

# Fundamental shift in ESG

Nina Röhrbein looks at how the ESG market in Switzerland is moving on from the ideological and political corner of SRI to the real performance of sustainability

As home to some well-known thematic funds, asset managers such as SAM and Sarasin and foundations such as Ethos, Switzerland is often linked with environmental, social and governance (ESG) or sustainable investing, although Swiss law does not require it.

But like in its neighbouring countries, the ESG market has undergone big changes in Switzerland.

On the back of the active marketing campaigns by sustainable investment managers, several Swiss pension funds invested a small percentage of their portfolios in SRI or sustainable funds in the latter half of the 1990s, according to Ivo Knoepfel, managing director at investment consulting and research company onValues.

"However, in recent years this type of investment has been increasingly challenged by consultants and the pension funds themselves who argue that if ESG issues are really material, sustainable investment criteria should be applied to the entire portfolio," he says. "Therefore the trend is now turning away from the old school screened or best-in-class SRI funds towards integration, which involves asking external asset managers to actively take ESG into account in their portfolio management and financial analysis. At the moment this mainly concerns equity mandates but ESG has also become a relevant approach for real estate investments. Switzerland is very advanced in terms of green property and some asset managers have started to offer investment strategies in this field, while several pension funds are looking at ways of using ESG more explicitly in their real estate investments.

"Due to some successful thematic funds, such as the water funds, interest for themes has also been growing and managed to break through the relative conservative attitude of Swiss pension funds toward SRI and sustainable investments."

However, Knoepfel admits that last year many institutions were quick to divest again from thematic funds in order to reduce overall risk levels, particularly as many of the thematic funds invest in small caps.

Michael Baldinger, head clients and distribution and member of the executive committee of SAM, confirms that redemptions have taken place in ESG products during the crisis but is quick to point out that they occurred to a smaller extent compared with traditional investments.

Swiss pension funds have a pragmatic attitude towards ESG, according to Baldinger. "They are prepared to invest according to ESG criteria if those can add extra performance potential," he says. "A fundamental shift has taken place over the last two years away from the ideological and political corner of SRI to the real performance of sustainability. The financial crisis in particular has led to the recognition that sustainability, cor-

porate governance and transparency are important factors in risk management."

Baldinger says ESG has also become more popular in recent times due to the broadening of the offering by investment managers in areas previously uncovered, such as private equity and fixed income. "Although equities remain the focus

## ➔ ESG at AHV/AVS

The €17bn first pillar Swiss Federal Social Security Fund AHV/AVS first implemented its mandate-based ESG policy in 1999.

Currently approximately 13% of AHV/AVS' total portfolio – or 60% of its equities – is invested following a best-in-class ESG approach.

This means that two of the reserve fund's large cap equity managers replicate the Dow Jones Sustainability indexes for Europe and North America.

On top of that the fund actively exercises its voting rights for all the Swiss companies it invests in.

"We believe that investing with the use of ESG criteria will be rewarded in the long term although the reward does not necessarily come in the form of higher returns," says Marc Pfenninger, manager, external investments at AHV/AVS. "It can also take the form of better governance of the companies in which we invest. And while the financial crisis did not change our approach toward ESG we believe that given the impact of remuneration as one of the factors leading to the crisis, governance will certainly be an investor focus in the future."

## ➔ ESG at Alcan Schweiz

Sustainability is a big issue for mining and exploration company Rio Tinto. That has also meant that the Swiss pension fund behind Rio Tinto, Alcan, which consists of three pension schemes with total invested assets of CHF1.4bn (€924m), felt it had to address sustainability in its portfolio.

"We issue some active equity and bond mandates and for those, we expect our active managers to take sustainability criteria into account in their analysis, as they are required to invest only in companies that will be successful over the long term," says Christoph Ryter, pension fund manager at Pensionskasse Alcan Schweiz. "This is the only way to generate alpha and outperform the rest of the market. However, we are not prepared to invest in special products with higher fees."

The pension fund also applies sustainability criteria to its real estate portfolio, which makes up 20% of its total investments. "We require in particular the newly built properties to comply with the Minergie quality standard, which is a Swiss label applied to energy-efficient buildings," says Ryter.

for sustainable investors we have encountered more demand for innovative ESG integration across the entire portfolio," he says. "Sustainability investing is becoming mainstream and as a result the industry has started to develop, particularly in areas such as fixed income and clean tech private equity."

OnValues has been trying to challenge asset managers to come up with better products and strategies for institutional investors because a lot of the existing ones have been developed for retail investors, according to Knoepfel. "And fees for those are unacceptably high for institutions," he says.

"Like in France, Germany and the rest of the continent active ownership approaches are not popular in Switzerland yet," Knoepfel adds. "But the ice is slowly being broken due to the work of the Ethos Foundation, which in the current climate has done some good work in challenging large corporations in Switzerland to improve their corporate governance, particularly with regard to remuneration. The shock of the crisis and the excesses that emerged have convinced more pension funds to think about engagement strategies, active ownership and voting although it is not widespread yet."

Knoepfel also puts this down to the fragmentation of the Swiss pension fund market. He says that the absence of very large pension schemes means that no scheme has so far wanted to take a lead on ESG issues and make the integration process more sophisticated.

However, he points out that the national pension reserve fund AHV/AVS has for some time been applying ESG criteria to a large part of its of its equity exposure (see box).

Although Baldinger sees interest from both large and small pension funds, according to Knoepfel it is mainly the public or civil servant schemes that show a commitment to ESG. Knoepfel cites the City of Zurich pension fund as well the ones of other large cities and cantons such as Geneva as the most committed ones. The Swiss Post Pensionkasse, the Swiss Radio and Television Pensionkasse and pension schemes for certain professions such as doctors and teachers also implement ESG strategies, he says.

"But despite some notable exceptions with the likes of the ABB, Nestlé and Novartis schemes, corporate pension funds have generally not shown an interest in the area," he says. "And often, as the public and consultant attitude is still one of scepticism, pension funds that apply ESG criteria do not speak about it publicly. The reluctance to publish their ESG strategies is also reflected in the fact that few of the signatories to the UN Principles for Responsible Investment (PRI) are Swiss."

An onValues study focusing on specialist SRI and sustainable investments (excluding integrated approaches) put the Swiss sustainable investment market at CHF20.8bn (€13.7bn) at the end of 2008. Half of that is made up by the institutional market, namely Swiss pension funds, according to Knoepfel.

"Some of the old SRI type investments are still in people's minds, so it will take time to relax that and shift to the new, more financially-oriented, integrated approaches," he says. "Active ownership is expected to grow too – however it will be a slow process."