

## **Integration of sustainable indicators into asset management**

**- As simple as possible but not simpler -**



# Contents



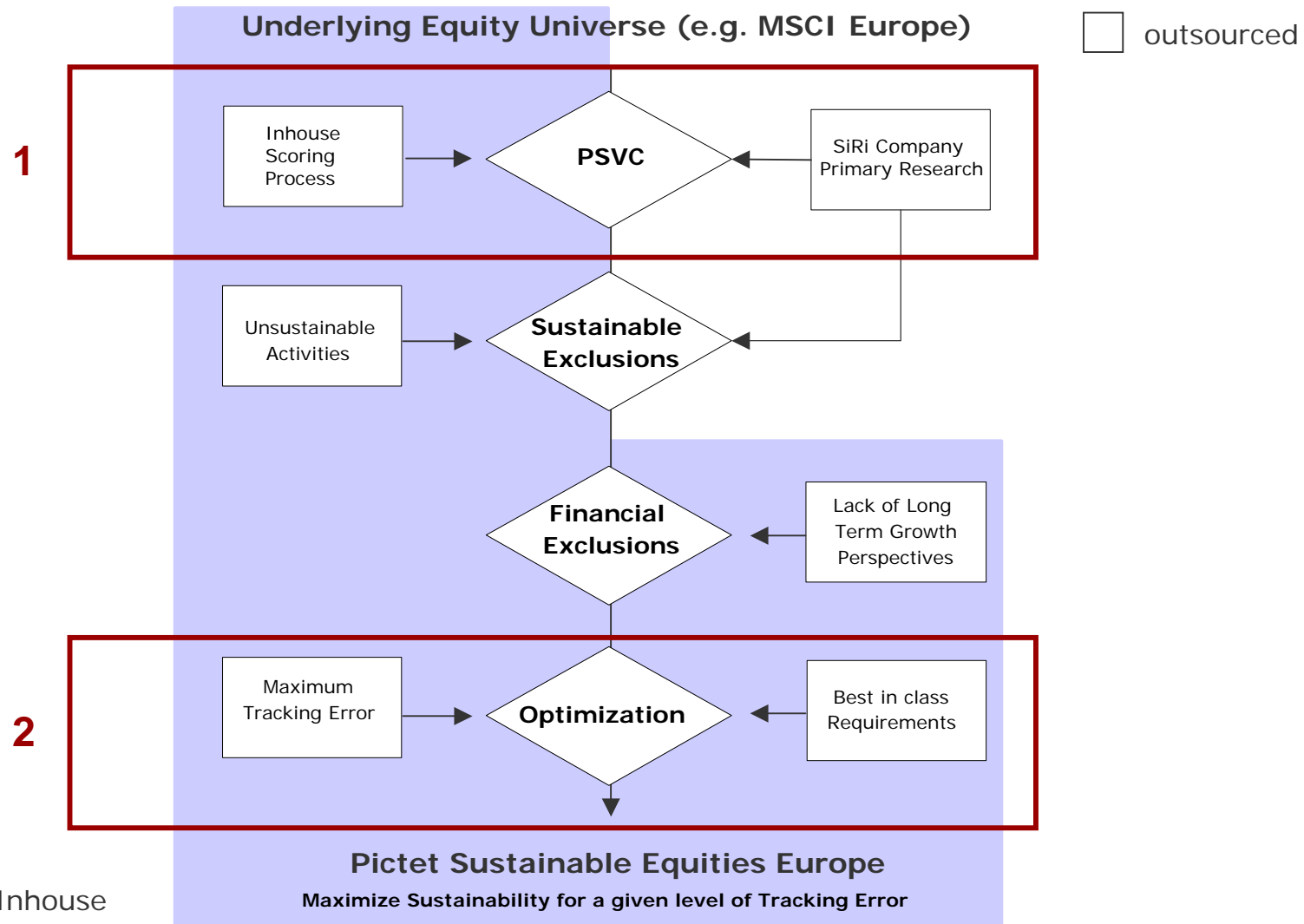
1. Indicators, their role and purpose
2. Sustainable investment process: overview
3. Aggregation & scoring method
4. Implementation in a financial portfolio
5. Financial performance of ,sustainable factors‘

# Indicators, their role and purpose



- Indicators are of paramount importance (‘gigo’ principle)
- Absolute versus relative indicators (‘functional units’)
- Cardinal, ordinal, binary types; ‘quantification’
- Needs of financial institutes vs. industry vs. academia
- Indicators for sustainability or financial performance?
- Pragmatism is king; avoiding to ‘die in beauty’
- Collaboration with Centre-Info, quest for ‘key indicators’
- Questionnaire fatigue, proliferation of criteria
- Less can be More – A new approach to SRI research (Pictet Study March 2005)

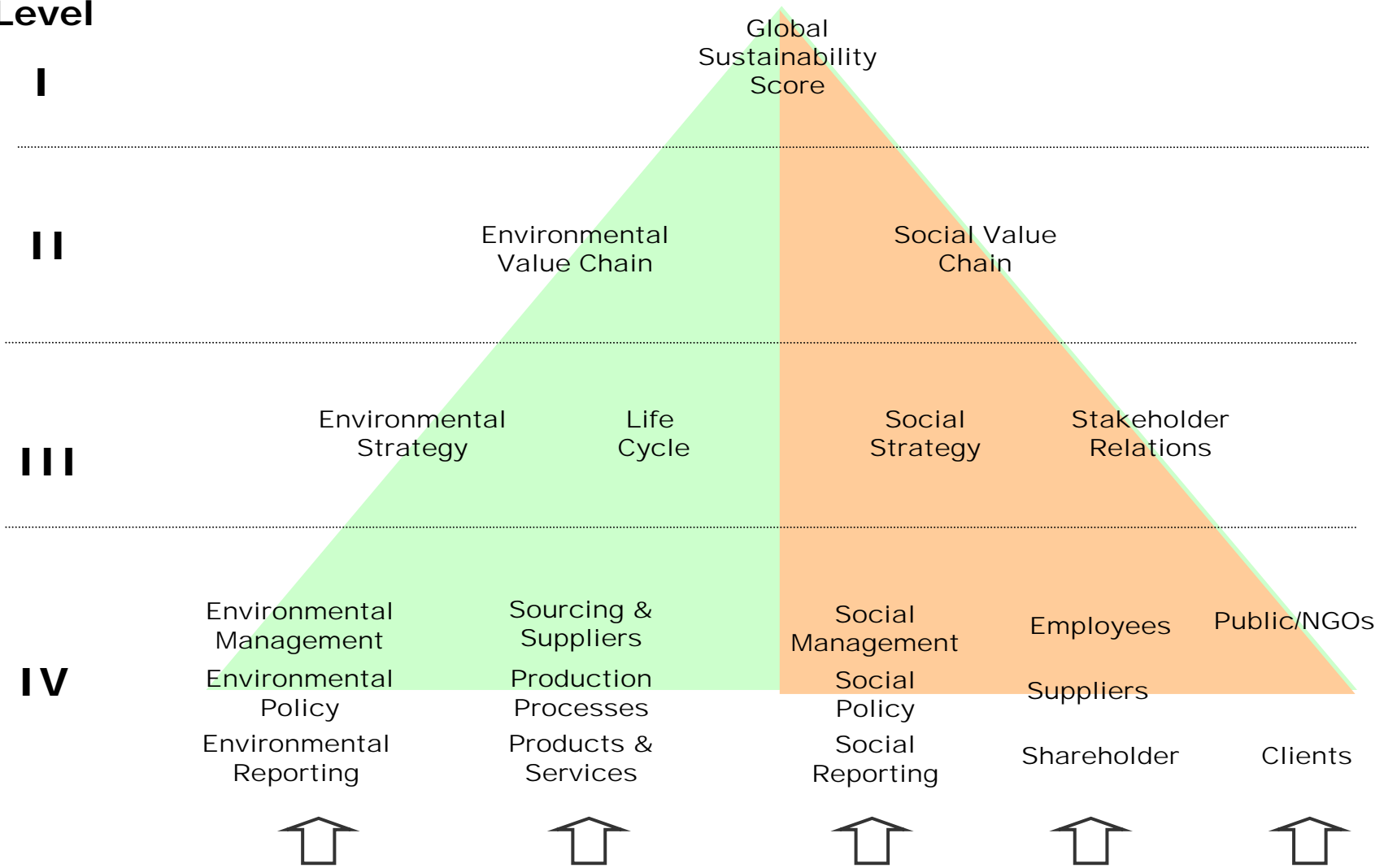
# Sustainable investment process: overview



# Underlying 'sustainability model' (PSVC Pyramid)



Rating  
Level



~100-180 environmental & social indicators sourced from SiRi Company (up to recently)

# Env. Value Chain: selected indicators & criteria



$W_{EP}$	Environmental Policy		
$W_1$	Environmental reporting	$W_2$	Content of environmental reporting

$W_{ER}$	Reporting		
$w_1$	Environmental reporting	$w_2$	Content of environmental reporting

$W_{EM}$	Environmental Management				
$w_1$	Environmental Officer	$w_2$	Environmental Department	$w_3$	Environmental Management System (EMS)
$w_2$	Scope of EMS	$w_3$	Environmental Programs	$w_4$	Environmental certification

$W_{s\&s}$	Sourcing&Suppliers		
$w_1$	Environment and Suppliers	$w_2$	Supply chain issues

$W_{Processes}$	Production Processes			
$W_{11}$	$w_1$	Resource consumption level & evolution	$w_2$	Waste production level & evolution
	$w_3$	Water emissions: level & evolution	$w_4$	Emissions into soil: level & evolution
	$w_5$	Local air emissions level & evolution	$w_6$	GHG emissions level & evolution
$W_{12}$	$w_9$	Locally damaging releases issues		
	$w_7$	Resources use issues	$w_8$	Waste issues
	$w_{10}$	Macro-ecological effect issues		

$W_{P\&S}$	Products&Services			
$W_5$	$w_1$	Environmental impact of the main products	$w_2$	Environmental impact of the secondary products
	$w_3$	Product development	$w_4$	Products beneficial to the environment
$W_6$		Products issues		

# Social Value Chain: selected indicators & criteria



W <sub>SP</sub>		Social Policy	
w <sub>1</sub>	Corporate statement and communication	w <sub>2</sub>	Employees policy
w <sub>3</sub>	Corporate Governance code	w <sub>4</sub>	Suppliers' policy
w <sub>5</sub>	Business ethics policy	w <sub>6</sub>	Customer Policy

W <sub>SR</sub>		Social Reporting	
w <sub>1</sub>	Business Ethics reporting	w <sub>2</sub>	Employees reporting
w <sub>3</sub>	Customers reporting	w <sub>4</sub>	Community reporting
w <sub>5</sub>	Suppliers reporting	w <sub>6</sub>	Reporting on corporate governance

W <sub>SR</sub>		Social Reporting	
w <sub>1</sub>	Business Ethics reporting	w <sub>2</sub>	Employees reporting
w <sub>3</sub>	Customers reporting	w <sub>4</sub>	Community reporting
w <sub>5</sub>	Suppliers reporting	w <sub>6</sub>	Reporting on Corp. Gov.

W <sub>E</sub>		Employees			
w <sub>19</sub>	w <sub>1</sub>	Remuneration	w <sub>2</sub>	Health and Safety level & evolution	
	w <sub>3</sub>	Social benefits	w <sub>4</sub>	Training	
	w <sub>5</sub>	Financial participation	w <sub>6</sub>	Work-life balance programs	
	w <sub>7</sub>	Job security	w <sub>8</sub>	Diversity level & evolution	
	w <sub>9</sub>	Employee satisfaction	w <sub>10</sub>	Social dialogue	
w <sub>18</sub>	w <sub>11</sub>	Wages and remuneration issues	w <sub>12</sub>	Equal opportunity issues	
	w <sub>13</sub>	Lay-offs issues	w <sub>14</sub>	Union issues	
	w <sub>15</sub>	Health and safety issues	w <sub>16</sub>	Child or forced labour issues	
	w <sub>17</sub>	Other employee issues			

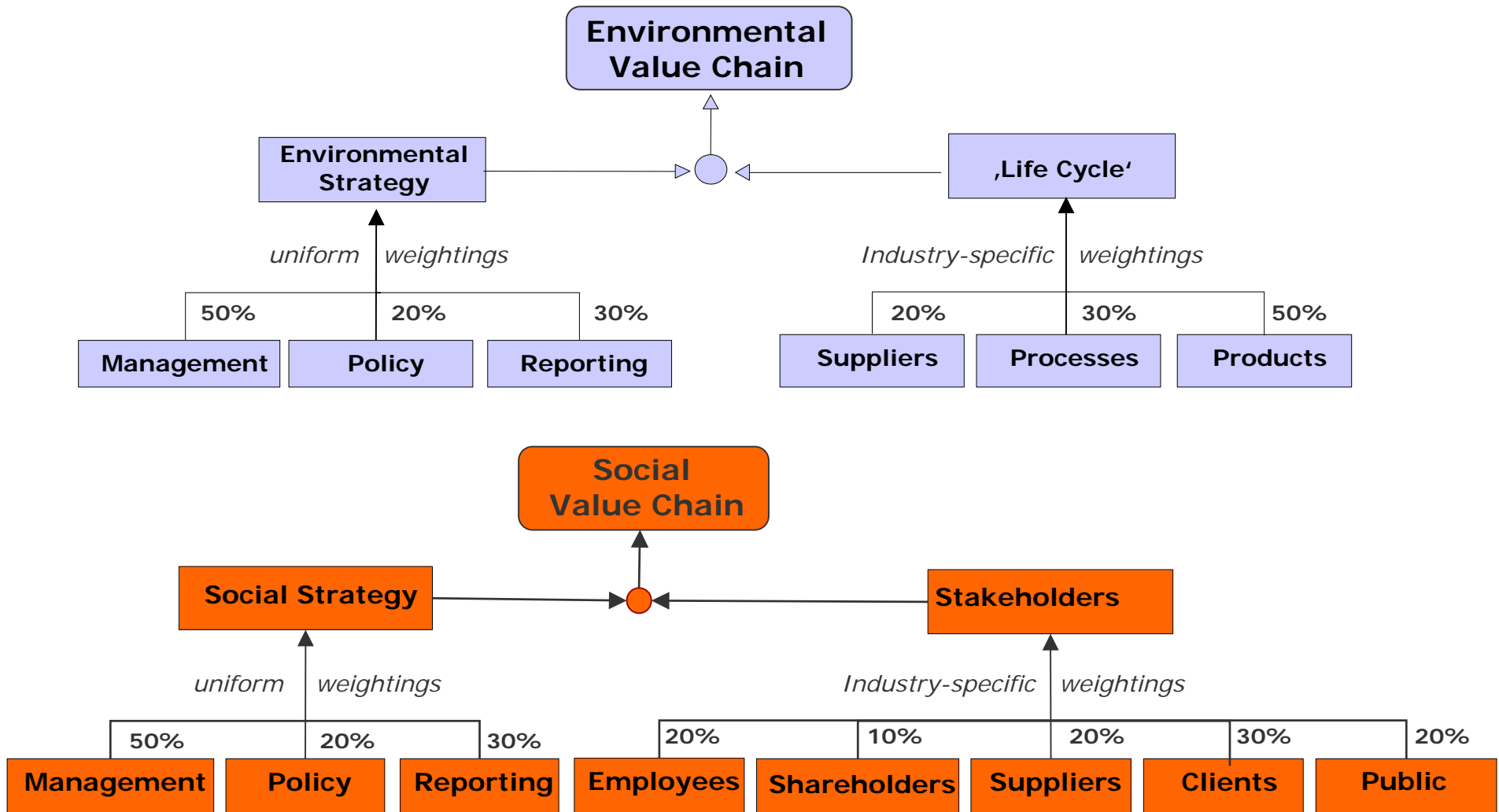
W <sub>CG</sub>		Corporate Governance			
w <sub>7</sub>	w <sub>1</sub>	Share capital structure	w <sub>2</sub>	Limitation of shareholders rights	
w <sub>8</sub>	w <sub>3</sub>	Remuneration issues	w <sub>4</sub>	Fraudulent practices issues	
	w <sub>5</sub>	Other Corporate Governance issues	w <sub>6</sub>	Notable Strengths	

W <sub>C</sub>		Clients & Customers			
w <sub>6</sub>	w <sub>1</sub>	Customer satisfaction	w <sub>2</sub>	Customer initiatives	
w <sub>7</sub>	w <sub>3</sub>	Anti-trust issues			
	w <sub>4</sub>	Product quality or safety issues	w <sub>5</sub>	Customer relationship issues	

W <sub>p</sub>		Public			
w <sub>18</sub>	w <sub>1</sub>	Charitable donations	w <sub>2</sub>	Total giving	
	w <sub>3</sub>	Primary area of support	w <sub>4</sub>	Philanthropic initiatives I	
	w <sub>5</sub>	Business ethics initiatives	w <sub>6</sub>	Philanthropic initiatives II	
	w <sub>7</sub>	Initiatives for local communities			
	w <sub>8</sub>	Human rights issues	w <sub>9</sub>	Dictatorial regimes issues	
w <sub>17</sub>	w <sub>10</sub>	Corruption issues	w <sub>11</sub>	Legal issues	
	w <sub>12</sub>	Environmental issues	w <sub>13</sub>	Tax issues	
	w <sub>14</sub>	Economical issues	w <sub>15</sub>	Political issues	
	w <sub>16</sub>	Other employee issues			

W <sub>S</sub>		Suppliers			
w <sub>6</sub>	w <sub>1</sub>	Suppliers' initiatives	w <sub>2</sub>	Suppliers' audits results	
w <sub>5</sub>	w <sub>3</sub>	Human rights issues	w <sub>4</sub>	Other issues	

# Linear aggregation steps on lower rating levels...

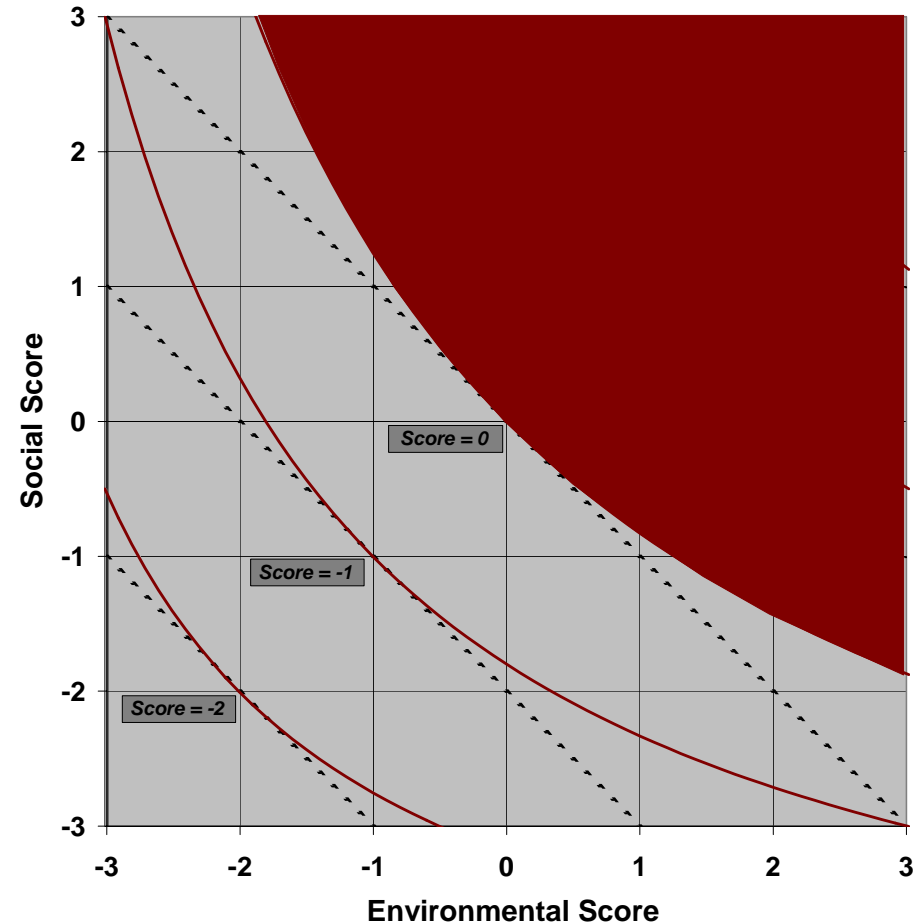
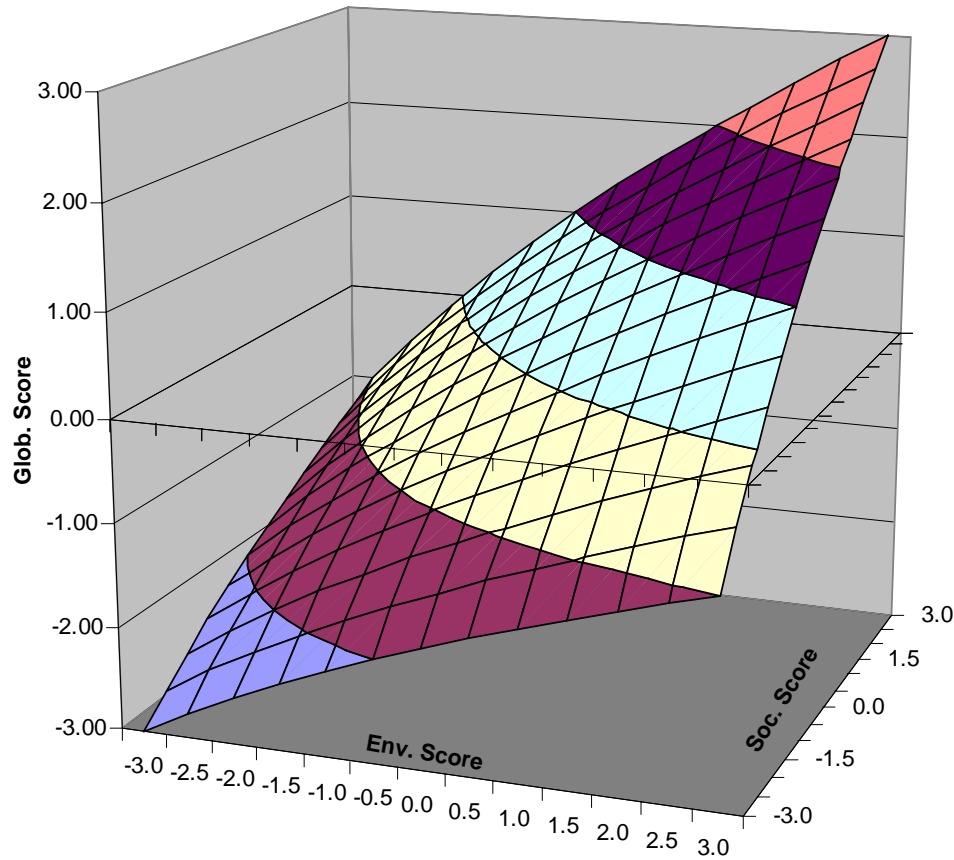




# ...non-linear aggregation steps for higher rating levels



- E.g. aggregation of environmental and social performance

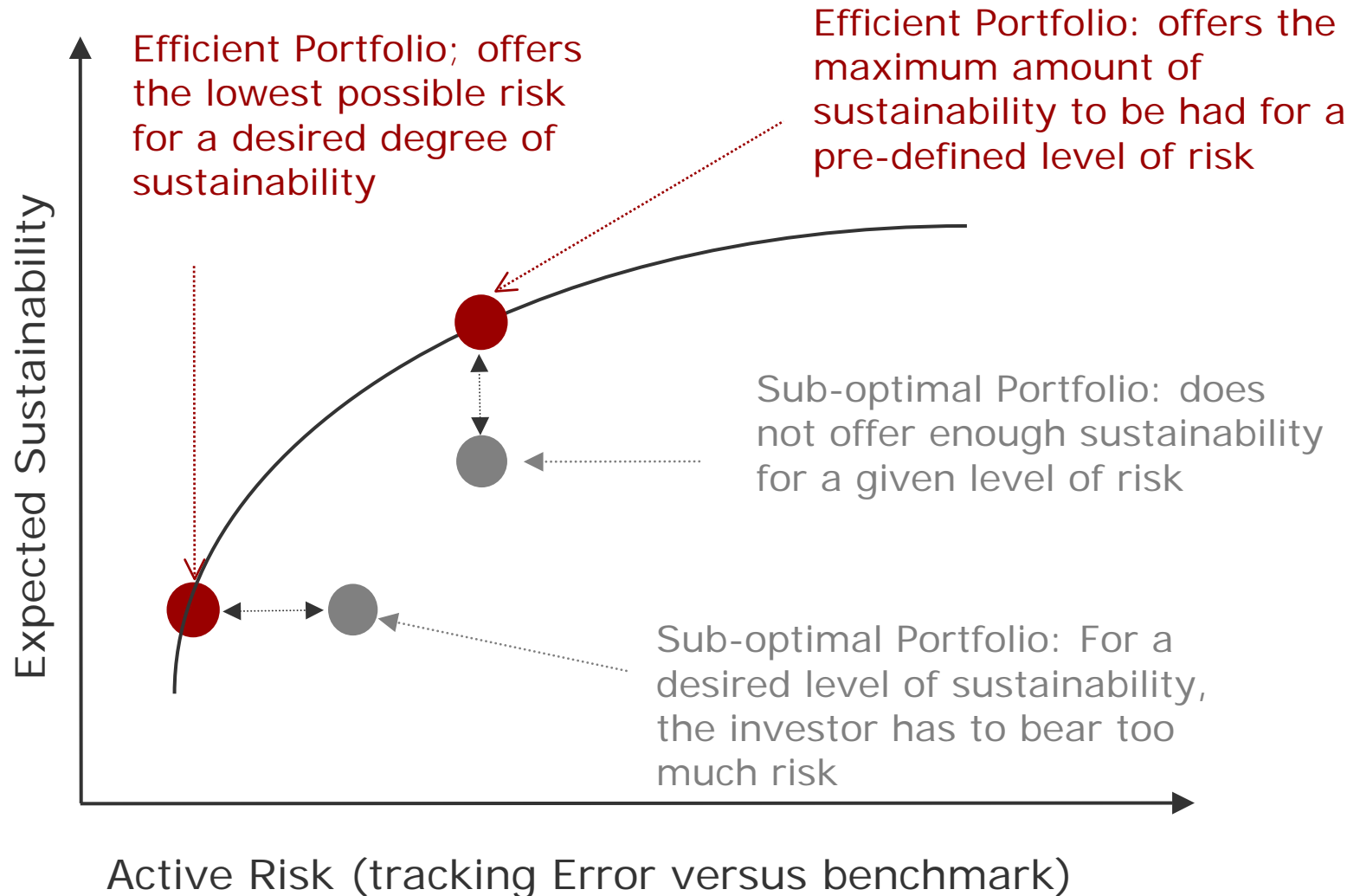


# How do sustainability ratings influence stock selection?



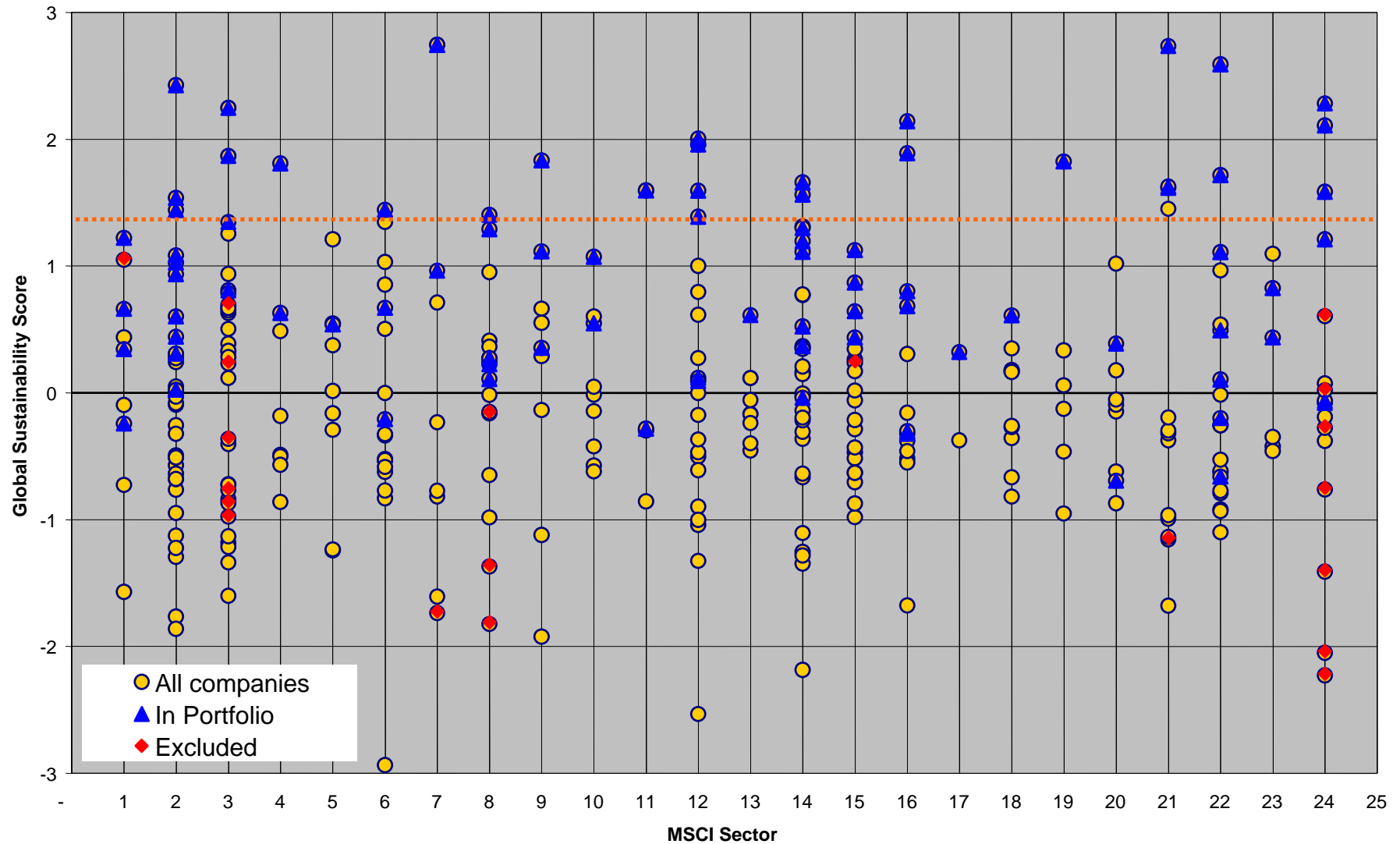
- Overwhelming majority of products has two-tiered approach
- First round (qualifying) & second round (title selection)
- Second round: exclusively traditional financial criteria
- Transparency re. title selection (sust./financ.) rather low
- Pure approach: maximise sustainability also in second round; sustainability score as input in optimizer
- Sustainability Score determines weighting of titles
- Scope of weighting is limited by risk constraints (e.g. Swiss market anomaly)
- ‚input-driven‘; measurement of effects still in its infancy (most mistakes have no consequences...)

# The Principle: Pictet's Sustainable Efficient Frontier™

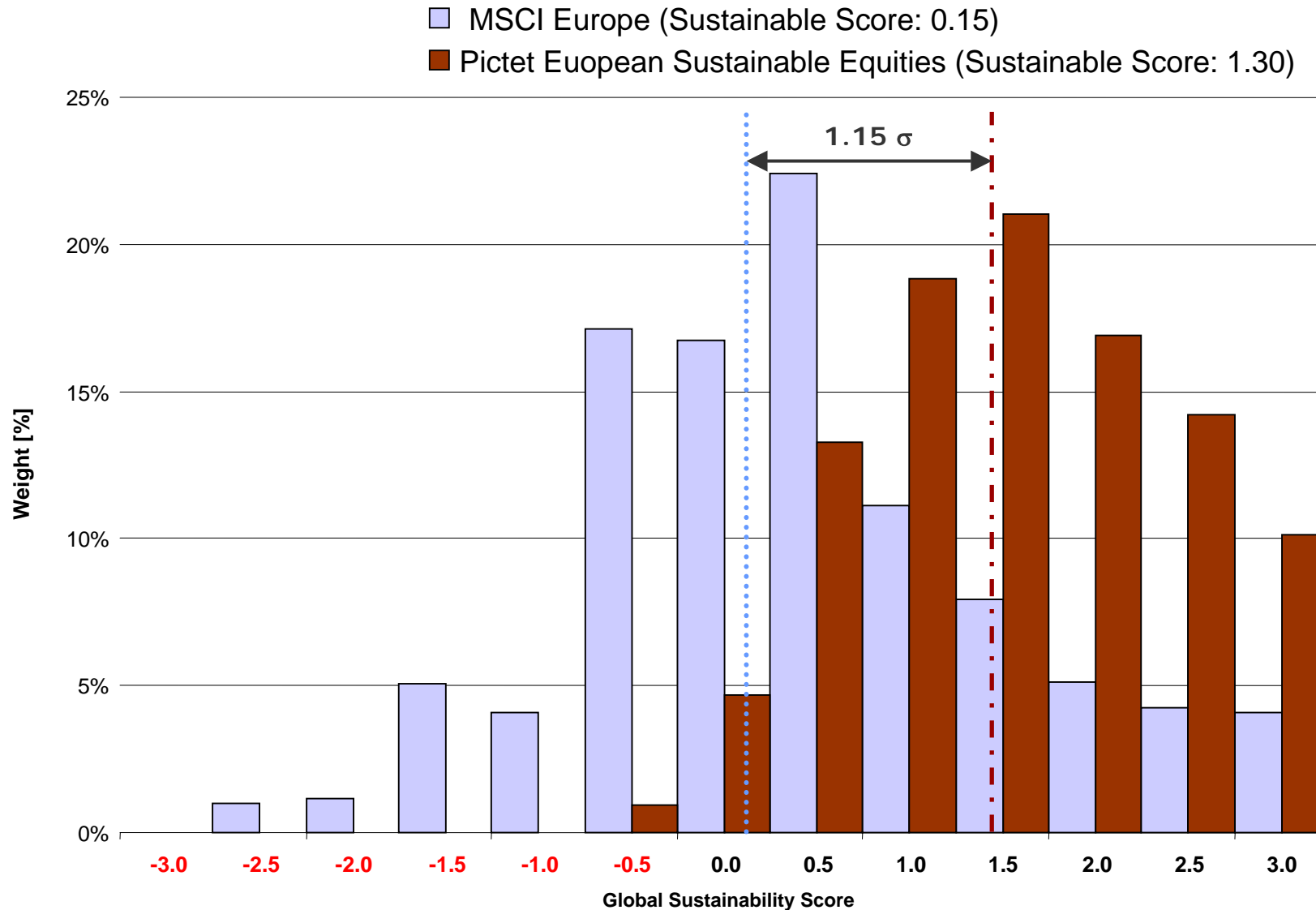


™ The proprietary concept of the 'Sustainable Efficient Frontier' has been developed in the 90ies by Pictet Quants and was introduced to sustainable asset management for the first time in 1999 within the scope of a Swiss equity product

# Strict «best-in-class» approach & stock selection



# Considerably higher sustainability than broad market



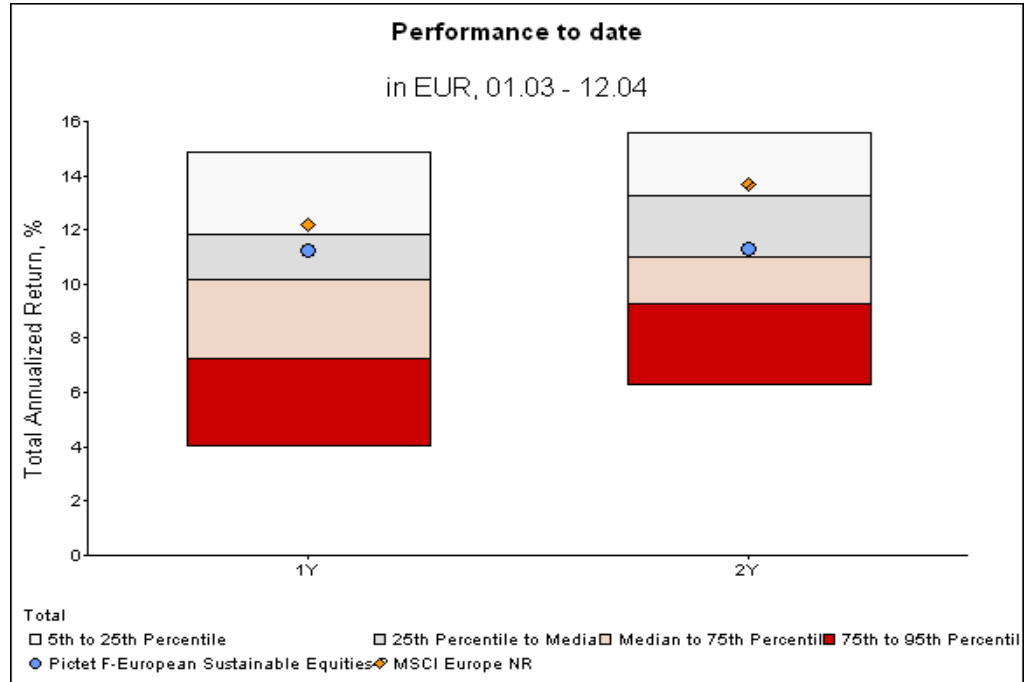
# Financial performance of a concrete product (mid-term)



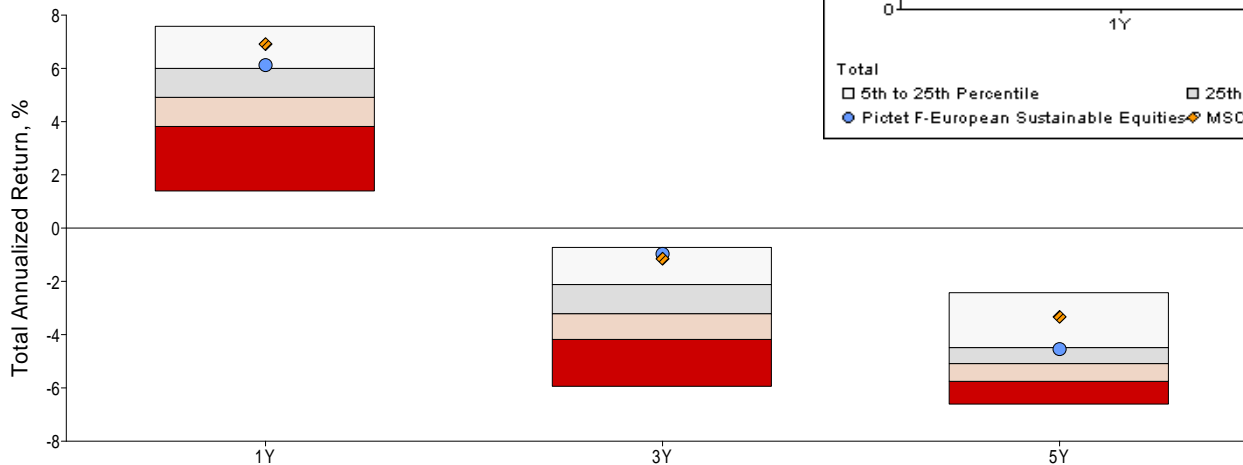
European Sustainable Equities:  
Track Record of 2.5 years

Swiss Sustainable Equities:  
Track Record of 5 years

Performance to date  
in CHF, 01.00 - 12.04



Created with MPI Stylus™ (Data: Lipper)

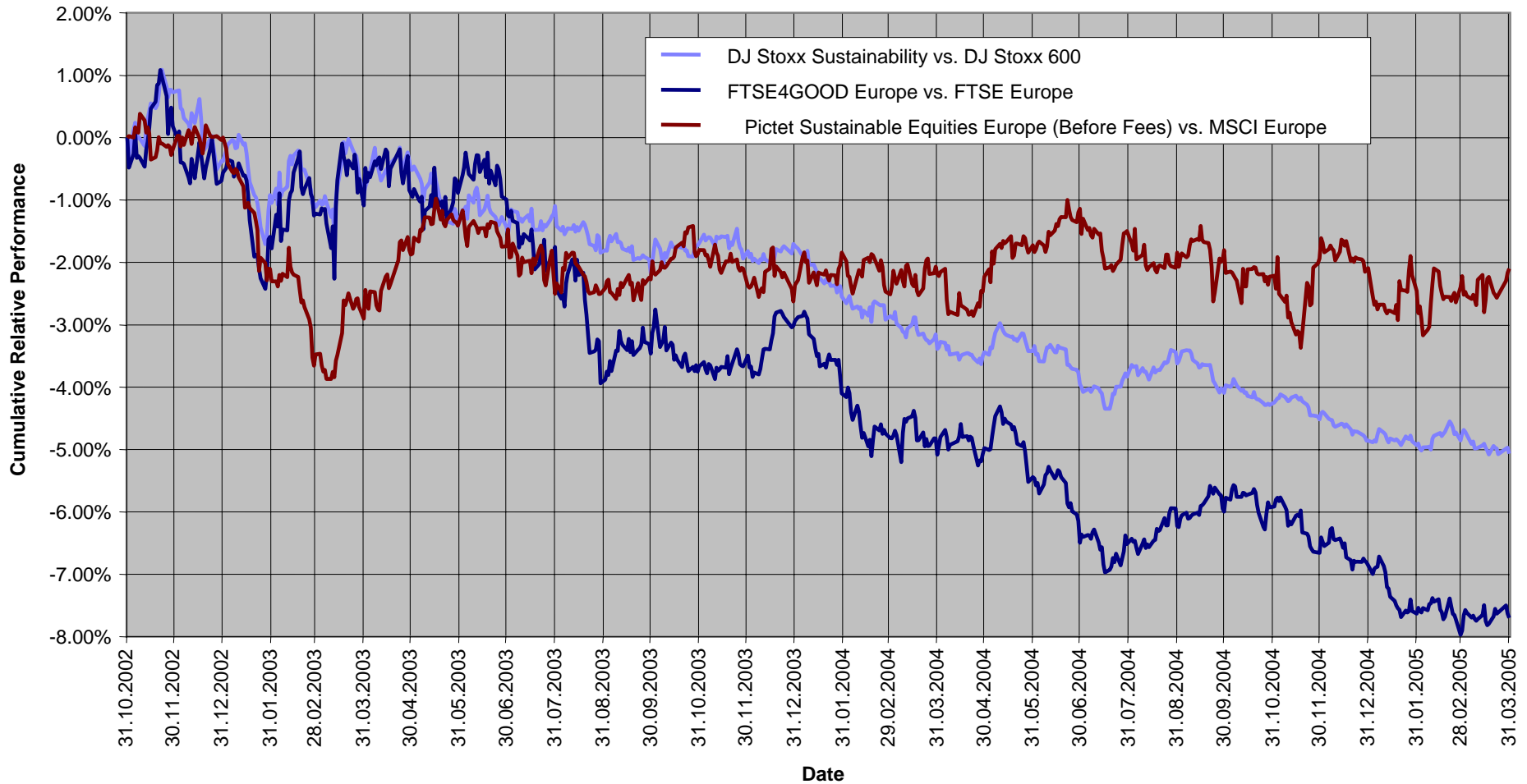


Total  
 □ 5th to 25th Percentile    □ 25th Percentile to Median    □ Median to 75th Percentile    ■ 75th to 95th Percentile  
 ● Pictet (CH)-Swiss Sustainable Equities P    ◆ Swiss Performance Index TR

# Sustainability pays – does it really?

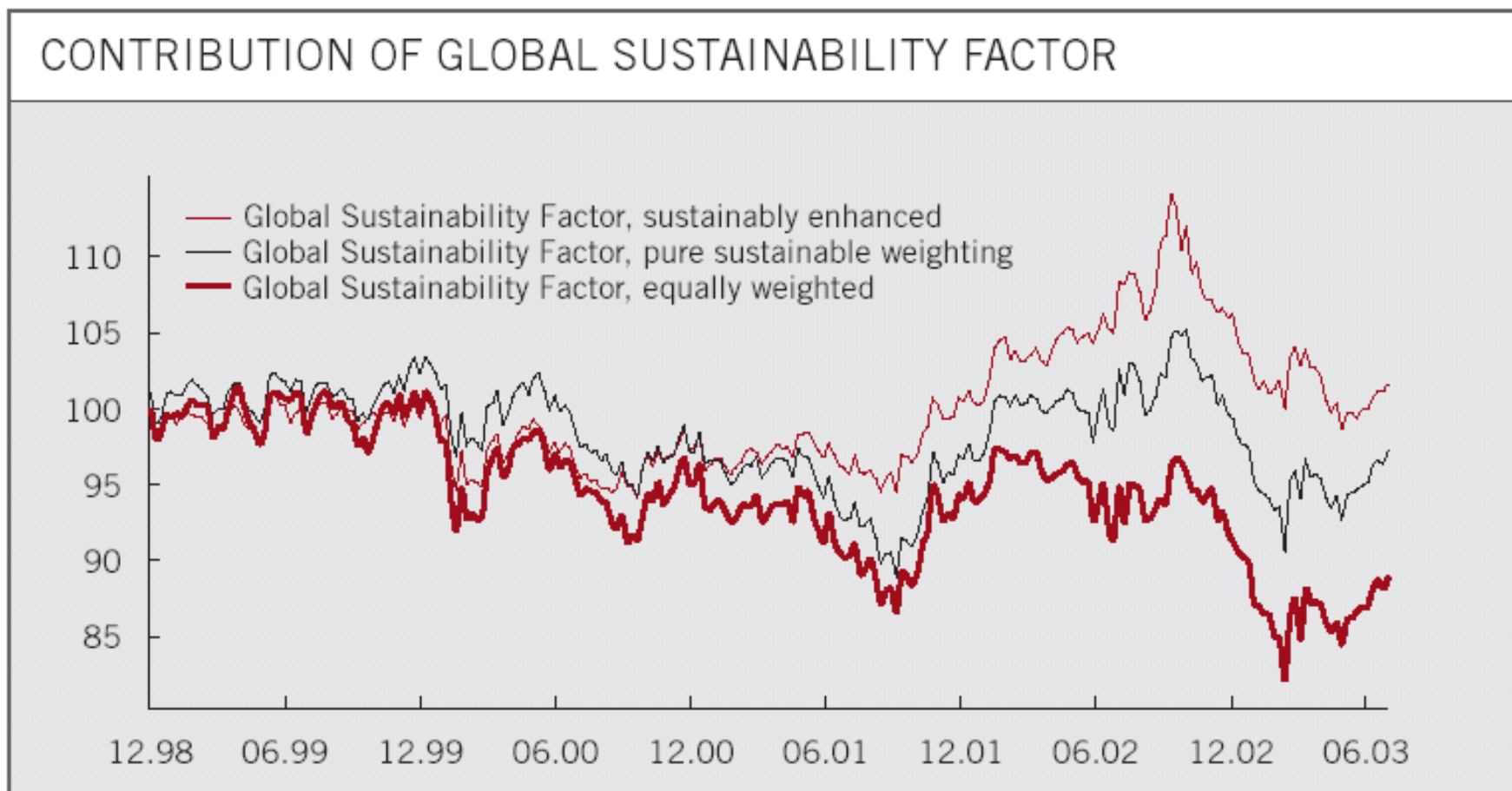


### Relative Sustainable Performance



Source: Datastream & Pictet Funds

## SRI performance: aggregation & weighting is key

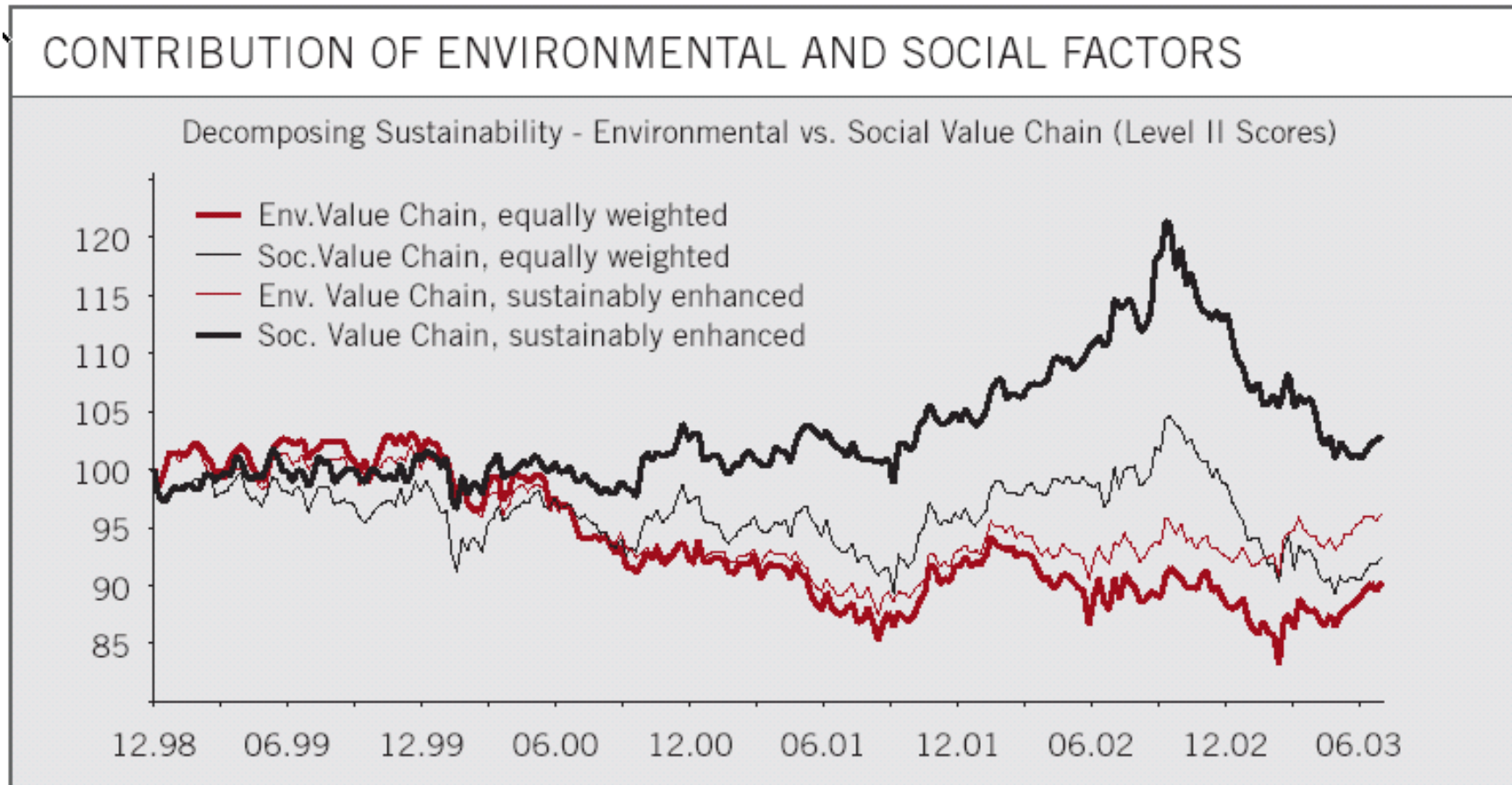


Graph 1. Factor returns on level I (Global Sustainability Scores). The graph displays the performance contribution of three different weighting scenarios over the last four and a half years.

Source: *Decomposing SRI performance – Extracting Value Through Factor Analysis (September 03)*



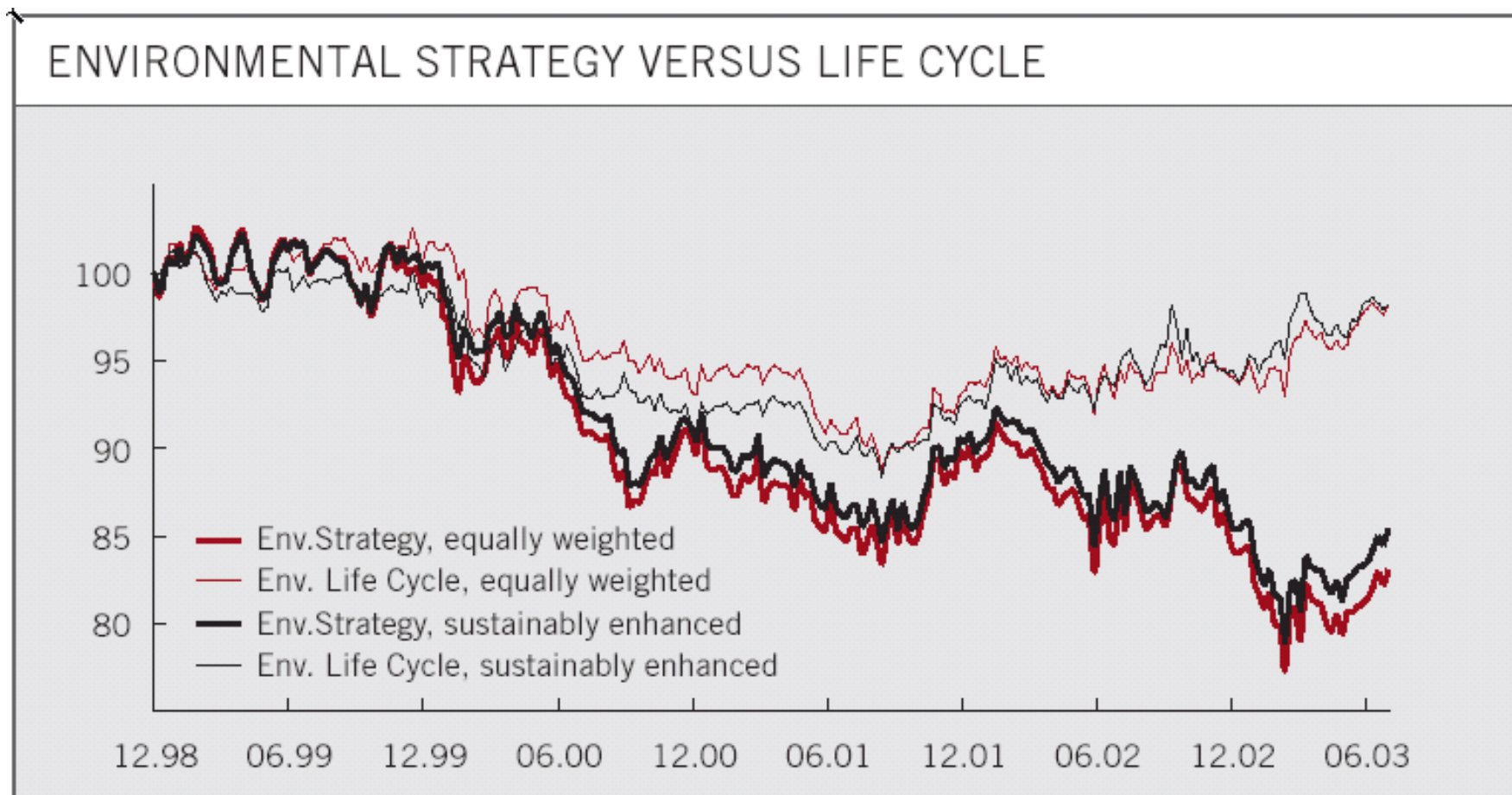
# Socially responsible beats environmentally friendly...



Graph 2. Factor returns on level II: Performance contribution of the environmental and the social value chain.

Source: *Decomposing SRI performance – Extracting Value Through Factor Analysis (September 03)*

## Emission reductions pay off better than lip service...



Graph 5. Factor returns on level III: Environmental strategy versus actual environmental performance along the life cycle. Comparison between the equally weighted and the sustainably enhanced weighting scenario.

Source: *Decomposing SRI performance – Extracting Value Through Factor Analysis (September 03)*

## ,'Radical' proposal: a single indicator for car manufacturers

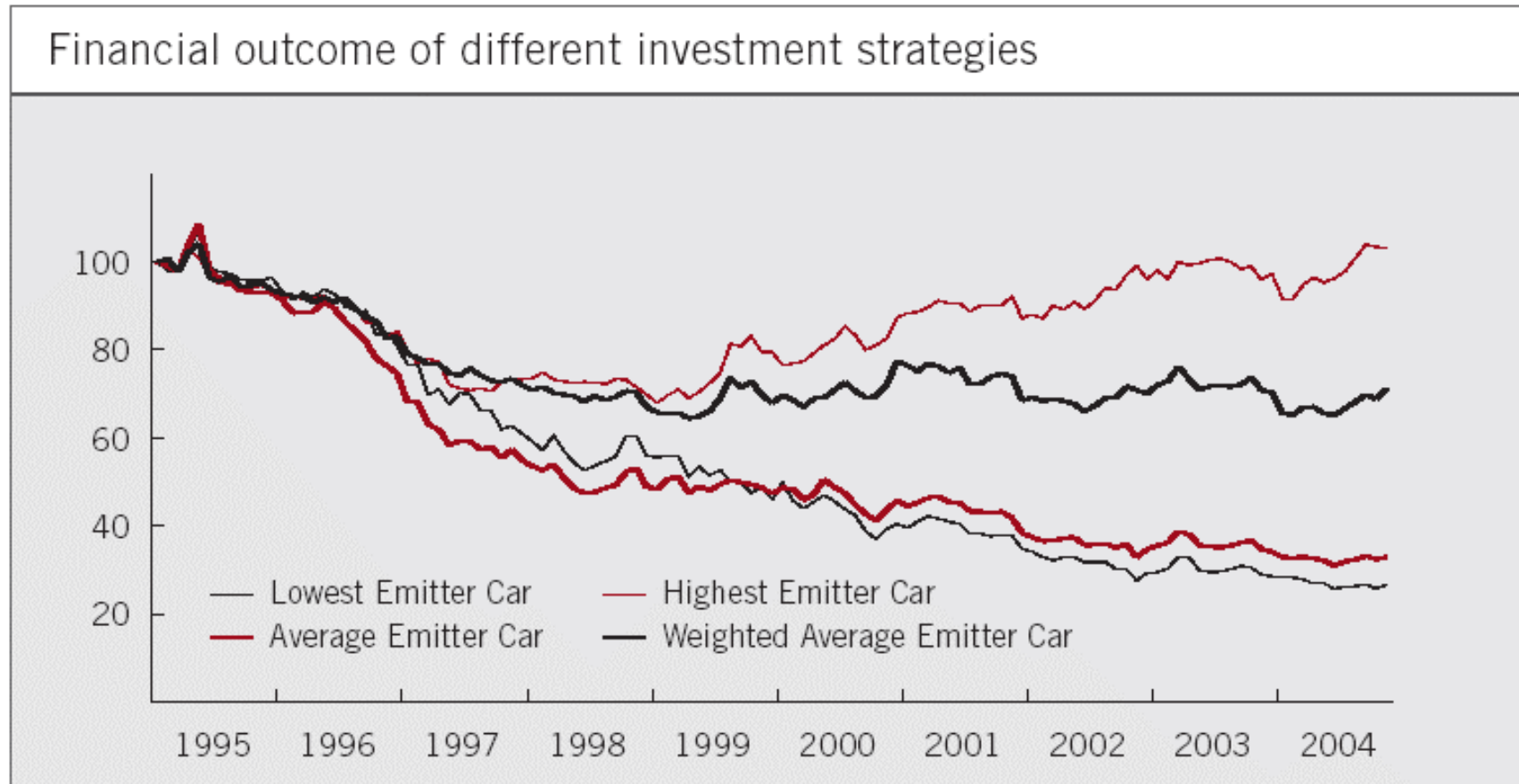


Chart. 3: Financial outcome of different investment strategies over the last decade, i.e. by overweighting those companies that scored high and underweighting those that scored low regarding the following criteria: best performance of highest/lowest emitter car, average emitter car and weighted average emitter car.

Source: *Less can be More – A new approach to SRI research* (March 2005)



**FINIS**

