Analysis of ‘socially responsible investment’ options

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Agenda

- What is a 'socially responsible investment'
- Market share
- Historical returns
- Fees
- Fossil fuels in fund portfolios
- Conclusions

What is a 'socially responsible investment'

- 'Socially responsible investment' (SRI) options screen out certain assets, based on judgments about their environmental, social, governance or ethical performance.
- SRI screening can be applied to exclude:
  - Particular investments based upon relative performance on specific issues (e.g. carbon emission benchmarks or governance standards), or
  - Entire sectors of activities (e.g. tobacco, gambling, armaments).
- Some SRI options screen out fossil fuels. For example:
  - AMP's 'Responsible Investment Leaders' options now exclude companies that derive more than 20% of their earnings from thermal coal mining, brown coal-fired power generation, oil sands and the conversion of coal to liquid fuels/feedstock
  - From September 2014, Unisuper's SRI options will screen out companies 'involved in fossil fuel exploration and production'.

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Market share

- Prevalence of SRI
  - From a sample of 59 funds we observed that 27 of these offer at least one SRI option.
  - Across these 59 funds we had data on 90 identified SRI options.
- The vast majority of super funds (95%) of the sample do not have an SRI default option
- The default option in some funds is an SRI option, among these are Australian Ethical, Christian Super and Vision Super.
  - Australian Ethical and Christian Super have a relatively small market share (0.32% of the sample - combined) when compared to other funds.
- For funds without an SRI default the percentage of SRI fund assets is likely to be very low (less than 1% of total FUM on average) as few members exercise choice (generally less than 10%) and those exercising choice usually invest in more conservative asset classes rather than SRI options

Historical returns

Performance – 30 June 2013					
	1-year	2-year	3-year	5-year	10-year
SRI option	23.95%	10.63%	8.62%	4.56%	7.52%
Conventional option	22.83%	10.95%	9.35%	4.65%	7.79%
Difference	1.11%	-0.32%	-0.73%	-0.09%	-0.28%

SRI options tend to underperform conventional options (with similar asset allocations) over long investment horizons (after fees and tax). This could be due to:

- higher investment management costs (see next slide)
- less diversification in the portfolio

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Fees

Fee rate (%)			
Growth %	Defensive 0%- 50%	Balanced 50%- 75%	Growth 75%- 100%
SRI option	0.87%	0.94%	1.15%
Conventional option	0.81%	0.64%	1.05%

Our sample of funds showed that investment management fees tend to be higher by up to 30bps for SRI options

Projections

- If a member aged 35 today and earning $75,000 had switched to a ‘balanced’ SRI option 10 years ago, these differences could have amounted to his/her final balance being $3,700 lower today
- At retirement, the difference would amount to $68,000 (in today’s dollars)
  - Assumptions: aged 35 today, with a salary today of $75,000 which had grown at 3% p.a. over 10 years, a starting balance of $50,000 with a difference in investment fees of 0.3% p.a.

- For a member aged 45 today and earning $120,000, the same switch could have amounted to his/her final balance being $7,000 lower today
- At retirement, the difference would amount to $57,800 (in today’s dollars)
  - Assumptions: aged 45 today, with a salary today of $120,000 which had grown at 3% p.a. over 10 years, a starting balance of $100,000 with a difference in investment fees of 0.3% p.a.

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Exposure to fossil fuels in portfolios is complex

- Many super funds invest in unlisted assets (i.e. those not listed on the stock exchange) to generate competitive and stable long-run returns.
- A number of unlisted infrastructure investments are essentially investments in fossil fuel production.
  - The recent investment in the Port of Newcastle – the world's largest coal export terminal - is a good example.
    - The winning bid was $1.75billion equally comprising Hastings Funds Management and China Merchants Group
  - Capital discount rates are high so the effective term of these investments is within the projected life times of current mines.

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Fossil fuels in portfolios

Exposure to fossil fuels in portfolios is complex

- Pure coal stocks make up a minority of coal production and a small proportion of market capitalisation (less than 0.5%).
- Most fossil fuel production is carried out by diversified companies that have other mining interests and also interests outside mining.
  - Divestment from the fossil fuel elements of these companies cannot be accomplished without divestment from the other elements too.
  - This could produce an unbalanced portfolio (i.e. reducing diversification and potentially increasing volatility).
  - The divestment could also affect the production of materials needed for alternative energy production.

Conclusions

- 'Socially responsible investment' options are niche products that account for a very small share of the total Australian superannuation market.
- The vast majority of super funds do not have an SRI default option.
- SRI options tend to underperform conventional options (with similar asset allocations) over long investment horizons (after fees and tax).
- A number of unlisted infrastructure investments are essentially investments in fossil fuel production
- Divestment from fossil fuels could produce an unbalanced portfolio (i.e. reducing diversification and potentially increasing volatility).

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