Phoenix INVESTOR RELATIONS

Our guest: Union Investment

Socially responsible investments are growing fast in Europe. For companies with commitment to sustainability issues, they are an opportunity. SRI investors are long-term investors with an ethical bias. An excellent example is Union Investment, number one SRI asset manager in Germany.

Ingo Speich, Fund Manager, Frankfurt, Germany.

After an apprenticeship in banking at the Dresdner Bank in Frankfurt, Ingo Speich studied Business Administration in Trier, Germany, and Boston, with an emphasis on portfolio management and some practical training in such exotic places as the Cayman Islands. He then joined Union Investment and followed the retail and later the auto sector, for which he is still responsible. After four years at Union Investment he got involved in sustainable investments and since July 2007 has been leading the SRI effort at Union. In addition Ingo Speich is a CFA Charterholder.

Can you give us a short overview of Union Investment?

Founded in 1956, Union Investment is the number three German fund manager by market share (10% of the market) and has round about €150 billion in assets under management. Its main shareholders are the German co-operative banks that also distribute Union Investment's products through their 1.200 branches. Union Investment manages over 670 mutual, private label and institutional funds and over 4,5 million investment accounts for private and institutional investors based in Germany and the surrounding European countries.

And in terms of sustainable investments, how is Union Investment positioned and organized?

Union Investment is the largest SRI asset manager in Germany, with €2.5 billion under management, two thirds of which are invested outside Germany in global markets, for mutual funds, institutional funds (called Spezialfonds in Germany) and advisory mandates. The reason for Union Investment's lead in SRI is historical: Union being the asset manager of the German cooperative banks, many of which have links to churches, charities or other non-profit organizations that happen to be the final investors in the SRI products.

We are presently building an SRI team that will ultimately include 10 people, including support functions, of which 4 for the "core competence center" focusing on dedicated SRI equity portfolio management. The SRI team is also coordinating SRI research within Union Investment, i.e. from the 40 sector analysts/ portfolio managers in the firm. They each follow at least one sector and dedicate 20% of their time to SRI research on these sectors. In my case, the sector is automotive, and on top of that I personally run the SRI equity funds, with assets of €450 million. All SRI research is centralized in a database and all our portfolio managers use it, with additional historical data from external providers like IBES and EIRIS (Ethical Investment Research Services). The sector research is fundamental research but there is also macro-based asset allocation input, quantitative research (alpha screening and risk-modelling), credit and derivative research.

What is the basis of your methodology?

In sustainability analysis we look at five broad sustainability themes:

1. Management: we look at the management's openness and commitment to SRI issues, and the quality of its SRI reporting.
2. Society: we examine the involvement of the company in society in general.
3. Environment: we track CO_2 emissions, waste management, logistical chain, etc.
4. Corporate governance: we focus on the way management is incentivised and controlled, how minority shareholders are treated.
5. Human resources: we are interested in social standards, security at work, diversity policies, if the company provides decent wages and services like child care, etc.

Corporate governance is particularly important as we represent minority shareholders.
We have an "engagement" policy, i.e. for years, our PM/analysts have been going to AGMs to express Union Investment's views and try to exert positive influence, mostly in Germany but also in the UK. We intend to push this further, but it is very time intensive.

How does the screening work in practice?

We start from the overall MSCI index universe, which comprises over 1000 securities. We select companies using 3 methods, then screen them for 100 sustainability criteria, positive and negative, in order to get "the perfect SRI companies".

1. The first method is called Exclusion. It is excellent from a sustainability point of view, because it excludes companies that produce contraceptives, alcohol, pornography, weapons, tobacco, that engage in intensive farming with animals or experi-

ment on animals, have nuclear energy or use child labour.

This gives you only excellent companies but in terms of diversification it is a challenge because you must exclude about 60% of the MSCI index components. So you are left with around 320 companies.

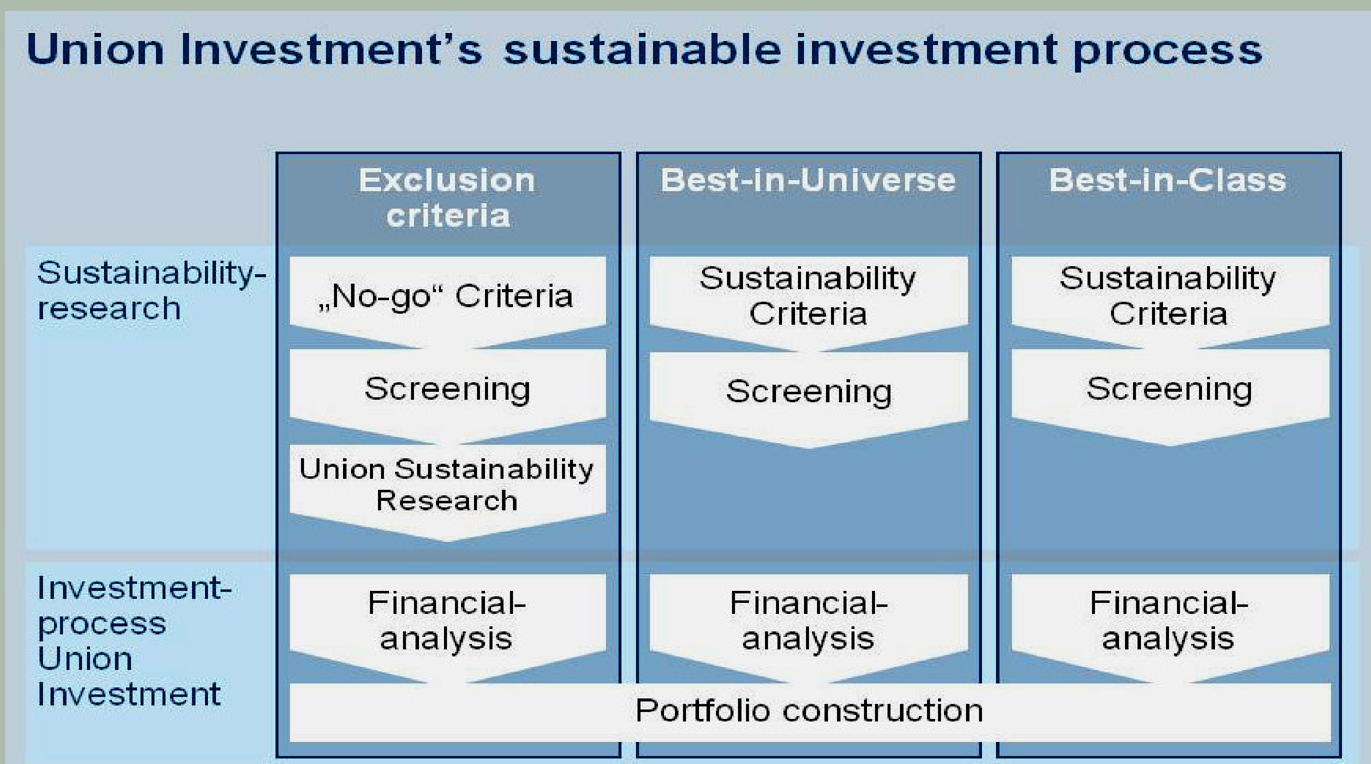
In parallel, we use two other methods: Best-in-Universe and Best-in-Class. Applied to the same 1000 securities, they reduce the universe to 300 securities.

2. The Best-in-Class approach is the best one in terms of diversification. We will take the best company in each sector in terms of SRI issues, excluding completely only a few sectors, like nuclear energy. So almost all sectors are included, but the screening is weaker from a sustainable point of view because you include many of the sectors with critical issues.

The companies selected using the Exclusion, Best-in-Universe and Best-in-Class methods then go through a screening process giving them positive or negative scores for 100 ethical, social and environmental criteria, followed by a multifactor analysis. This gives us a core universe of 100 companies, "the best third". Afterwards, we use our fundamental research process to invest in equities or bonds.

How are your portfolios then structured and managed?

We act as stock-pickers; we have a bottom-up approach. To have proper diversification in a large equity fund, you need 80 to 90 stocks. Our portfolios are quite stable; the average holding period will be 18 to 20 months. The analysis leading to the investment is quite thorough so we tend to keep stocks fairly long as well. So you can define us as a long-term investors with an ethical bias.



3. Best-in-Universe is an intermediate approach that will lead you to take for instance the 10 best companies on an SRI level, regardless of sector weightings; the problem is that you will end up with clusters, as some industries are good and others less good on the sustainability level. So this approach will give you less diversification than the Best-in-Class.

The sectors represented in our SRI products will depend on the fund. For instance, in a fund for Catholics I am not allowed to invest in contraceptives (for instance, Bayer acquired Schering that produces them, so I cannot invest in Bayer). Other clients do not have such strong restrictions. As a rule, however, the most represented sectors are insurance, bank and telecom companies. They are the less sensitive sectors in terms of sustainability. It is a very difficult topic, however, to summarize in two sentences.

We will rotate our portfolios based on financial criteria but our SRI screening is also dynamic. So I regularly look through my investment universe at current SRI issues rather than company-specific issues. Currently, banks are a major concern. Although I said they are usually not too sensitive, they are problematic now because of the layoffs. The subprime issue is also very bad; it led us to sell Washington Mutual, Merrill Lynch, FannieMae and FreddieMac very early due to corporate governance issues and incentivisation of management. We detected that in 2007. It ended up being a good investment decision.

Our funds are tilted towards large caps, because of our benchmarks, but also because I don't want to have small caps in this kind of environment. At this time, my overweights are all in the defensive sectors, and I have no cyclicals at all. Currently, I am underweight financials, insurance and mining but overweight telecom and some utilities (those that are SRI compliant) and I hold a lot of cash.

Because I went defensive at the end of 2007, I am 75% ahead of the benchmark, and this makes my clients happy; on a 3 year period our SRI funds have also been quite successful; for instance, Liga Pax Cattolico Union, one of our catholic funds, has a 5 star rating from Morningstar and screens in the top quartile of SRI funds. This year it is 4% ahead of the benchmark, last year 5%.

How important are meetings with companies in your investment process?

We have one challenge. Companies come very rarely to Frankfurt with their Head of SRI. There are only a few specifically SRI investors in Frankfurt, and although we see about 800 companies per year at Union Investment in one-on-one meetings, only a handful of these come with the Head of SRI, and the CFO is the wrong person to ask our specific questions to. Only four companies a month come with the Head of SRI.
So we need to organize our own trips; for instance I went to London in June and saw 20 companies, and also went to Chicago and the Detroit area in the US and saw 30 companies, purely on SRI issues. Soon I will also visit companies in Germany. During these trips, we visit production facilities, examine logistical issues, etc.; the focus depends from company to company but this is required by our SRI approach. We also go to specific conferences organized by dedicated SRI associations, rather than stockbrokers. On SRI topics, the team meets roughly 150 companies a year.

Are companies becoming more aware of SRI investors?

Companies generally know that SRI issues are becoming more important and they are paying more and more attention to them, and helping investors. Not only the companies that would naturally come to mind but also less obvious ones like mining companies, that want to emphasize what they do in terms of security at work, depollution, etc.
The best developed companies in terms of SRI (i.e. having an SRI contact, reports, etc.) are in the US, the UK and then in continental Europe. Germany and France are catching up rapidly and the rest are a little bit behind.
Depending on the company, the Head of SRI will have an environmental or corporate governance background. Although they may be aware of the positive impact of paying attention to SRI issues for the company's share price (waste management, energy management saves money), these people are not Investor Relations specialists.

Can you give some examples of companies that screen well in your system?

I see several excellent companies in the US like Microsoft, McDonald's, Baxter or Starbucks. McDonald's may appear as a strange example, because they have obesity issues but otherwise it is a very sensibly-run company: they pay a lot of attention to waste management, water management, labour issues, they have local sourcing, good energy management. The management is pretty dedicated to SRI and publishes extensive reports. So it screens very high in our universe.

I can also give you several examples in some European countries:

1. France: France Telecom is very good; they have a lot of ongoing education programmes, use safe energy, etc. Véolia Environnement also screens well but I have problems with the attitude of the management.

2. Belgium: I like Colruyt; they developed the safe energy issue ten years ago, and they have a lot of wind and solar energy equipment in their stores. In all the packaging issues they are also ahead of the curve. I would say they are one of the best SRI companies in Europe.

3. Netherlands: Philips is also very good, thanks to its energy efficient lighting business, energy saving projects and their social commitment.