



## The Nordic approach to Socially Responsible Investing

*Socially responsible-oriented thinking is inherent in the Nordic mentality and so it is not surprising that the Scandinavian countries are global leaders in numerous related aspects. Here we take a look at SRI in the Nordea fund range.*

In its broadest sense, SRI is a generic term covering ethical investments, responsible investments, sustainable investments and any other investment process that combines financial objectives with concerns about environmental, social and governance (ESG) issues.

SRI has its roots in the 18th century when a community of Quakers decided to prohibit their members from financially participating in slavery and human trafficking activities. However it has only been in the last 5 years that Europe has seen an increase in market share for SRI funds. At the same time the number of SRI funds within Europe is steadily rising and, according to European Sustainable Investment Forum (Eurosif) data, probably reached 17.6% of the total number of funds in the European asset management industry by the end of 2007.

### SRI in the Nordic countries

Investment management according to SRI principles covers a large range of approaches, almost as many approaches as investment houses. However, it is possible to distinguish three main categories:

- Exclusion
- Best in class
- Engagement

The oldest is “exclusion”. As the name suggests, portfolio managers exclude investment in certain stocks because these companies do not adhere to requisite principles. Such ethics may adhere to the United Nations Principles for Responsible Investment (UNPRI, <http://www.unpri.org/>) but can also be defined much more thoroughly depending on the investment process. The Swedish state pension fund AP7 is a good example here.

The “best in class” approach has flourished in recent years. The aim is to actively select only those companies that represent a role model according to SRI principles. Such approaches



vary widely as it can tend to favour social principles or environmental stocks depending on the investment house. This approach is typically based on soft facts. The incorporation into the investment process can range from additional screening criteria in stock analysis to a weighting that accounts for up to 50% of the stock selection process. Sustainable Asset Management in Switzerland is one of the bigger firms specialising in “best in class” funds.

The last but perhaps least known approach is “engagement”. Here the investment manager does not exclude a stock or privilege a role model corporation, but instead continues to analyse stock purely on its return potential. The intention with engagement is to change the behaviour of companies that do not adhere to the desired SRI principles. As an example, the investment house would then enter a dialogue with the non-compliant firm to push for changes over a period of time. Divestment becomes the weapon of last resort.

Nordea has chosen the latter “engagement” approach to deal with SRI in the belief that solid corporate citizens should play an active role in changing corporate behaviour, rather than passively avoiding certain companies or taking a blinkered approach by only rewarding best practice. Only by actively engaging in SRI can a difference be made.

### United Nations Principles for Responsible Investment (UNPRI)

The Nordea engagement process is based on UNPRI principles. Indeed, in November 2007 Nordea signed the United Nations Principles for Responsible Investment (UNPRI). By signing Nordea commits itself to incorporate environmental, social and corporate governance issues into investment analy-

ses and decision-making processes. This means being active owners and incorporate environmental, social and corporate governance issues into ownership policies and practices. It also entails seeking appropriate disclosure of environmental, social and corporate governance issues from any entities invested in.

## Nordea's SRI process

Both internally and externally managed funds at Nordea apply the engagement process, based on an SRI committee headed by Erik Feldt, Managing Director of Nordea Fonder AB in Stockholm.

The process of identifying companies violating international norms for corporate responsibility, falls to Ethix (<http://www.ethix.se/>) who is a recognised expert in this field with extensive experience. Investments are screened twice a year to identify if they include companies that are subject to verified violations. Based on this screening, a watch-list of stocks is established, which is reviewed on a semi-annual basis by the SRI committee.

Ethix provides Nordea with individual company analyses and customised recommendations, which are then reviewed by Nordea's own SRI committee. The SRI committee decides on the level of engagement with companies that have verified involvement in unaddressed violation.

The SRI committee then decides upon the appropriate actions and necessity to enter into an engagement according to the defined principles. As an example, this year engagement issues range from violations of human rights over environmental concerns to labour standards.

## Action – being an active owner

The engagement and dialogue is then performed on Nordea's behalf by another external partner Hermes EOS. Hermes (<http://www.hermes.co.uk/>) is an international investment company and a pioneer of active ownership. The company is owned by British Telecom (BT Pension Scheme). In addition to British Telecom and Nordea, Hermes represents over 200 other institutional investors.

Based on advice from Ethix, Nordea's own SRI committee decides the level of engagement in the companies Hermes should

enter into dialogue with. The aim is to change their attitude and behaviour in social responsibility matters. Involvement includes a dialogue with the companies' executive bodies, influence on board composition, cooperation about joint voting at annual general meetings and generally keeping a strict eye on the company. Since Hermes is talking to companies on behalf of numerous investors, and not only Nordea, the probability of successful engagement is increased.

This means that instead of excluding companies in breach of SRI norms, we encourage the company to try to bring about a change. Nordea believes that dialogue and active ownership is a more efficient way to work to change behaviour. Divesting is the ultimate loss. It means forfeiting responsibility and opportunity to influence. Also, by divesting or excluding companies, shares could be passed on to new owners that may be less concerned with SRI. Indeed there is a clear international trend away from exclusion. Ultimately if it proves impossible to change a company's behaviour, Nordea will divest and exclude the company from its portfolio.

Contrary to many other investment houses, the idea is not to have one or two products branded SRI following exclusion or best in class model, even if such filters can be implemented if institutional clients require. Instead the engagement principle is applied to all Nordea 1, Sicav managed funds; from the Emerging Consumer Fund to the European Equity Fund or Corporate Bond Fund.

## Nordea's main guidelines for socially responsible investment:

- Identify companies in our fund portfolios that violate the UN Global Compact (<http://www.unglobalcompact.org/>) and international norms for corporate responsibility.
- Exercise active ownership, among other things through dialogue, to change behaviour that is violating the norms.
- Divest in companies if it is not possible to achieve change through active ownership.

*"We want to create performance in a responsible way and secure that our clients' money is invested in accordance to certain international norms"*



Erik Feldt, Head of Governance & SRI in Nordea

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