Sustainable Investing in the Nordics: A Short Introduction

Stockholm (HedgeNordic) – In a series of articles over the coming months leading up to its special report in October, HedgeNordic examines SRI/ESG implementation, conflicting attitudes and broader developments in the Nordics.

SRI: A Growing Business

> "There is growing interest among our clients to invest in a more sustainable and responsible manner in light of the trends and challenges we see around us in the world today" – Thomas H. Kjærgaard, Head of Sustainable Investment, Danske Invest

As a matter of – increasingly ineluctable – principle across the investment spectrum, the explosion of interest in SRI (Sustainable Responsible Investment) in tandem with ESG (Economic, Social & Corporate Governance), from institutional investors to hedge fund managers, appears set to continue its acceleration into a fundamental component of investment activity across numerous industry sectors. In an upcoming special report and series of articles over the coming months, HedgeNordic endeavours to closely examine this phenomenon, with a particular emphasis on the Nordics and their seemingly tailor-made environments for SRI/ESG implementation.

Within the framework of sustainable and responsible investment, investors try to account for the ethical issues of environmental, social and corporate governance. In a snapshot of current attitudes in the Nordics, Opalesque reported last month on global service provider Northern Trust's recent survey of 50 Nordic institutional investors in Stockholm, which found that 80% among them expect investor allocations to alternative assets to increase within the next 5 years. Notably, half of these expected a greater focus on ESG factors within the investment process, with 25% of these even saying ESG credentials would make or break deals.

What took off in earnest as a reaction to the financial crisis of 2007-2009, therefore, appears to be developing into a normative standard in its own right. The crisis compelled consumers and investors to pay more attention to democracy and responsibility in markets, accompanied by increased attention to transparency and accountability of market participants themselves. Now, initiatives such as last year's Arabesque Asset Management/Oxford University report, *From the Stockholder to the Shareholder* (based on over 200 academic studies, industry reports, articles and books) point towards consistent evidence that companies pursuing SRI policies exhibit the best operating results across a range of measures.

Among the distinct advantages of sustainable investment, the report claims 88% of research shows that solid ESG practices result in better operational performance of firms, with 80% of studies showing that stock price performance of companies is positively influenced by good sustainability practices, and 90% of studies on the cost of capital showing that sound sustainability standards lowers the cost of capital of companies. Other findings determined that it is in the best interest of investors and corporate managers to incorporate sustainability considerations into the decision making process, and that active ownership allows investors to influence corporate behaviour and benefit from improvements in sustainable business practices.

A Brief History

The notion of 'sustainable and responsible investment' has been developed in recent years predominantly under auspices of the UNPRI (United Nations Principles on Responsible Investment), part of the UN Global Compact predating the economic crisis and developed by investors themselves, which celebrates its ten-year anniversary this year. Signatories, which number in the thousands representing well upwards of US$60 trillion in assets, submit to 6 defining principles, of which incorporation of ESG issues into investment analysis and decision-making processes, incorporation of ESG issues into active ownership and practices, and demanding appropriate disclosure on ESG issues by entities in which funds invest, are paramount.

Adherence to UNPRI terms as signatories has not always been smooth sailing, however, as the 2013 case of Danish investors deserting the PRI over its own opaque governance structure attests. Moreover, SRI (which is not exactly the same as ESG – more on this later) predates the PRI convention and has grown exponentially of its own volition over the past two decades, superseding conventional investment in some areas and developing industry-wide norms through such imperatives as shareholder activism, community investing, investment screening and social venture capital funding. It began as having been undertaken by larger financial and institutional investors, but the market for it has since diversified as it has come to encompass various stakeholder interests across society, from the financial sector to social and other organizations (NGO's, governments, labour unions, etc.).

In addition, the SRI implementation process is also in the process of transformation; whereas earlier SRI was predominantly based on negative screening, current SRI is increasingly based on proactive positive screening and shareholder engagement. For example, the newly launched enterprise from Danske Invest, the Danske Invest European Corporate Sustainable Bonds fund, strives to be equally assiduous in determining as to what it *should* invest in, alongside screening out what it *shouldn't* invest in, based on SRI. Whereas it maintains a list of sectors it will not invest in, ranging from alcohol to weapons to fossil fuels, it also looks forward to attempting to incorporate the "entire spectrum" of sustainability, e.g. by investing in the development of new sustainable technologies, water purification and biotechnology.

Whither Nordics?

The Nordics – Sweden, Denmark, Norway and Finland – all have a global reputation for excellent performance in SRI-related international rankings such as the Human Development Index and the Environmental Performance Index alongside occupying top positions in sustainability ranks, with their business communities and government policies often held up as an example to other countries. While there is a high degree of homogeneity among the Nordics, cultural as well as institutional, and particularly in terms of civil and common legislation, there are also fundamental differences between them that have an impact on the degree of SRI implementation and attitudes more broadly. Among these, as among others Professor of Banking and Finance at St. Andrews Bert Scholtens and colleagues have researched, are how factors like economic openness, the size of the pensions industry, cultural values such as relative gender equality and risk avoidance lead to differences in terms of attitudes to SRI across the four countries.

HedgeNordic will be providing a panoramic view of SRI across Scandinavia alongside examining the practices of specific funds in each country, taking some of the aforementioned factors into account. The next instalment in this series will consider some key differences between SRI, ESG and Corporate & Social Responsibility (CSR), and evaluate how these are reflected across the Nordics.

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