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Press release

Prudent development of extra-financial screening of governments

Paris - 4 May 2010. Today, Novethic is releasing a working paper on the extra-financial rating of governments and on SRI sovereign debt. Three years following Novethic's first publication on the subject, results are questionable. Extra-financial ratings for governments are not nearly as developed as those for companies, and investors remain prudent by limiting investments to bonds issued by European countries.

The paradox

At the end of 2008, outstanding SRI bonds in France represented 9% of open-ended funds (EUR 1 billion) and 48% of separate account management mandates (EUR 7.4 billion). Government bonds account for a significant portion but are concentrated in the euro zone and European countries. Although 75% of SRI assets under management are held by asset owners, many remain prudent about extending this type of investment to government bonds. If they were to more actively promote the PRI (Principles for Responsible Investment), they would be encouraged to extend the incorporation of ESG criteria to all of their assets. Asset owners are the biggest holders of government bonds, but there are 5 French firms have signed the PRI - la Caisse des Dépôts, Crédit Agricole Assurance, ERAFP, FRR and MAIF - and they are not investment managers.

Lack of consensus

SRI selection strategies for governments remain problematic in investment universes that are already restricted, as most bond funds that invest in sovereign debt focus on just a few countries. This explains why some managers emphasise that OECD or EU member states inherently comply with the acceptance criteria that are equivalent to a systematic SRI approach. However, criteria such as the levels of corruption, social policies and environmental commitments diverge within the EU. This does not prevent half of the investment managers concerned from favouring a selection approach to the method of overweighting or underweighting governments within portfolios.

The methodologies used vary widely, and this disparity is reflected in the classifications by investment managers. Adjustments can significantly alter the position of certain countries. This is due to a lack of consensus regarding benchmarks, trust and conviction. Some asset owners want to show their engagement by excluding, for example, governments that have not adhered to international treaties on controversial weapons or that use the death penalty.

Relative impact

While owning shares could be used to exercise influence over companies' environmental and social policies, this approach is non-existent when it comes to investing in governments. The primary motivations for applying SRI to governments bonds are to remain consistent with an existing SRI approach for equity funds.

In any case, more research on the analysis of governments is needed to develop this market. The growing demand from asset owners requires the parallel development of ratings from investment managers or rating agencies. Rating agencies offer multi-criteria rating tools that can be configured in line with investors' choices (see table).

The debate sparked by current events on the financial rating of governments may indirectly result in the assessment of other Environmental, Social and Governance (ESG) parameters.

View the study "SRI: How to rate and select governments?": http://www.novethic.com/novethic/v3_uk/upload/Note_Govies_EN.pdf

About Novethic: Novethic, subsidiary of Caisse des Dépôts, is the leading research centre in France on Socially Responsible Investment (SRI) and Corporate Social Responsibility (CSR) and a sustainable development media expert. novethic.com

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