Korea Exchange plans to develop an eco index and SRI index in the near future. In addition, the UN Global Compact Standards has been relatively successful in South Korea. One of the largest influencers of the SI debate is the South Korea National Pension Fund, who issued a search in 2006 for an investment fund that incorporated ESG issues.
- South Korean companies have historically had poor corporate governance and lacked transparency (largely because of the existence of chaebols (family-controlled companies). However, the current South Korean government has placed greater emphasis on improving transparency and accountability.
- At a company level, there has been some growth in the number reporting on sustainability issues, but the number remains relatively small (50 in 2008).
- The 'E' of ESG is likely to become a more significant opportunity for South Korean investment managers as the government aims to halve carbon emissions by 2050 through the 'Low Carbon Green Korea' initiative, increasing the proportion of energy supplied by the renewable energy sector from 2% (current levels) to more than 20% by 2050.
- During the research meetings, investment managers noted that they are keen to see a stronger compliance regime sanctioned by the government to effectively further the pursuit of SI. Some also believed high
- quality investment relevant information on ESG issues is difficult to find. There is also some concern from investment managers that engagement on ESG issues could result in a reduction in the ability to gain access to company management, as it was felt culturally inappropriate to challenge senior business leaders on these types of issues.
- The three South Korean equity managers with the highest ratings for integrating ESG factors into their investment process were **Rexiter Capital Management, RCM and Samsung Investment Trust Management.**

5.1.1. Overview of sustainable investment in South Korea

Since the Asian financial crisis of the late 1990s, South Korea has experienced considerable growth. Along with its economic development, South Korea's stock market has begun to develop SI initiatives whilst representing one of the strongest economies in the MSCI emerging markets index and S&P/IFCI emerging market index.

South Korea is included in the report as an emerging market that is in transition. Since falling victim to the 1997 financial crisis, as well as the ill-effects of government-directed banking and currency systems, South Korea has achieved reasonable levels of GDP growth.³⁹ This growth is export driven and stems from improvement in the dominant information and communication technology (ICT), coupled with subsequent external demand, mainly from China.⁴⁰

The recent global financial crisis has, however, brought into question the strength of South Korea's economy and its status. With recession fears gripping global economies, a "flight to safety" by investors to developed economies has left emerging markets and Korea in a position of extreme pressure.⁴¹

Despite limited exposure to the US mortgage debt market, as with all emerging market countries, the South Korean economy has been hit by capital outflows and decreased export demand that have resulted in a 40% drop in both the stock market and the value of its currency. Radical monetary policy changes as well as reforms to the banking and currency systems are required to alleviate the current state of affairs.⁴² However, Mercer notes that South Korea will reach a major turning point in its transition from classification as an emerging market to a developed market country in September 2009.⁴³

39 Kim, Suk, H, Asian financial crisis of 1997: The case of Korea, *The Multinational Business Review*, Spring 2001, available at http://findarticles.com/p/articles/mi_qa3674/is_200104/ai_n8940217, accessed 23 January 2009.

40 OECD Economic Surveys: Korea [serial online]. June 2007:11-19., available from: Business Source Premier, Ipswich, MA, accessed 20 January 2009

41 Reuters, 2008, Bailout rejection spurs flight to safety, *Asia One News*, available at: <http://www.asiaone.com/News/AsiaOne%2BNews/World/Story/A1Story20080930-90890.html>, accessed 20 January 2009.

42 Federal Reserve Bank of San Francisco, 2008, Economic Conditions in Korea and Japan, FRBSF Economic Letter, Number 2008-38, December 19, 2008.

43 Wang, T, 2008, South Korea Graduates to 'developed' status, *Forbes*, available at: http://www.forbes.com/2008/09/18/korea-developed-ftse-markets-equity-cx_tw_0918markets03.html, accessed 23 January 2009.

“The biggest reasons for the South Korea discount are poor corporate governance and a lack of management transparency. Domestic investment managers’ active stance could lower the discount rate and bring a re-rating of the local stock market...”

Growth in sustainable investment funds

South Korea has recently seen the most rapid growth in sustainable investments in Asia, with the number of SI labelled funds increasing from 2 in December 2005, to 14 in December 2006, and to 45 in May 2008.⁴⁴ These 45 SI labelled funds include 37 public funds, 2 private equity funds and 6 SRI pension mandates mainly focused on corporate social responsibility and environmentally aware funds.

SI amongst South Korean listed companies

Recognising the increasing importance of ESG issues to the way businesses are conducted in South Korea and globally, the South Korea Exchange announced in July 2008 that it will be developing an eco index listing. The eco index will track companies that engage in the production of eco-friendly goods and alternative energy development projects. The development of the eco index is in line with the South Korea Exchange’s plans to establish a SRI index in the future.⁴⁵

SI global standards

There are currently 136 South Korean companies, including South Korean investment managers, that are signatories to the UN Global Compact. A joint conference between the United Nations Environment Program Finance Initiative (UNEP FI), the United Nations Global Compact and the Principles for Responsible Investment was held in June 2008. The “Seoul Declaration” was launched during the conference on the role of businesses, financiers and investors to address ESG issues in their processes. Immediately following this event, the International Corporate Governance Network (ICGN) annual conference was held in Seoul with major international pensions and institutions committing to greater shareholder collaboration on matters of corporate governance.

Other voluntary initiatives that have achieved some profile in the local investment industry include the Global Compact South Korea Network, which has been instrumental in encouraging Asian businesses to build a community around corporate responsibility in the region.⁴⁶ The network has grown from 20 business participants at the time of its launch

in September 2007 to more than 120 participants in 2008. The network has gathered the support of large South Korean organisations including KT Corporation and Shinhan Bank.

The South Korea National Pension Fund is also an influencer in the SI debate having issued a public tender to search for investment funds that incorporated ESG in 2006⁴⁷ and in considering SI policy and the PRI.

The South Korea Sustainability Investing Forum (KoSIF) established in 2006⁴⁸ has also contributed to the promotion of SI in South Korea and is a member of ASRIA.

The above events have led to five investment managers and three professional service partners in South Korea becoming signatories to the PRI (as at September 2008).

Corporate governance

South Korea has made progress in regard to corporate governance and sustainability since the Asian economic crisis in the late 1990s. The Asian crisis, however, uncovered serious deficiencies in South Korea’s economy and hence its sustainability namely, indiscreet “fleet” type management by South Korea’s “chaebols” (family-controlled companies), with management decisions being made by controlling stakeholders.⁴⁹ The traditional structure of South Korea’s chaebols is characterised by an absolute concentration of ownership within the family of the founder and a highly diversified business structure. The chaebol structure promotes owners’ interests without regard to the interests of minority shareholders or the need for management transparency and accountability.

In recent times, there have been several high-profile cases of tax evasion, accounting fraud and embezzlement amongst South Korea’s chaebols. The 30 largest chaebols control almost 40% of the economy, according to the Bank of Korea.⁵⁰ The current South Korean government has placed strong emphasis on raising the standards of corporate governance and its long-term focus on introducing global standards to South Korea’s corporate governance and

44 www.asria.org

45 http://www.koreatimes.co.kr/www/news/nation/2008/07/123_27715.html

46 http://www.unglobalcompact.org/newsandevents/news_archives/2007_09_17.html

47 <http://www.newswiretoday.com/news/39137/>

48 <http://www.kosif.org/>

49 Wong, Calvin, Standard & Poor “Corporate Governance in Korea” available at http://www.acga-asia.org/loadfile.cfm?SITE_FILE_ID=158

50 <http://www.iht.com/articles/2008/04/23/business/samsung.php>

investment system. Initiatives by the government based on recommendations by international organisations including the International Monetary Fund (IMF), have enabled regulations and systems related to corporate governance to be brought closer to international standards. Significant improvements have been made during a relatively short period of time, including the establishment of the South Korean Corporate Governance Service (KCGS) in 2002.⁵¹ The KCGS is an independent, non-profit organisation that was established under the joint sponsorship of the South Korea Stock Exchange (KSE), Kosdaq Stock Market, South Korea Securities Dealers Association, South Korea Listed Companies Association, Asset Management Association of South Korea and Kosdaq Listed Companies Association.

In the past, domestic investment managers were often criticised as rubber stamping corporate policies, ignoring their fiduciary duties to protect the interests of their investors. Increasingly, more investment managers are becoming aware of the role that they can play in governance through proxy voting and annual shareholders' meetings.⁵²

Shareholder activism began to gain attention in South Korea with Sovereign Asset Management, a Dubai-based investment fund, enforcing greater shareholder transparency and change in SK Corp's management of South Korea's largest oil refiner.

Analysts believe that the rising interest in shareholder activism will help resolve the "South Korea discount" that restrains share prices. *"The biggest reasons for the South Korea discount are poor corporate governance and a lack of management transparency. Domestic investment managers' active stance could lower the discount rate and bring a re-rating of the local stock market,"* said one investment manager.

Corporate sustainability

The Swiss-South Korean joint venture SolAbility⁵³ recently published the results of its second annual assessment of companies listed on the South Korean Stock Exchange.

The assessment covers 350 large and medium-sized companies. A portfolio of the leading 34 sustainable South Korean companies outperformed the South Korea Composite Stock Price Index (KOSPI) by more than 220% since 2002 and more than 110% since 2007.

According to SolAbility's press release, the study was conducted based on industry peer comparisons, using over 400 indicators and 60 types of sustainability criteria, across 29 different industry sectors.

The study noted the number of companies reporting on sustainability issues has increased from zero in 2001 to more than 50 in 2008.

The carbon economy

In July 2008, the government announced its aim to increase the proportion of energy supplied by the renewable energy sector from the current level of 2% to more than 11% by 2030 and more than 20% by 2050.⁵⁴ The government promised to increase investment in alternative energy sources and promote green technology. Some of South Korea's major conglomerates have already invested in developing renewable energy technologies, including Samsung, LG and Hyundai. Some companies are focusing on solar-energy production and Doosan Heavy Industries is investing in wind-power technology. Investment managers are increasingly adding these types of investments to their portfolios.

As part of the government's goal to halve its carbon emissions by 2050, the "Low Carbon, Green Korea" initiative was launched in 2008.⁵⁵ The South Korean President signed an agreement in August 2008 with local companies to develop battery packs for plug-in hybrid vehicles and decided that selected products will be labelled to show their carbon footprint, starting in 2009.⁵⁶ These recent initiatives show commitment by the government and local companies to promoting environmental sustainability in South Korea.

51 http://www.cgs.or.kr/eng/center/c_cgs.asp

52 <http://www.legatum.com/lc/pressreleases/20070319.htm>

53 SolAbility is a Swiss-Korean joint-venture providing strategic sustainability advice to corporate clients and assessing the sustainability performance of listed Korean companies. <http://www.solability.com/eng/SRI/overview.htm>

54 <http://www.kdb.co.kr/weblogic/Board?BID=25&NID=32302&ACTION=VIEW>

55 <http://www.ens-newswire.com/ens/jul2008/2008-07-28-02.asp>

56 <http://www.kdb.co.kr/weblogic/Board?BID=25&NID=32426&ACTION=VIEW>

5.2. ESG integration capabilities of investment managers in South Korea

Managers interviewed included global managers and local managers, as well as managers that are joint ventures between a global manager and a domestic manager.

Global managers, including joint ventures between global and domestic managers, **demonstrated ESG awareness which did not necessarily translate to a formal ESG policy** for the South Korean portfolio managers. Investment managers noted that they are **keen to see a stronger compliance regime sanctioned by the government** to further the pursuit of SI. The portfolio managers did not explicitly consider ESG factors during the investment process in a comprehensive way, but some managers were innovative in their research and search for new investment themes.

Of the 10 strategies researched, a number of portfolio managers expressed the view that they believed the current changes in South Korea's economy, which encompasses **changes in labour laws, family run conglomerates (chaebols), and the stronger focus by the government on environmental issues, will provide new investment opportunities** to mainstream equity managers.

A number of local portfolio managers expressed concern that engagement on ESG issues could reduce the portfolio manager's ability to gain access to company management, and that **it could be culturally inappropriate to challenge senior business leaders**. They looked to South Korean activist funds for insight and felt that engagement undertaken by global firms was of limited value in the South Korean context.

A further concern raised by the South Korean investment managers was the **lack of high-quality, investment-relevant information on ESG issues for the South Korean equities market**. The remuneration and bonus system for a large number of domestic managers, in particular, centres on short-term performance. Portfolio turnover was significantly higher among local manager strategies compared to global manager strategies.

5.2.1. Highest ESG rated managers in South Korea

Among the 10 managers interviewed, three managers: Rexiter Capital Management, RCM and Samsung Investment Trust Management; received the highest rating on integration of ESG factors and active ownership activities across their investment process. Comparatively speaking, South Korean investment managers exhibited some of the most advanced practices with respect to investment implementation of the asset managers across all the regions included in this study.

Rexiter Capital Management Korean Equity

Rexiter Capital Management Korean Equity (Rexiter) was one of the highly rated South Korean ESG equity strategies. It is led by a portfolio manager who has been managing South Korean equities for the past 14 years.

Overall, Mercer found that corporate governance factors are considered systematically in the investment process both as a risk management and idea generation function. Some environmental and social issues have been regarded as material to certain companies in the portfolio as one of a number of factors.

Rexiter uses a specialist ESG research provider for some stocks in the portfolio, although there was little evidence to illustrate how systematically the ESG research is applied to the decision making process and how any gaps in the research coverage are filled.

The investment manager has a watchlist and has identified certain environmental issues from an investment point of view, whereas governance and social issues were considered more as risks to manage (rather than value drivers). The fund does not use external brokerage reports and relies on the capability of the team to adequately cover all sectors, supplemented with other in-house research that is available, such as ESG data.

The fund's investment horizon is three years, which supports the investment manager's view that stocks with strong governance factors require a longer holding period for the fund to benefit from these factors.

The investment manager conducts a minimum of two site visits for each company held in the fund. Discussions during these site visits predominantly focus on the company's management and governance structure. Environmental and social issues are not specifically addressed in these discussions. However, social issues such as labour rights issues in the type of industry that could materially affect the valuations of the companies held in the portfolio, are monitored as a risk. At the organisation-wide level, Rexiter delegates the function of voting to a third party provider.

RCM Active Korean Equities

Another highly rated fund in South Korea, **RCM Active Korean Equities** (RCM), demonstrated a stronger focus on corporate governance issues than environmental or social issues. In certain investments, environmental and social issues are factored in as part of a range of investment considerations based on the manager's ESG research data.

The manager has a global SI team and the research provided by the global SI team is available to the South Korean equities investment team via a desktop system and database using live data. The team includes a member with previous SRI research experience who contributes to the fundamental bottom-up research process and is familiar with SI approaches.

The investment manager also subscribes to a global ESG research provider for research data. ESG scores for some stocks in the portfolio are considered when weighting the stocks in the portfolio. However the ESG research coverage on South Korean stocks is insufficient from the manager's point of view, and is supplemented by the manager's own global proprietary research which provides both ESG and mainstream ratings. Both the portfolio manager and research manager displayed knowledge and interest in recognising ESG issues within the fund's investment processes.

The fund's portfolio construction process focuses on sector research and there is no evidence that ESG issues are used as a means of weighting sectors explicitly. Stocks are held for approximately 12 to 14 months, which is longer than some peer strategies Mercer assessed which were for less than 12 months. When required, feedback is provided to companies on ESG issues but this is conducted via the manager's global SI team.

At the organisation wide level, the manager is a member of SI collaborative initiatives such as the CDP, PRI and is a founding member of the Enhanced Analytics Initiative (EAI). Currently very few Korean companies have been involved in the feedback/engagement process and there is currently no Asia Pacific representative in the global RI team within RCM.

Samsung Investment Trust Management Korean Leading Group Fund

Samsung Investment Trust Management's (Samsung) investment team considers governance factors and their impact on the valuation of stocks in the idea-generation stage. Environmental and social factors are not explicitly considered but are viewed as potential indicators of risk rather than investment opportunity. The product manager cited an example of the impact of increasing desertification in China, which results in desert sands blowing over South Korea at certain times of the year, as evidence of climate change affecting South Korea's environment. According to the portfolio manager *"These kinds of climate change issues will become increasingly relevant to companies in South Korea and investors over the next three years"*.

There is no systematic approach for weighting ESG factors in the portfolio construction process. Similar to its peers, the fund is focused on short-term returns and has high portfolio turnover (circa 200% pa) which makes it difficult for the investment manager to integrate ESG factors in a consistent way.

Governance issues are analysed at a stock level, and the fund is sensitive to any short-term social and environmental factors as they believe that these factors can affect the valuation of the stocks and sectors within the portfolio. Samsung has been monitoring certain Korean companies whose corporate governance structure has evolved over the last 12 months, and believes the current value of these companies has benefited from improved governance.

The portfolio manager participates in proxy voting. In the past year, the manager has voted twice against management on the issue of directors' remuneration packages. The portfolio manager conducts company visits, engaging management of these companies primarily on issues of corporate governance. The manager will discuss social issues, such as worker pay and rights, with company management if the issue has been widely covered by the media and could impact the company's reputation.

The firm has developed an ESG policy. However, there appears to be little communication between senior management and the portfolio managers about how to integrate ESG issues in the day-to-day management of the Korean equity strategy. The portfolio manager suggested that the limited access to independent data sources and the limited support from senior management has prevented the wider integration of ESG factors in the fund's investment process. The firm has 2 SI-labelled products; a water theme fund and a renewable energy fund, and future fund launches are in the pipeline.

6. Sustainable investment practices in Brazil

This section presents the key findings of SI practices of 10 investment managers based in Brazil. It includes an overview of the investment landscape in Brazil and examples of the most highly rated products in terms of ESG integration and active ownership.

6.1. Key findings

- Brazil's first SI labelled fund was launched in 2001.
- Brazilian companies tend to have a fairly weak level of corporate governance standards when compared with their global counterparts, with controlling family/groups typically dominating most boards. In addition, a poor level of financial disclosure acts as a barrier to active ownership.
- Mercer's research highlighted that although there appears to be firm-wide commitment to ESG issues and a general awareness of sustainability/ESG amongst most investment managers, this does not necessarily translate to integration into the investment process in Brazil.
- Corporate governance was the strongest factor impacting on investment decisions rather than environmental or social issues.
- Collaborative engagement has emerged as a tool that local investment managers are increasingly willing to utilise on a range of ESG issues.
- There is significant potential for investment managers in Brazil to develop market leading practices on ESG integration, due to the country's history and familiarity with promoting corporate governance standards and also the significant uptake of the PRI by Brazilian asset owners and asset managers. For this reason, Mercer expects practices to improve over time in response to asset owner demand, provided clear signals are sent from the pension fund community.
- The three Brazilian equity managers with the highest ratings on integrating ESG factors into their investment process were ABN Amro, HSBC Global Asset Management and Rio Bravo.

6.1.1. Overview of sustainable investment in Brazil

Brazil began embracing the concept of sustainability as early as the 1990s, when corporate social responsibility emerged as a significant force.⁵⁷ Brazil launched its first SI-labelled fund—ABN AMRO Ethical Fund—in November 2001.⁵⁸

In December 2005, the Sao Paulo Stock Exchange, BM&F BOVESPA, launched Latin America's first sustainability index, the Bovespa Corporate Sustainability Index (Índice de Sustentabilidade Empresarial—ISE), in Latin America. The index, which was developed with the support of IFC, consists of up to 40 local companies selected according to their ability to meet specific standards for environmental, social and corporate governance.⁵⁹

The PRI, one of the major drivers for sustainable investment globally, has also attracted 28 signatories in Brazil, including 18 pension funds, 8 asset managers and 2 professional service providers. Most of the signatories are pension funds, which may reflect the efforts of the PREVI (the Pension Fund of the Banco do Brasil employees) and the ABRAPP (Brazilian Pension Funds Association) to educate the investment community about the importance of the principles.

⁵⁷ SustainAbility, IFC and ETHOS, 2002, 'Developing value: the business case for sustainability in emerging markets'.

⁵⁸ See further <http://www.environmental-finance.com/2001/0111nov/news.htm>

⁵⁹ See further IFC Launches Brazil's Sustainability Index, available at http://www.ifc.org/ifcext/media.nsf/Content/IFC_Launches_Brazils_Sustainability_Index and see also Bovespa Corporate Sustainability Index, available at [http://www.ifc.org/ifcext/home.nsf/AttachmentsByTitle/Brazil_Corp_Sus_Index/\\$FILE/Brazil_Corp_Sus_Index.pdf](http://www.ifc.org/ifcext/home.nsf/AttachmentsByTitle/Brazil_Corp_Sus_Index/$FILE/Brazil_Corp_Sus_Index.pdf)

Corporate governance

Brazil has set up a Corporate Governance Stock Market Index (Índice de Ações com Governança Corporativa Diferenciada or IGC) in 2000, which is composed of companies that have demonstrated high governance standards.⁶⁰ Typically, Brazilian public companies have a controlling shareholder or group. According to a recent study of 116 companies,⁶¹ board independence is an area of weakness when assessed against global governance standards. The boards of Brazilian private firms are usually dominated by representatives of the controlling family or group who also strike up shareholder agreements to protect their own interests.

Recent governance studies found that a number of firms had no independent directors, placing minority shareholders in a particularly weak position and generally undermining opportunities for active ownership by shareholders. Only a minority of firms in Brazil provide minority shareholders with take-out rights above the legal minimum on a sale of control, which means that in the majority of cases these shareholders are prevented from considering meaningful corporate engagement.

Financial disclosure amongst Brazilian companies is another barrier to active ownership, as only a minority of firms provides a statement of cash flows or consolidated financial statements. That said, a growing majority does provide English language financial statements. While Audit Committees are uncommon, many Brazilian firms have what is known as a Fiscal Board⁶². The overall picture is hard to reconcile with models in which firms consciously choose those governance structures which best meet their needs. It suggests instead the potential value of legal or institutional reforms which impose minimum quality rules on public firms.

⁶⁰ Ibid. p.2.

⁶¹ Black, Bernard S., De Carvalho, Antonio Gledson and Gorga, Erica, An Overview of Brazilian Corporate Governance (July 2008). U of Texas Law, Law and Econ Research Paper No. 109; Cornell Legal Studies Research Paper No. 08-014; ECGI—Finance Working Paper No. 206/2008. Available at SSRN: <http://ssrn.com/abstract=1003059>

Research Paper No. 08-014; ECGI—Finance Working Paper No. 206/2008. Available at SSRN: <http://ssrn.com/abstract=1003059>

⁶² Ibid

Collaborative engagement

A good example of asset owners engaging with companies in Brazil was a PRI-wide campaign focused on the Brazilian charcoal production sector. PREVI and other Brazilian pension funds were involved in the initiative. Useful mechanisms used by Brazilian owners to promote the role of engagement include the Global Reporting Initiative (GRI) as part of the International Emerging Markets Disclosure Project and the Carbon Disclosure Project. Another key body in Brazil that acts to promote engagement and sustainability is the Brazilian Association of Pension Funds.⁶³

⁶³ P 65 Responsible Investment in focus – how leading public pensions are meeting the challenge UNEP FI and UKSIF 2007

6.2. ESG integration capabilities of investment managers in Brazil

Our research suggested that many investment managers in Brazil prefer to **consider ESG issues as risk factors where the predominant tool is one of screening and SI-labelled funds**, rather than value enhancement through capital allocation or active ownership activities within mainstream investments (although some examples of the latter have emerged amongst the leaders).

Of the leaders, **corporate governance emerged as the dominant factor influencing investment decisions** rather than E and S issues. Collaborative engagement has also emerged as a tool being increasingly used by some asset managers.

6.2.1. Highest ESG rated managers in Brazil

The following are some general characteristics of the top three rated strategies:

- Most strategies have a dedicated analyst on ESG factors and the analyst would be actively involved in the investment process
- Portfolio managers plan to improve or formally introduce ESG factors analysis into their investment processes in the future, so there is potential for improvement in practices
- These managers have also started participating in proxy voting, as well as engagement with companies
- Most of the managers interviewed by Mercer either have sustainability labelled strategies already or plan to offer this type of product in the near future. The development of specialist SI-labelled products has been the tool of choice amongst investment managers for responding to demand for ESG integration, more so than efforts to integrate into mainstream strategies

The sustainable investment practices of the top three rated strategies are discussed below.

ABN Amro Fi Ações Ativo II

ABN Amro Fi Ações Ativo II's (ABN) strategy has a dedicated SRI analyst, and both the CIO and the SRI analyst have a good understanding of what ESG factors are and how these factors can be incorporated into the investment process. The SRI analyst is a member of the equity committee (which makes decisions on stock selection and portfolio strategies), and presents to the equities selection committee. The committee decides whether and how to invest in companies in the light of ESG factors.

While the portfolio manager looks at ESG factors in the stock-selection process, it is yet to become a formal or mandatory part of the investment process. However, all companies are assigned a qualitative governance score by analysts that can influence buy/sell decisions and portfolio weights. In some instances, the analysts or portfolio managers might apply insights and ideas provided by the SRI research group, but ESG integration, if it occurs, depends on individual analyst interest and skill. The CIO and sector specialist for utilities, oil and gas, and petrochemicals analyst (who is also the SRI specialist) suggest there is a relatively high level of focus on key issues for sectors where ESG is considered to be most relevant.

ABN also has a proxy voting policy, but for this particular strategy, voting is limited to meetings where the entire investment management organisation has significant holdings and particular issues have been identified. Engagement is limited to asking companies for improved disclosure and clarification relating to ESG issues.

Overall, ABN has made a strong commitment and demonstrated leadership in the promotion of sustainable business practices across Brazil. There was evidence to suggest that the investment process of the strategy reviewed takes account of some ESG factors, although it is not a mandatory part of their process and is sector focused. The internal ESG research from the SRI specialist and her attendance at equity committee meetings are both positive indicators of some degree of ESG integration into the mainstream process.

HSBC FIA Multi Ações

HSBC FIA Multi Ações (HSBC) portfolio manager has made an effort to integrate ESG factors into its investment-decision process at the firm-wide level, and there is evidence to suggest that it is feeding through to its equity strategy. HSBC has also employed an SRI analyst who is responsible for adjusting and implementing its practices relating to SRI factors in Brazilian companies.

Corporate governance is included in its companies' valuation model and the team is working on adjustments to their valuation model in order to incorporate environmental and social factors. In addition, their analysts consider all ESG factors during the companies' valuation process and will adjust the companies' estimated price in cases where these factors could impact the companies' value.

For HSBC's mainstream strategy, ESG analysis is an important part of the investment process. However, idea generation is a process focused on a fundamental analysis of the company's net income growth and EBITDA among other factors, and the ESG analysis will complement the analysis. Depending on the results of the ESG analysis, the expected price of the company being analysed may receive a premium or a discount. Their process and models already evaluate governance and they are currently adjusting their modelling in order to include 'E' and 'S' factors.

The manager will not hold companies in their portfolio if they have serious ESG problems, and conversely does not select stocks just because the company receives a favourable ESG analysis. The investment team uses HSBC internal research and has input from an SRI analyst based in Brazil who shares potential research/concerns/ideas with mainstream strategy analysts.

HSBC has a non-participation voting policy regarding shareholder meetings of companies in which it invests in Brazil. This does not preclude participation but it is not part of their core process. The current policy is under revision to comply with regulation changes that came into effect in 2008. It will describe the voting process for each type of asset and event and it will be public.

Overall, HSBC has an investment process that includes corporate governance as one of the factors it gives weight to when selecting stocks. The manager indicated that is looking to further adjust its valuation model in order to incorporate environmental and social factors. The manager evaluates ESG factors and when necessary, adjusts the value of the companies being evaluated on a case by case basis. On the downside, the non-participation approach to voting is weak and there was little evidence produced to demonstrate that the investment manager engages with corporations on ESG issues for this strategy.

Future plans include launching new sustainability funds and incorporating HSBC's processes related to ESG practices more widely. The firm is active in the PRI and making good headway in integrating ESG into this investment strategy, compared to the typical stage of development for many investment managers across all the regions included in this research.

Rio Bravo Fundamental FIA

Rio Bravo Fundamental FIA (Rio Bravo) portfolio manager of this strategy employs a very specific and unusual approach – one that Mercer would not expect to find replicated elsewhere in Brazil. One of the main characteristics of the fund's strategy is that the portfolio is comprised of small- and medium-cap companies with which the managers are actively engaged. At times, the manager even participates as a member of the companies' boards.

The manager believes that their capability to engage with companies and to participate in their governance and strategic decisions will contribute to the improvement of company results and therefore, the potential for out-performance. ESG factors may be taken into consideration before deciding to buy a company. The information is sourced from industry and company analysis based on public material and research reports, visits to companies and interviews with management and industry executives, as well as company suppliers and clients.

Once a company is included in the portfolio, one of Rio Bravo's objectives is to support the company to adopt high corporate governance standards through engagement, especially on governance issues. Environmental and social factors will also be taken into consideration whenever they can be used to influence company performance.

The Rio Bravo Group has a comprehensive proxy voting policy that defines the approach to voting by asset class and investment strategy. For managers within Rio of long-only/fundamentalists/governance strategies they are instructed to vote at general meetings of the invested companies. The policy is publicly available. An engagement policy does not currently exist but is being developed. Engagement is generally considered part of an investment manager's day to day responsibilities across all investment strategies.

Overall, our research suggests that ESG factors are taken into consideration when deciding which stocks will compose the equity fund portfolio however, these are not a primary (but rather secondary) part of the investment process and the focus is on governance as a value driver. This might reflect the fact that Rio Bravo also has expertise in this area with an activist fund called the RB Fundamental Fund (value and activism fund) whose strategy seeks to actively influence the invested companies towards improving operations and enhancing corporate governance.

7. Development of SI-labelled investment

This section presents the key findings of SI labelled practices of 10 investment managers globally. It includes an overview of the SI labelled investment landscape in emerging markets and examples of the most highly rated products in terms of ESG integration and active ownership.

7.1. Global overview

7.1.1. Key findings

- The global survey data suggests that investment in SI-labelled EME funds has risen more than fivefold since 2003 to over \$US50 billion in 2008.⁶⁴ While this is a significant increase, it is still only a small fraction (1.55%) of total EME investments⁶⁵ compared to 2.73% in developed markets⁶⁶ as at 30 June 2008.
- The data suggests there are 110 global SI-labelled equity funds that invest some of their assets into emerging market equities. Our research suggests that the average exposure of these funds to emerging markets is 6%, although the actual investment exposure varies between 0% and 40%. These funds account for an additional \$US15 billion of investment in EME.

64 Source: Mercer GIMD.

65 MSCI Emerging Markets Index market capitalisation was used as a proxy for total EME investments. Source: MSCI Global Investment Monitor.

66 MSCI Global Investable Market Index market capitalisation was used as a proxy for total equity investments in developed markets. The total AUM of SI labelled funds in developed countries was calculated using the following sources:

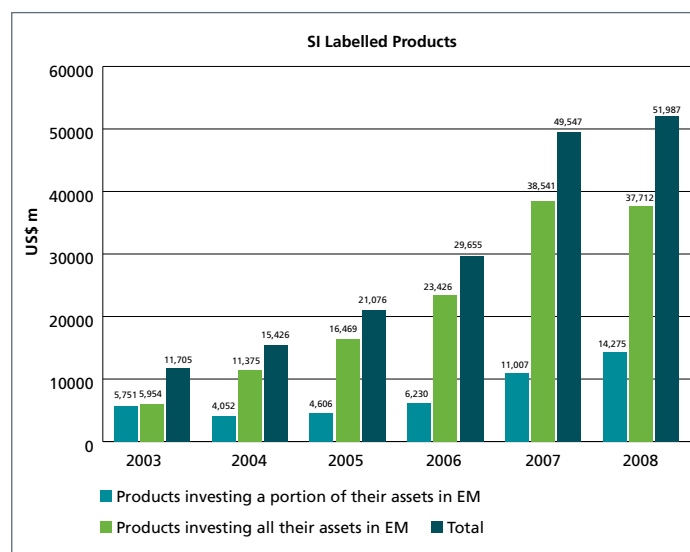
- European Social Investment Forum (Eurosif) 2008, “2008 European SRI Study”
- Responsible Investment Association Australasia’s (RIAA) 2008, “Responsible investment: a benchmark report on Australia and New Zealand”
- US Social Investment Forum’s (US SIF) 2008, “2007 report on socially responsible investing trends in the United States”.

7.1.2. Overview of SI-labelled funds in emerging markets

Based on Mercer’s global survey, there is over \$US50 billion of emerging market assets invested in SI-labelled funds, the bulk of which are investing in global EME rather than representing country specific investments. (Refer Table 3 on P 19)

As the chart in Figure 5 illustrates, investment in SI-labelled products in EME has grown considerably over the past five years.

Figure 5. Growth of SI-labelled products



Source: Mercer GIMD Global Survey results

The SI-labelled products that invest all their assets in EME have seen the most dramatic rise—increasing more than sixfold over the past five years. They account for over 75% of the sustainable assets invested in EME. Over the same period, sustainable emerging market assets invested via global equity, broad regional and balanced products has doubled. This increase has largely been over the past two years, after remaining largely static from 2003 to 2005.

The SI-labelled products that invest all their assets in EME have seen the most dramatic rise—increasing more than sixfold over the past five years.

The growth in assets over the past five years is impressive, when compared with the growth in emerging markets generally. Over the period June 2003 to June 2008, the MSCI Emerging Markets index increased by around 400%. Over the same period, the MSCI World index rose by only 70%. In part, this accounts for the difference between the growth rates in funds that invest all their assets in emerging markets and funds that invest a portion of their assets in emerging markets. The more recent decline in emerging markets has also impacted the growth rate of SI-labelled funds over the past year.

Major EME countries have experienced phenomenal economic growth in the past five years although the credit crisis and ensuing global slowdown has reversed some of this growth since mid 2008. An estimate of total investment in emerging markets derived from the market capitalisation of 25 EME stock exchanges reached approximately USD 3.3 trillion in June 2008.⁶⁷ Within that pool of capital, sustainable investment represents a comparatively small amount and is still a relatively new concept in emerging markets.

The table below lists the SI-labelled products with the largest investments in emerging equity markets.

Table 6. SI-labelled products with the largest AUM—EME

Manager name	Product	Product type	Assets in EME (USD M)
Genesis	Emerging markets	Global emerging markets	20,500
Colonial First State	Asia Pacific leaders	Pacific Ex Japan	10,000
Scottish Widows	Core emerging markets	Global emerging markets	4,100
Principal	Emerging markets	Global emerging markets	4,000
Colonial First State	Global emerging markets	Global emerging markets	3,700

Source: Mercer GIMD Global Survey results

⁶⁷ MSCI Global investment Monitor, 30 June 2008.

7.2. Research on leading SI-labelled funds

7.2.1. Key findings

- Mercer conducted detailed research on 10 SI-labelled funds investing into emerging market equities globally. The key themes emerging from these research meetings were:
 - A belief held by most of the investment managers that sustainability issues are at least as, if not more, important in developing markets than developed markets
 - That access to robust ESG information and data is important, but is very challenging to obtain, particularly in emerging markets where the analyst coverage of ESG issues is less progressed
 - Active ownership is challenging in many emerging markets for both local and global investment managers due to opaque ownership structures, cultural barriers that often do not fit with engagement approaches and weak rights for minority shareholders. Where corporate activities have been identified as potentially risky for long-term shareholder value, many investment managers prefer to exit (and sell the stock) rather than use their voice through engagement.
- SI has gained exposure in some markets through the launch of responsible investment indices. For example, there are indices in India (S&P ESG India Index based on research by Standard & Poor's, CRISIL and KLD Research & Analytics), Brazil (BOVESPA launched a Special Corporate Governance Stock Index in 2001 and a Corporate Sustainability Index in 2005), and South Africa (the JSE's Socially Responsible Investment Index was launched in May 2004).
- The SI labelled strategies with the highest ratings on integrating ESG factors into their investment process were: Colonial First State—Global Emerging Markets Sustainability Fund, Industrial Fund Management Company (IFMC)—China Equity SRI Fund, Lloyd George (LG)—Asian Green Fund.

7.2.2. Research on SI-labelled emerging market strategies

In addition to the 40 research meetings conducted on-site in China, India, South Korea and Brazil, Mercer researched 10 SI-labelled EME strategies globally. Mercer researched the first SRI strategies ever to be introduced in China, as well as SRI strategies investing into India, South Korea, Brazil and South Africa.

Broad themes from the managers' research meetings

- Many of the investment managers Mercer interviewed indicated that **sustainability issues are at least as, if not more, important in developing markets than developed markets**. Many indicated that the consideration of ESG factors can contribute to better risk-adjusted returns.
- Access to robust ESG information is important, but challenging to obtain. Many of the investment managers Mercer researched rely heavily on third-party researchers where there are **still significant shortages in research coverage of EMEs**.
- Active ownership is challenging in many emerging markets. For global emerging market strategies investing in multiple countries, this challenge is especially pronounced, as **working with the diversity of cultures and regulatory environments can be resource-intensive** (in addition to weak rights of minority shareholders that prevails across many of the markets).

7.2.3. Highest ESG rated SI-labelled emerging market managers

The top three rated strategies are summarised below:

Colonial First State Global Emerging Markets Sustainability Fund

The stated ethos of the **Colonial First State Global Emerging Markets Sustainability Fund** is that emerging market companies are going to have to think differently about their development prospects as they face development challenges that many Western economies did not have to deal with at the same stage in their growth. This is clearly the belief of the investment manager, who is well informed about both ESG factors and the specific difficulties facing companies operating in emerging markets. Consideration of ESG factors is a key part of the process of First State's mainstream emerging market funds. It does however go further than this: ESG factors are seen as the primary drivers of value, rather than just as potential risk or opportunity factors within a more general process. First State has a particularly considered and culturally-aware approach to voting and engagement.

Industrial Fund Management Company (IFMC) —China Equity SRI Fund

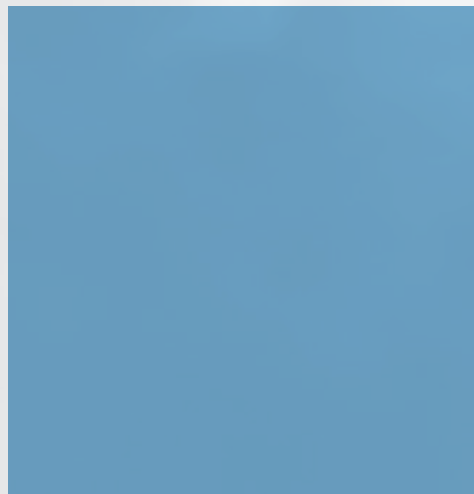
The research team of **Industrial Fund Management Company (IFMC)** has a good understanding of ESG issues and is clearly aware of the ESG investment methodologies used by international peers. The investment team sees the potential value of ESG integration into their investment process and attempts to raise the social awareness of SI in China.

IFMC has also developed a proprietary model to assess the ESG factors of each stock in their investment universe. Only those stocks with good ESG assessments can be included in the portfolio. After reviewing their model, Mercer was impressed by both the breadth and depth of ESG factors covered by the model, as well as its appraisal methodology. Some examples given by the investment manager show that short-term investment opportunity positions are not taken if ESG risks are identified. The team's targets of pursuing low volatility and medium and long-term returns are also consistent with the firm-wide investment philosophy. IFMC does not have a specialised ESG investment team, demonstrating that there are multiple models for integrating ESG into the core investment process that can be carried out effectively—having a specialist ESG research team can be beneficial but does not necessarily promote integration of ESG by mainstream investment managers. This strategy's well-developed process certainly demonstrates the potential for integrative thinking on ESG issues in the absence of such a team.

Lloyd George (LG) Asian Green Fund

LG Asian Green Fund invests in the Asian region with an environmental focus, but social and governance issues are also given priority and supported by a firm-wide commitment to corporate governance and the integration of ESG. The relevance of ESG appears to be embedded across the firm as a whole, and environmental issues are prioritised as a primary driver of value. The lack of transparency in some markets is tackled by the consistent use of detailed ESG questionnaires—some of which are sector-specific—in company research. Valuation models factor in potential costs or competitive advantages arising from ESG issues. Governance is a priority, but the manager recognises the difficulty of applying the same standards of corporate governance to emerging market companies as to developed market companies. Identifying appropriate standards is seen as critical, and the strategy has locally based managers carrying out fundamental research.

8. Findings and recommendations



In the past few years, there was also an increase in the number of SI indices or government policies in key emerging market countries including the ISE in Brazil, S&P ESG India Index, JSE in South Africa and requirement that State-owned enterprises (SOEs) implement Corporate Social Responsibility (CSR) in China.

8.1. SI is a growth story in emerging markets

Mercer's research found that the growth of SI was primarily driven by investors in developed markets investing into EME to achieve diversification benefits. This coincides with the research finding of this study that the AUM of global EME managers (whose clients are mainly asset owners from developed markets) account for more than two thirds of the USD300 billion in SI EME investments.

Mercer's research indicates that as at June 2008, SI labelled funds in EME are estimated to be over USD50 billion.

In the past few years, there was also an increase in the number of SI indices or government policies in key emerging market countries, including the ISE in Brazil, S&P ESG India Index, JSE in South Africa and requirement that State-owned enterprises (SOEs) implement Corporate Social Responsibility (CSR) in China. Markets dominated by retail investors (such as India), lag compared to those with institutional backing and the support of government policies (such as in Brazil and South Korea).

8.2. Governance is a well-understood concept in major emerging markets

Compared with environmental and social factors, governance is consistently well understood in major emerging markets such as China, India, South Korea and Brazil. Nevertheless, Mercer notes the following.

- **Lack of transparency**

One of the challenges for investment managers in emerging markets is to obtain clarity on companies' governance structures given the poor transparency and reporting standards that prevail across the developing regions. Moreover, there is an absence of standardisation in reporting that make comparability across countries an additional challenge for managers to grapple with.

- **Governance vital at stock selection stage**

Mercer's study revealed that the best-practice examples in dealing with this challenge at the stock selection level are those where the investment managers directly investigate governance standards in their meetings with, and appraisal of, investee companies. Indeed, Mercer believes that until transparency and reporting standards become more comparable, it is imperative that investors in emerging markets go beyond publicly available information. Often the information they need to make a prudent investment decision can only be obtained through face-to-face meetings and scrutiny of management. It is Mercer's opinion that the most efficient and prudent way to obtain this information is for investment managers to elicit this directly from companies in their appraisal process.

- **Active ownership is not a high priority**

Increasingly, asset owners are more focused on being active owners. The focus on governance and engagement is on the increase amongst the two thirds of global managers surveyed in this study, particularly PRI signatories⁶⁸.

A large proportion of managers Mercer surveyed have a voting policy, with two thirds of these managers making their policy public. However, less than one third of the managers have a policy on engagement with companies. Only 18% of managers surveyed would engage with companies on ESG issues in emerging market countries, and compared to developed markets, emerging market countries require culturally sensitive approaches.

Mercer's study also revealed best-practice examples where engagement is implemented by the portfolio manager to pre-empt potential risks and enhance returns through improving corporate standards of existing portfolio holdings. Again, until reporting standards improve and become more standardised internationally, it is imperative that investment managers play an active role in any engagement activities. Such practices may impact on existing portfolio holdings, and should not simply be outsourced to a specialist team without feedback mechanisms in place to inform the investment decision making processes.

68 PRI Work in Progress Report 2008, UNEP Finance Initiatives

EME managers recognise that clean technology and alternative energy are new growth sectors in emerging markets and a number of managers were investing in solar and other alternative energy related industries.

8.3. The environment and climate change—a trend

In Mercer's study, many EME managers noted that environmental issues were of significance, especially during manager research meetings in China and South Korea. Whilst managers expressed the view that climate change and carbon issues could potentially affect investment returns, it may take a few years yet for these issues to be integrated into the investment process. Further, managers were aware of the impact that a carbon-constrained economy may have on emerging nations, particularly China and India, and the consequences for their investments in these countries.

For example, some of the managers identified issues such as the pending impact of climate change in countries where infrastructure is poor, as a significant investment risk that will play out in the next few years. Local managers who look to attract foreign investment believe regulation is needed in local markets to bring stronger rules to bear to address SI issues, particularly in regard to climate change and carbon risk. The lack of adequate regulation and control of the use of water was identified by many managers in major emerging market countries. Managers talked of drought and the increasing effects of desertification in countries such as China, as well as the effects of water shortages on investee companies. EME managers recognise that clean technology and alternative energy are new growth sectors in emerging markets and a number of managers were investing in solar and other alternative energy related industries.

8.4. Social issues are addressed better by local emerging market managers

Many emerging market countries have less transparency and regulation around human rights and health and safety than do developed countries. EME managers saw such social issues as an important indicator of the quality of management and a source of insight into the business model of a company. For example, in Korea and Brazil, managers provided examples of social issues, such as health and safety for workers in rubber and asbestos industries, as one of a number of factors to be considered. In many instances our research found that managers have divested

from companies in response to ongoing labour issues. Interestingly, local managers seemed to place higher priority on social factors than global managers, perhaps due to the deeper level of understanding of the most pressing social issues in their local market. Mercer expects that as the ESG research quality and breadth develops, such issues will become more mainstream in the next five years.

8.5. Emerging market ESG research is lacking

A number of EME managers that genuinely sought to integrate ESG into core investment processes decried the lack of solid research available for the countries and companies in which they invest. Many investors did not feel that having access to third-party data was enough and that deeper research was needed, particularly when much of the specialist research information available merely represented a compilation of publicly available information. On the whole, Mercer found many examples where the investment teams had access to some data and some specialist resources on ESG analysis, but the integration of such concepts in the risk/return framework and active ownership practices was still largely absent.

The examples where practices were most leading edge were twofold. First, when the investors had access to third-party ESG research *and* in-house research. Second, when the mainstream investors of the strategy internalised ESG into their core process and evaluation of companies (including in their research meetings with company directors); rather than relying on third party providers.

Mercer's view is that the absence of integrating ESG research into investment decisions is not a characteristic particular to emerging markets—it is also typical of mainstream investment managers in developed economies. Drawing from experience in the developed markets where ESG research standards are generally higher, it is not a “given” that improved research will lead to better integration of ESG factors. There is likely to still be a barrier to investment managers' interpretation and translation of ESG data into the investment process until clients mandate that SI is material. Nevertheless, Mercer expects to see progress in terms of ESG research in EME over the coming years.

8.6. Global standards are beginning to influence emerging markets

Despite the fact that SI is still in an early stage of development, there are some signs that it is a fast developing area. For example, groups such as the ICGN and major pension funds with diversified portfolios such as CalPERS and Stichting Pensioenfonds voor de Gezondheid, Geestelijke en Maatschappelijke Belangen (PGGM) have collaborated to bring influence to some major companies in emerging markets.

Global initiatives promoting ESG and CSR will also have a flow-on effect on EME market managers. Companies, asset owners and managers have signed up to voluntary global standards such as the ones below.

- **The Principles for Responsible Investment (PRI)**

Launched in April 2006, the PRI was developed by the United Nations (UN), with Mercer as a key contributor. Building on the foundations established by the Global Compact (GC) and the Global Reporting Initiatives (GRI), the PRI is an industry initiative that promotes the integration of SI into the investment process of mainstream investors and investment managers. Since August 2008, the PRI has registered over 400 signatories representing over USD15 trillion. The membership consists of 160 asset owners, 219 investment managers and 92 professional service partners.⁶⁹ Among Mercer's survey participants, 38% of emerging market managers indicated that they are PRI signatories.

The PRI Emerging Markets Project Launched was in 2007 as a United Nations Environment Program Finance Initiative (UNEP FI) and Swedish International Development Agency (SIDA) initiative. This two-year program was designed to promote responsible investment in emerging markets and developing countries. A two-pronged approach has been used to firstly promote understanding of the Principles, with a view to fostering their adoption and implementation by emerging market investors. The second objective is to endorse responsible business practices by companies in emerging markets by coordinating interaction with their peers in developed and emerging markets.⁷⁰

69 List of signatories is available at: <http://www.unpri.org/signatories/>. Figures were at 30th January 2009.

70 UNEP FI, 2008, *Work Streams, Principles of Responsible Investment*, <http://www.unpri.org/workstreams/#4>

In its first year, the project had active presence in 10 of the target emerging markets. Membership currently stands at 70 signatories managing assets worth USD440 billion.

- **UN Global Compact (GC)**

Launched in 2000, the Compact aimed to set high-level standards of CSR practices among companies. The Compact is composed of ten principles and provides a broad framework for companies to take sustainability into account in their everyday business management. As at April 2008, 206 major companies and 93 medium and small-sized companies globally are signatories to the global compact, including companies that are based in emerging markets.⁷¹ In early 2008, signatories to the PRI launched a campaign to target companies that are GC signatories but failed to implement its principles in practice. The campaign was led by PGGM, which divested from PetroChina (a signatory to the GC) over the company's involvement in human rights violations in Sudan.⁷²

- **The Global Reporting Initiative (GRI)**

Another global standard that provides guidance for companies to disclose their sustainability performance to shareholders and stakeholders. In 2006, the GC and GRI formally joined forces to highlight the benefits of sustainable business management and to encourage companies to manage ESG issues and report on them.

- **Emerging Market Disclosure Project (EMDP)**

This initiative is co-chaired by IFC, Calvert and the US Social Investor Forum, and supported by institutional investors to seek sustainability data disclosure from emerging market companies. The project result is to be available late 2009.⁷³

- **Carbon Disclosure Project (CDP)**

The Carbon Disclosure Project (CDP) is a coordinating secretariat for a group of institutional investors that writes annually to the 500 largest companies in the world (by market capitalisation), asking for the disclosure of investment-relevant information concerning their

71 List of signatories is available at http://www.unglobalcompact.org/Issues/Environment/Climate_Change/index.html

72 Wheelan, H. 2008, "UN PRI cuts its teeth with first public investor campaign", available at: http://www.responsible-investor.com/home/article/un_pri/P0/, accessed 22 January 2009.

73 IFC 2009, "Sustainable Investing: project example", available at: http://www.ifc.org/ifcext/sustainability.nsf/Content/SustainableInvesting_ProjectExamples, accessed 23 January 2009.

greenhouse gas (GHG) emissions. In 2008, the project was expanded to 3,000 companies, including the largest companies in Canada, United States, Germany, Japan, France, the United Kingdom and Brazil. The project was founded on the belief that climate change can impact shareholder value both positively and negatively, but that there is not currently enough information available for the market to properly assess and value the issue. Responses received from companies are meant to help close this information gap in the short term, as well as to pave the way for companies to develop more comprehensive reporting frameworks in the future. Through the disclosures, the investors seek to: a) learn about how companies are managing their GHG emissions; and b) to encourage more widespread disclosure. Participants in the CDP are not members per se, but rather signatories to the initiative on an annual basis. In 2008, such signatories included 385 institutional investors with combined assets of some USD57 trillion under management.

- **ASrIA**

ASrIA has been promoting sustainable investing in emerging markets in Asia since it was founded in 2001, and has been working closely with asset owners, asset managers and companies to drive ESG integration into the investment process. ASrIA has also been managing the Carbon Disclosure Project in Asia since 2005.

- **KoSIF**

KoSIF was established to promote Sustainable and Responsible Investment (SRI) in Korea. KoSIF has 15 corporate members, including asset management companies with SRI funds and several sustainability consultancies, and 40 individual members who are interested in sustainable investment practices.

KoSIF's mission covers five key areas:

To encourage:

1. Sustainability values of environment, society, and good governance
2. The culture of long-term investment in the financial market
3. Efforts to develop and promote standards for SRI
4. Awareness of investors for shareholders' rights and shareholder engagement and
5. Contribute to integration and development of society through SRI. (www.kosif.org)

- Launched in 2006, The **Latin American Sustainable Finance Forum (LASFF)** is an outcome of the 2005 International Conference on Sustainable Finance in Emerging markets.⁷⁴ LASFF was created in response to interest in sustainable investment vehicles stemming from several Latin American investment managers. The Forum is currently hosted by the CES-FGV⁷⁵ with seed funding provided by IFC.⁷⁶ Membership is mainly made up of but not limited to Brazil's largest banks and investment managers including Banco Real, HSBC and Banco do Brasil.⁷⁷ Presently, platforms to advance and support sustainable finance have been set up ensuring proper education, information disclosure and the development of responsible investment competencies in Brazil and wider Latin America.⁷⁸

⁷⁴ Sao Paulo Brazil, December 2005.

⁷⁵ The Center for Sustainability Studies of the Leading Business School in Brazil.

⁷⁶ CES-FGV: Centro de Estudos em Sustentabilidade – Fundacao Getulio Vargas; Sustainability Institute of Brazil's leading business school, <http://www.ces.fgvsp.br/?fuseaction=content&IDassunto=15&IDidioma=2>

⁷⁷ List of members is available at: <http://www.lasff.org/en/index.cfm?fuseaction=conteudo&idSecao=58>

⁷⁸ LASFF, 2008, About LASFF, <http://www.lasff.org/en/index.cfm?fuseaction=conteudo&idSecao=58>

Investors should also write to their current EME managers requesting explanations of how ESG factors are integrated into their investment processes.

Recommendations

To further promote sustainable investment in emerging markets, Mercer suggests that:

- **Asset managers improve training and awareness of ESG issues**

One of the important aspects of integrating ESG into investment research and investment decision making in EME is to ensure that ESG training and tools are promoted across all offices amongst investment teams. Mercer recommends that managers can improve understanding of ESG throughout the firm by developing SI policy and promoting existing policies consistently and providing training regardless of location.

- **Local EME managers consider using active ownership tools**

Managers in local firms interviewed by Mercer demonstrated a keenness to better understand whether ESG was material to investments. Accordingly, Mercer recommends that local asset managers would benefit from raising awareness and educating their investment staff via available resources and tools designed to encourage asset managers to better incorporate ESG research and investment considerations into their processes. Tools such as the implementation options associated with active ownership offered through the framework of the PRI and the International Corporate Governance Network, for example, could provide a useful starting point for managers.

- **Asset owners refine policies with respect to ESG in EME**

One of the first steps that asset owners can take to promote improved ESG and active ownership standards across their emerging market investments is to clarify their expectations with respect to investments in the emerging market region. This would ideally distinguish itself from the broad investment policy and recognise the unique characteristics of emerging markets, paving the way for the establishment of more focused policies that can be easily understood by investment managers, and therefore more likely to be implemented across the investment process. Such policies should also specify asset owners' expectations regarding ESG integration into mainstream mandates versus SI-labelled products, as well as their preferred approach towards active ownership.

- **Asset owners incorporate ESG into EME selection criteria and mandates**

Given the areas of strength and weakness of ESG integration and active ownership highlighted in this report, Mercer recommends that asset owners based in both developed and developing markets should send a clear signal to the market by mandating their emerging market equity managers to translate relevant ESG factors into active ownership practices and investment criteria. This will provide clear incentives for asset managers to pursue sustainable investment in emerging markets. ESG ratings and investment ratings for EME managers can assist investors to focus their priorities. Investors should also write to their current EME managers requesting explanations of how ESG factors are integrated into their investment processes. In addition, they should incorporate an assessment of investment managers' voting and engagement capabilities and set minimum standards for activities and disclosure.

- **Asset owners and managers consider joining collaborative networks**

Asset owners should consider joining collaborative networks (see 8.6). Joining these networks will give owners access to peer practices for sustainable investing in emerging markets, and will also provide a framework for engaging global and local EME managers and investee companies on key ESG issues. For example, through the collaboration of the network, they can jointly write to their investee company directors (directly or through managers) to encourage them to report on their CSR practices and participate on CDP projects. In addition, joint investor groups can lobby emerging market governments to establish more rigorous legal and regulatory frameworks for corporate governance and CSR reporting.

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Appendix 1

Acronyms and abbreviations

ABRAPP	Brazilian Pension Funds Association	KCGS	South Korean Corporate Governance Service
AUM	Assets under management	KoSIF	South Korean Sustainability Investing Forum
ASrIA	Association for Sustainable and Responsible Investment in Asia	KSE	South Korean Stock Exchange
GDP	Carbon Disclosure Project	MEP	Ministry of Environmental Protection
CSR	Corporate Social Responsibility	MSCI	Morgan Stanley Composite Index
CSRC	China Securities Regulatory Commission	NCSSF	National Council for Social Security Fund
CII	Confederation of Indian Industry	Previ	Pension fund of the Banco do Brasil employees
EAI	Enhanced Analytics Initiative	PRI	United Nations Principles of Responsible Investment
EBITDA	Earnings before interest, taxes, depreciation and amortization	QFII	Qualified Foreign Institutional Investor
EME	Emerging markets equities	RI	Responsible investment
Eurosif	European Social Investment Forum	RIAA	Responsible Investment Association Australasia
ESG	Environmental, social and governance	SEPA	State Environmental Protection Agency
GIMD	Global Investment Manager Database	SI	Sustainable investment
GC	Global Compact	S&P	Standard and Poors
GRI	Global Reporting Initiative	SRI	Socially responsible investment
GHG	Greenhouse gas	SOEs	State-owned enterprises
ICGN	International Corporate Governance Network	SEBI	Securities and Exchange Board of India
ICT	Information Communication Technology	SASAC	State-owned Assets Supervision and Administration Commission, China
IFC	International Finance Corporation	TERI	Energy and Resources Institute, India
IGC	Índice de Ações com Governança Corporativa Diferenciada	UN	United Nations
IPOs	Initial Public Offerings	UNEP FI	United Nations Environment Program Finance Initiative
ISE	Índice de Sustentabilidade Empresarial	US SIF	US Social Investment Forum
JSE	Johannesburg Stock Exchange		

Appendix 2

Investment data analysis

**SI Labelled Products where all assets are in emerging markets
(30 June 2008)**

Region/Country	ESG Funds	
	\$m	Index Weight
S&P/IFC Investable Global	200,843	100%
Global Emerging	171,413	
Latin America	5,045	25%
Brazil		18%
Emerging Asia	137	50%
China	14,934	14%
India	2,906	6%
Indonesia	27	2%
Korea	274	13%
Malaysia	163	2%
Taiwan	0	10%
Thailand	242	1%
EMEA	397	25%
Eastern Europe	5,305	15%
South Africa		7%

Source: Mercer GIMD

Appendix 3

Managers interviewed

Ten Managers interviewed in China

Manager Name	Strategy researched
Bank of China Investment Management (BOCIM)	China Equity—Sustainable Growth Fund
Bosera	China Equity—Value
China Asset Management Company (China AMC)	China Equity—Large Cap
China Southern Fund Management (CSFM)	China Equity—growth
China International Capital Corporation	China Equity—Segregated Accounts
Halbis	China Equity—Chinese Equity Capabilities
Fortis Haitong Investment Management	China Equity — Best Selection
Harvest Fund	China Equity—Growth
Martin Currie (MC China Ltd)	China A Share Fund
RCM	RCM China Alpha Fund

Ten Managers Interviewed in India

Manager Name	Strategy researched
ABN AMRO Asset Management	ABN AMRO Opportunities Fund
AIG Investments	Indian Equities (On Shore)
DSP Merrill Lynch Investment managers	DSP Merrill Lynch Opportunities Fund
HDFC Asset Management	HDFC Equity Fund
HSBC Global Asset Management	HSBC Equity Fund-Growth
JPMorgan Asset Management	JPMorgan India Equity Fund
Kotak Mahindra Asset Management Co. Ltd.	Kotak 30
Reliance Capital Asset Management	Reliance Growth Fund
SBI Asset Management	Magnum Multiplier Plus 93
Tata Asset Management	Tata Equity Opportunities Fund

Ten Managers interviewed in South Korea

Manager name	Strategy researched
Credit Agricole Asset Management	Korean Equity
Daewoo Securities	Korean Equity
Daishin Investment Trust & Management	Daishin Korean Equity Fund
HSBC Global Investment Funds	Korean equity
RCM	Active Korea Equities
Rexiter Capital Management	Korean equity
Samsung Investment Trust Management	Korea Leading Group Fund
Schroders Asset Management	Korean Equity
Woori Credit Suisse Asset Management	Frontier Bluechip
Shinhan BNP Paribas	Bonjour Korea Fund

Ten Managers interviewed in Brazil

Manager name	Strategy researched
Western Asset Management (Legg Mason)	Legg Mason Prev IBrX Ativo Ações Fundo de Investimento
Banco Itaú	Itaú Ações
BRAM—Bradesco Asset Management	Bradesco FIA Institucional Ativo
HSBC Global Asset Management Gestão de Recursos Ltd	HSBC FIA MULTI AÇÕES
Schroder Investment Management	Schroder Alpha Plus FIA
Votorantim Asset Management	FI Votorantim IBrX em Ações
Unibanco Asset Management	Unibanco Classe Mundial FIA
ABN Amro Asset Management	ABN AMRO FI AÇÕES ATIVO II
Rio Bravo Investimentos SA	RB Fundamental FIA
BNP Paribas Asset Management Brazil	BNP Paribas Ace FIA

Ten SI-Labelled EME managers interviewed

Manager name	Strategy researched
BankInvest	Global Emerging Markets Equity SRI
Colonial First State Global Asset Management	Asia-Pacific Sustainability Fund & Global Emerging Markets Sustainability Fund
Dexia Asset Management	Emerging Market Sustainable Equity
HSBC Investment Sinopia	Sinopia GEM Fund
Industrial Fund Management Company (IFMC)	China Equity—SRI Fund
Investec Asset Management	TDi Fund & Responsible Investment Equity
Lloyd George	LG Asian Green Fund
Rexiter Capital Management	GEM Sustainability Fund
Lazard Corporate Governance Fund	Lazard Korean Corporate Governance Fund
ABN AMRO	FI AÇÕES ETHICAL II

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MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Argentina

Malaysia

Australia

Mexico

Austria

Netherlands

Belgium

New Zealand

Brazil

Norway

Canada

Philippines

Chile

Poland

China

Portugal

Colombia

Singapore

Czech Republic

South Korea

Denmark

Spain

Finland

Sweden

France

Switzerland

Germany

Taiwan

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India

United Arab Emirates

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