



# SRI AND PENSIONS IN ASIA

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Association for Sustainable & Responsible Investment in Asia

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## SUMMARY

Asia, the world's most populous region, faces a profound challenge in the coming decades: a social security crisis. At the same time the region's environmental problems are "pervasive, accelerating and unabated"<sup>1</sup>. Both these trends suggest a bleak future for the majority of Asians. This report reveals why the solution to the first problem could also be a large part of the answer to the second.

We looked at the social security and environmental crises in Asia, with special attention to 10 countries of the Asia Pacific Rim: Japan, China, South Korea, Taiwan, Hong Kong SAR, Philippines, Malaysia, Thailand, Singapore and Indonesia. We also examined the role of socially responsible investment (SRI) in helping to solve these problems. The key findings from the report are:

- The majority of SRI funds are not asking about the adequacy of pensions provision as part of their due diligence on workplace standards. While this issue may be less relevant in other markets, it should be considered a priority issue for Asia
- SRI is not yet an investment option for pensions management in Asia

As a result of these findings and other conclusions drawn from the research, we recommend:

- Support for existing and new efforts to improve pensions provision across the region
- SRI experts start asking the pensions question
- Investors recognise the importance of SRI in supporting sustainable business practices to ensure long-term prosperity
- Pension funds include the SRI option in their policies

As far as we are aware, no analysis of this kind has been undertaken previously. We see the work as a foundation to build from, to understand better how pensions investment in Asia can best enhance the common good while meeting all fiduciary requirements. We welcome all feedback on the report, recommendations of additional research and information which should be considered, and suggestions for further analysis.

We want to help make responsible pensions investment a reality for Asia.

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<sup>1</sup> Environmental Outlook 2001, Asian Development Bank



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**Disclaimer:**

While every effort has been made to ensure the information in this report has been obtained from sources which we believe to be reliable, we have not independently verified the information and do not guarantee that it is accurate or complete.

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## 1. INTRODUCTION

This research has two goals:

- **Social Security**

To investigate the role of pensions provision in building social safety nets and to identify the role of SRI in encouraging adequate pensions provision. (Section 2)

- **Sustainable Economy**

To investigate how SRI contributes to sustainable economies and to explore the role of pension funds in supporting SRI. (Section 3)

Asia's demographic time-bomb is ticking. While Asia accounted for 28% of the world's population aged 60 and older in 1985, that proportion will more than double to 58% in 2050.<sup>2</sup> The rate of aging in the region will be the fastest in the world, and in absolute numbers, the "global challenges facing social security systems" will be largely Asian.<sup>3</sup>

At this stage, these estimates could bode a terrible crisis or conversely, a great opportunity. The outcome will be determined by critical decisions at the policy, as well as the market, corporate, and individual level. Asian prosperity could be supported by a pension investment-driven, multi-decade bull market.<sup>4</sup> With the right investment policies, financial institutions and regulatory criteria in place, this bull market could result in environmentally and socially sustainable economic growth for Asia.

According to World Bank estimates<sup>5</sup>, if growth turns out to be 5% annually until 2008 and it is equally shared, the number of people living in poverty in East Asia, including China, would fall from 278 million to 72 million. Slower growth of only 4% and with less equal income distribution would leave more than twice as many - 182 million - in poverty in 2008.

While there are substantial variations from country to country, these estimates clearly show that building a social agenda that embraces the vulnerable groups of society remains a deep-seated challenge for East Asia as a whole. The private sector is central to the social agenda - especially in the provision of adequate healthcare, education and old age security systems for employees. We put the case that socially responsible investors can encourage Asian corporations to do these things.

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<sup>2</sup> United Nations 2001, as quoted in Turner, John. 'Social Security Development and Reform in Asia and the Pacific'. London: The Pensions Institute, March 2002.

<sup>3</sup> Turner, 2002. p.1

<sup>4</sup> Credit Suisse First Boston (CSFB) – HK. Paterson, Stewart et al. 'Asian Sticks and Flows'. Vol. 1, Hong Kong: CSFB Equity Research, November 2001.

<sup>5</sup> Jemal-ud-din Kassam, VP East Asia and Pacific Region, World Bank, 23.3.00, speech in Hong Kong <http://Inweb18.worldbank.org/eap/eap.nsf/General/E8285EDFF3269B66852568CE0053D615?OpenDocument>

The pollution problems facing the region are familiar to anyone living there, especially in one of Asia's major cities. But there are also the more invisible problems which must be addressed such as depletion of fresh water sources, over-consumption of other resources such as timber, fish and minerals and the pervasive, but potentially highly destructive phenomenon of climate change. The smart way to grow economies is to build in renewal. This is the point of truly sustainable development.

Pension funds with SRI policies can play a crucial role in financing sustainable enterprises and encouraging corporate best practice in strategy, eco-efficiency and human betterment. Meeting such goals will lead to long-term economic prosperity and enhanced welfare of Asia's workforce.

## Recommendations

### 1. Raising the Pensions Question

We recommend that responsible investors and SRI Research Groups ask:

- What retirement schemes does the company run?
- Does the company take any measures to improve pensions provision beyond what is required by law?
- Does the company scheme benefit all employees? If not, which categories are excluded? Do part-time employees benefit?
- Has the company discontinued any of its pension plans?
- Is there evidence of malpractice regarding its management or the allocation of funds?
- Are the company's pension plan(s) fully funded? Is this verified by the company's auditors and confirmed publicly?
- Has the company moved from a defined benefit DB plan to a defined contribution DC plan? If so, have employees benefited from educational programmes so they understand the implications of such a move?

### 2. Investing for Sustainability

**SRI pension options ensure investment with a long-term interest in corporate performance and development. Resolving the present social security crisis through SRI could help to ensure strong institutional support for Asia's financial markets and corporations. We recommend the following:**

- For Asian governments, especially those with the more developed pensions systems, to make Statements of Investment Principle (SIPs) which embrace the SRI dimension, a legal requirement of occupational and private pension schemes
- For pension officers, trustees and their advisers to familiarise themselves further with SRI and to consider the long-term responsibilities of their investment strategy in relation to national and global environmental constraints
- For pension trustees to request information on SRI policies appropriate for pension funds and to select options appropriate for the fund
- For DC plan sponsors to offer an SRI option and to consider making this the default option when no selection is made
- To consider surveying the views of plan beneficiaries with regard to their long-term investment objectives and views of SRI
- To provide information for beneficiaries on the fund's corporate governance and SRI policies and practices
- To collaborate with other like-minded pension funds to build understanding and best practice

## 2. PENSIONS IN ASIA

### Highlights

- Asia's population is ageing faster than any other region in the world
- Pensions provision is a core feature of social security and support for the elderly. Making sure retirement schemes are adequately funded is a major contribution to poverty eradication
- Under-funding of pension schemes in some countries is a major problem

Opportunity for responsible investors to raise expectations with Asian corporates that pension schemes are fully funded

- Employees may be outside mandatory pension provision law requirements

Encourage best practice, above the letter of the law, to extend coverage to workers who may currently be outside existing schemes, such as part-timers

- SRI can attract more people to contribute to schemes

DC plans and State schemes should include an SRI option

### Reforms

- National provident funds being reformed to incorporate DC plans
- Some socialist countries are moving towards market economies – this involves reformulating their old-age benefits provision
- Market-oriented countries with DB social security schemes are reforming them, opening the market to private pension fund providers
- A fiduciary approach to pensions provision is emerging
- Employees are having greater access to choice about how their retirement funds are invested

## 2.1. Retirement Plans: An Overview of the Asian Context

Pension plans represent the fastest-growing flow of funds into global capital markets today. Over the past 50 years, the phenomenal growth of pension funds in the United States for example is nothing less than a silent 'revolution'. The United States' pension fund assets grew from only \$14.3 million in 1949 to more than \$8.7 trillion in 1998.<sup>6</sup> This pattern of pension fund growth is global. Pension funds are one of the fastest growing and already one of the largest pools of capital in Asia. And not a moment too soon. Asia needs to build its pensions industry for three reasons.

### 2.1.1. Growth of the Urban, Nuclear Family

With growing urbanisation, modernisation and a preference for nuclear families, the extended family has ceased to be the social safety net it used to be for aging adults. Fewer children are taking responsibility for caring for their parents in their retirement. As a result, older generations have to look elsewhere for financial support during their retirement years.

While much of Asia is still firmly rooted in the extended family model of old-age-care, rapid urbanisation and declining fertility rates are causing families to become smaller and more geographically dispersed. Previously, most Asian elderly lived with one or more of their children.<sup>7</sup> Confucian values that "emphasise family responsibility for the economic support of older family members" slowed the development of social security programmes. For example, a national social security programme was only introduced in South Korea in 1988 and in Thailand in 1998.<sup>8</sup> Rapid socio-economic change is now eroding the family support tradition.

### 2.1.2. Rapid Aging Driven by Low Fertility

This transformation is evident in China, Taiwan, and other East Asian countries in which the one-child policy is "undercutting the traditional family approach to caring for aged parents, leaving the Government to care for the elderly."<sup>9</sup> Population aging in most of Asia has been driven by low fertility, with fertility rates below replacement (2.1) in Thailand, China, South Korea, Taiwan, Japan and Hong Kong. Fertility rates vary across the region, with Japan at a point where the long-term fertility rate has fallen to 1.39 children per woman, while other Islamic and Catholic populations such as Malaysia and the Philippines still maintain a high fertility rate of around 3.5. Japan is the second oldest country in the world today with 22 percent of its population age 60 or older, while the Philippines is a young country with only 6 percent of

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<sup>6</sup> Clowes, Michael. *The Money Flood: How Pension Funds Revolutionized Investing*. New York: Wiley, 2000. p.4

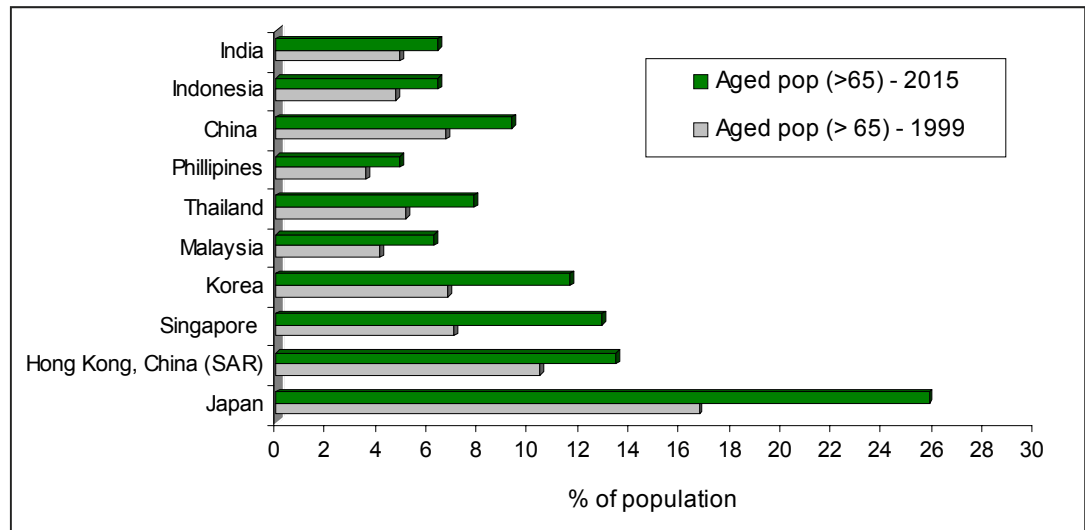
<sup>7</sup> Gillion, Turner, Bailey and Latulippe, 2000, as quoted in Turner, 2002.

<sup>8</sup> Turner, 2002. p.3

<sup>9</sup> Pitsilis, Emmanuel et al, 'Pensions pose Problems'. *South China Morning Post*, April 22, 2002.

its population in the same age bracket. While it is projected that it will take the US 81 years (1933-2014) to double the percentage of its population over 60 years of age (from 10 to 20%), Singapore may only take 18 years (1999-2017) to achieve the same doubling.

**Figure 1: A conservative estimate of aged population trends in Asia - 1999 and 2015** (Data source: UNDP Human Development Report 2000)



### 2.1.3. Demographic and Sectoral Shifts in Asian Workforce

People are generally living longer and retiring younger than they did when engaged in rural/agricultural activities. The average person is therefore spending more years in retirement now than before, triggering even greater dependence on pension payments<sup>10</sup>, especially in urban and industrialised areas.

The rapid economic development in Asia has caused many more workers to enter wage employment contracts from previously being self-employed or casual workers. Between 1980 and 1995-96, the number of employees as a percentage of the economically active population grew from 54 to 73 percent in Malaysia, and from 22 to 37 percent in Thailand<sup>11</sup>. This trend is not common to all of Asia. In Indonesia for example, despite growing industrialisation and urbanisation, most growth in the workforce has been in agriculture or the urban informal sectors that still rely primarily on family support in old age<sup>12</sup>.

<sup>10</sup> Mishkin, Frederic, and Stanley Eakins. Financial Markets and Institutions, 3rd edition. New York: Addison Wesley, 2000. p.563-564

<sup>11</sup> Gillion, Turner, Bailey and Latulippe, 2000, as quoted in Turner, 2002. p.4

<sup>12</sup> Turner, 2002. p.4

## 2.2. Current State of Pensions Funding in Asia

### 2.2.1. Overview

*Everybody's in on it. Pension reform swept the region in 2001, from Hong Kong's Mandatory Provident Fund to Japan's new defined contribution law and Singapore's 401(k)-like Supplementary Retirement Scheme, to mainland China's Liaoning Province experiment. Even South Korea's bureaucrats are humming away at designing a new defined contribution structure. The entire region is responding to the pressures of greying populations, declining traditional family support systems and the desire to institutionalise their capital markets.*

— PensionsAsia magazine, cover story, Winter 2001-02

Present pensions provision in Asia, where it exists, is inadequate in terms of coverage, contribution, savings pool and management. According to Credit Suisse First Boston (CSFB) estimates, Asia - excluding Japan, has a pension pool of about US\$250bn (2001 estimate). Even the most basic level of old age income provision going forward requires a savings pool of US\$2.2tn (2001\$ terms) by 2020 – a real CAGR of around 13%. The savings pool required to deliver additional benefits comparable to those of the U.S at Asian income levels would require about US\$7.5tn (2001\$ terms) by 2020, implying a real CAGR of around 20%.

Asian countries have vastly different levels of pensions funding and coverage. We looked at 10 countries in detail and further details of these schemes are described in Appendix 1. However, as a general rule, Asia's pensions capability tends to be less developed than other countries at similar levels of economic development.<sup>13</sup> Differences in the level of per capita income partially explain the variation in social security coverage in the region, the low levels of which are a serious concern in many Asian nations. Low coverage is partly because many of the existing contributory social security programs exclude workers employed in the informal economy, self-employed workers, and employees of small firms (<10 employees)<sup>14</sup>, who constitute a large portion of some Asian workforces such as Indonesia's. The prevalent systems of pensions provision can be broadly divided into two categories: 1) defined contribution, provident fund type schemes such as those in Singapore, Malaysia, Indonesia and Hong Kong or 2) defined benefit, pay as you go, social security type schemes such as those in Thailand, South Korea and the Philippines.

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<sup>13</sup> Turner, 2002. p.4

<sup>14</sup> Gillion, Turner, Bailey and Latulippe, 2000, as quoted in Turner, 2002. p.5

## The World of Pensions

Pensions are replacement income for those too old to work. "Funded" pension plans have a pool of assets large enough to meet their future liabilities. Pay-as-you-go (PAYGO) plans have little or no assets and rely on future payments into the plan to finance benefit payouts. There are two kinds of pension benefits.

- Defined-Benefit (DB) plans promise a monthly income calculated on the basis of previous earnings and years of service. In order to run a DB scheme, the plan need not be funded but there must be a solvent guarantor.
- By contrast, Defined-Contribution (DC) plans simply accumulate a savings account that will buy whatever annuity is available on the market at the time of retirement. DC plans require assets and safeguards but no guarantor of a promised level of benefits because there is no such promise.

Government-sponsored plans in most major industrial countries are based on PAYGO arrangements. This means that everyone's pension is paid by some other people down the road. Successful PAYGO plans presume that the working population as a proportion of the total, will grow (or at least not decline!) and labor productivity in the economy will also grow. Such public pensions include elements of income redistribution: from rich to poor, also from later generations of contributors to the initial generations of recipients, and from men with short life expectancies at retirement to women with long ones. Governments often earmark a payroll tax to cover the ongoing expenditures of the PAYGO system.

The escalating costs of security systems are forcing countries to reevaluate the formal programmes that provide income maintenance support to the aging. Many countries have a reform strategy built around three systems, or "pillars" - a public pillar with mandatory participation; a private, mandatory savings plan; and a voluntary savings system.

**Source:** World Bank website

## **2.3. Relevance of SRI to Pensions Provision in Asia: Asking the Questions**

### **2.3.1. The Role of Pensions Provision in Tackling Poverty**

As already described, the pensions market in Asia is underdeveloped and significantly under funded<sup>15</sup> if it is to meet its future obligations in any satisfactory way. Apart from Japan, no country has universal coverage. In fact most countries have coverage rates well under 50% of their working population. With the demographic and funding situation as it stands, we could well be looking at decades where the old are left in poverty to fend for themselves.

Although many Asian companies have yet to communicate their social policies comprehensively and effectively, this does not mean there are no cultural and social traditions of support and responsibility towards employees. For example, Chinese and Singapore companies can be slow to dismiss people because they recognise that employers also have a duty to provide.<sup>16</sup> While this approach can at times lead to stagnating labour markets, this foundation of employee-care and welfare that is inherent to many Asian businesses provides a sound base for greater support for retirees and their dependants.

However, even though pension laws exist in most Asian countries, many corporate schemes are under-funded and the benefits may not reach all employees such as part-timers. As Asian corporations cater to global investors, so these investors can in turn support and encourage greater pensions provision. The global SRI community can help lead this process. Employee benefits, particularly retirement savings, are equally essential to workers in the USA as they are to workers in Thailand. It is this commonality that makes it possible for adequate pensions provision to be recognised as a duty of Asian corporations and governments alike, and for responsible investors to engage with Asia to help ensure that the region's elderly will be provided for.

Since responsible investors and SRI funds can have greatest influence over the pay-out policies of corporate pensions schemes, it should be noted that the primary beneficiaries of these schemes are workers and their dependents in the more industrialised and commercial regions. However, retirees may retire back to their rural roots or send money back to dependents there. Corporate pensions schemes therefore tend to contribute most to eradicating urban poverty and give only un-guaranteed, indirect support to the rural poor. However, this is at the level of pension fund pay-outs. Section Three highlights some of the ways pension funds can help to finance sustainable economic growth, including the development of rural areas and disadvantaged communities.

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<sup>15</sup> Even developed economies are now having to cope with under-funding problems.

<sup>16</sup> 'Will Socially Responsible investment (SRI) take hold in Asia?' FinanceAsia, April 30, 2002.

## The World of SRI

SRI, sustainable and responsible investment or socially responsible investment, is an investment strategy that allows investors to take into account wider concerns than purely financial, such as environmental protection, social justice, poverty alleviation and peace. Financial performance is a critical component of the investment decision, just like any other investment strategy, but additional values are also taken into consideration.

SRI has evolved from a purely ethical movement to an investment strategy that addresses the wider business-related issues as part of basic risk management. As part of their strategy, SRI analysts look in great detail at qualitative issues at the macro and micro level.

At the company level, qualitative factors such as brand, reputation and management can be decisive in company success. At the macro level, changes taking place in society and the environment, such as population growth, resource use intensity and climate change, can have significant impacts on business sectors. SRI investors undertake detailed analysis of these factors when analysing companies and structuring their portfolios.

There are a number of approaches to SRI. Some investors employ a 'screening approach' where unacceptable activities such as tobacco production, gambling, pornography, nuclear power or arms manufacture are avoided. Conversely, an investment strategy which favours certain sectors, or 'industries of the future' such as renewable energy, waste and water management, mass transit, healthcare, nutrition, education may be the focus, or it may be a combination of these two approaches. Another approach is more relative, focusing less on sector exclusions, and more on selecting companies from any sector that are 'best in class' on environmental and social matters, relative to their peers. Still other investors adopt an 'engagement' approach which is not about stock selection and more about the investor's role as an owner of the company. These investors encourage companies to improve performance and may vote at shareholder meetings and file resolutions to press for improvements.

SRI is now a mainstream investment product in the west and SRI products are now available in more than 21 countries. Almost US\$2.4 tn is invested with some regard to environmental, social and/or ethical concern as well as financial returns. In the Asia region, Australia is the largest market with A\$13.9 billion (approx. US\$7.7 billion) invested in funds with SRI policies (as at June 30, 2002). The industry is growing fast, up 32% in 12 months, whilst overall managed funds have declined 0.1% in a weak market. In Japan there is approximately US\$1 billion at current market valuations invested in eleven fund options. Elsewhere in Asia, a handful of fund options have become available in the last year and more are planned.

## 2.4. Making Pensions Provision an SRI Assessment Criterion

SRI has been at the forefront of defining corporate responsibility, highlighting best practice and encouraging companies to improve their record. For many years workplace issues such as health and safety policies, equal rights for women and minorities, family benefits, wage policies and profit-sharing have been on the list of issues which responsible investors may consider. However the agenda has been driven by the concerns of the countries where SRI has originated, namely North America, Europe, especially the UK, and Australia. Other priorities such as pensions provision have not been considered because no problem was perceived. Even this is changing and the pensions issue is beginning to raise its head in these markets too. Clearly pensions provision is a major social issue for Asia and should be considered a top priority for SRI analysis of corporates in the region.

### 2.4.1. Current SRI Research Criteria

ASrIA conducted a survey of 27 leading SRI research groups and think tanks worldwide (primarily from Europe, Australia, North America, Japan) in June-July 2002 to identify the inclusion or conversely the exclusion of adequate pensions provision in their current research criteria. The results confirm that pensions provision is not currently a focus for SRI research. Of the 16 responses received, 5 considered the question of pensions provision not applicable to their research, 3 explicitly do not question or engage on the subject, 6 conduct assessments on the subject but do not engage, or engage only from a distance, and only two of the surveyed groups specifically and actively question on the subject of adequate pensions provision, though without engaging. In part, this reflects the current focus of most SRI research on developed markets, where pensions have been a less pressing issue, although even this is changing. Furthermore, since the majority of surveyed groups were research organisations, they tried to maintain an 'objective' third-party investigative role and do not commit to engagement directly with corporations.

Groups from Australia and the UK, who catered to country specific stakeholder groups, considered the survey questions not applicable (N/A) to their work as these countries have mandatory pension/superannuation schemes. Therefore, unless a particular company had problems in the area, they could not see why engaging on pensions in and of itself might constitute an important query. However, one responder pointed out that the issue might not be as inconsequential as generally considered, even within countries like the UK with mandatory schemes. Pensions provision, he pointed out, is currently a big topic in the UK. Many companies are closing final salary pensions DB schemes to new members switching instead to money purchase DC schemes - which involve a significant risk transfer from the company to the employee. SRI groups, however, have not looked into this issue as yet, and our N/A responses only confirmed the absence of discussion on the topic.

A number of the groups that do ask about pensions provision almost uniformly pointed to the need for more serious involvement on the issue. One responder wrote that they were particularly interested in addressing the question of adequate pensions provision for employees in non-OECD countries, where “corporate initiative has to counterbalance the comparatively weak public domain.” Not surprisingly, a responder from Japan was especially supportive of the possible alliance between pensions funding and SRI in Asia, but regretted to note that the present level of awareness even in Japan was far from adequate.

KLD Research & Analytics, Inc., a prominent US based research agency, is one of the two surveyed groups that includes adequate pensions provision as a specific assessment criterion. This includes looking at whether or not the company has a defined benefit plan and/or a defined contribution plan (a.k.a. 401(k) plan), looking to see what the company contribution to the 401(k) plan is and whether or not that contribution is made in stock or cash, or if the contribution is based on profits, and finally, checking to see that the defined benefit plan is at least 85% funded. Michael Jantzi Research Associates Inc. (MJRA, Canada), the other research organisation that responded affirmatively, provided a list of specific questions related to pensions provision that it addresses. These include:

- a) Does the company offer a pension plan for part-time employees?
- b) Has the company moved from a defined benefit plan to a defined contribution plan?
- c) Are the company's pension plan(s) fully funded?
- d) Has the company opted out or raided the pension plans?

The responder further pointed out that though there was a general interest on the issue of pensions provision from their clients, their labour and union clients were the people most interested in this criterion. As is commonly recognised by employees but rarely discussed, the financial details of companies’ pension provision are not always readily available or clear, which only underlines the need for disclosure pressure and accountability in this area.

## 2.4.2. Recommendations to the SRI Community

We make the following recommendations to investors concerned to support adequate pensions provision in Asia.

### Raising the Pensions Question

We recommend that responsible investors and SRI Research Groups ask:

- What retirement schemes does the company run?
- Does the company take any measures to improve pensions provision beyond what is required by law?
- Does the company scheme benefit all employees? If not, which categories are excluded? Do part-time employees benefit?
- Has the company discontinued any of its pension plans?
- Is there evidence of malpractice regarding its management or the allocation of funds?
- Are the company's pension plan(s) fully funded? Is this verified by the company's auditors and confirmed publicly?
- Has the company moved from a defined benefit DB plan to a defined contribution plan DC\*? If so, have employees benefited from educational programmes so they understand the implications of such a move?

#### Pointers for responsible investors asking about corporate pension schemes in Asian countries.

Refer to Appendix 1 for more information on the pension schemes operating in each country

**Japan:** Assume company compliance with regulations. 99% of company schemes are DB and some two-thirds are now under-funded. Ask to what degree and what management intends to do to become fully-funded.

**South Korea:** Companies may be unwilling to disclose but many schemes will be under-funded, so keep asking.

**China:** Many companies are not complying with the law to make contributions to the State system. Companies can provide supplementary benefits, either DB or DC and funded, but many with historic liabilities attached.

**Taiwan:** Certain industries are required to contribute to the Central Trust of China, but not all comply. Ask if any additional commitments made and if these are properly funded.

**Hong Kong:** If companies pay more than the MPF minimum, they should be credited. Older companies will have DB schemes, some 20-30 out of the top 100 companies; these may be in deficit, possibly to a level which could affect share price. A new accounting standard is being issued at year-end to require disclosure.

**Singapore:** Companies likely to be complying with CPF, very few doing anything more than this.

**Malaysia:** Not all comply fully with the EPF, some operate supplemental DB schemes

**Thailand and Indonesia:** Start asking questions.

\* This is usually disadvantageous to employees – as many companies reduce their contributions when they switch to DC.

### 3. SUSTAINABLE INVESTMENT STRATEGIES FOR ASIA

#### Highlights

- Asia's economies among the most dynamic anywhere in the world
- Environmental trends serious and getting worse
- New business opportunities arising to address environmental and social problems... great prospects for 'industries of the future'
- PLUS corporate governance enhances shareholder value

SRI is part of the corporate governance agenda

- The growing pensions capital pool can help to finance sustainable economic development and grow domestic markets
- SRI is an attractive pensions option for many Asians

DC plans and State schemes should include an SRI option. SRI worldwide has attracted many first time investors who are often middle income earners, female, make donations to charity or are part of an environmental or religious network. In Asia many women work and control the family finances, people are becoming more and more environmentally aware and there are active religious groups. Japanese eco funds have attracted these types of investors, other Asian markets have similar characteristics

#### Reforms

- Laws requiring pensions funds to have regard for SRI emerging around the world
- Some pension funds setting new SRI precedents
- International and national regulations will favour sustainable business practice more and more e.g. the Clean Development Mechanism
- The hidden subsidies to unsustainable industries will decline

### 3.1. Facing the Critical Environmental and Social Questions

*Investment is the process of foregoing immediate expenditures in order to build a more prosperous future. What kind of future are we now building?*

Bob Monks  
The New Global  
Investors 2001

Consideration of a country's pension systems and old-age care provision, especially one involving the accumulation of individual life savings, quickly involves questions about long-term investment objectives: What are the impacts of pension investments? Is this significant capital source creating revenue flows that reinforce or undermine basic necessities such as ecological security, human welfare and peace? After all, a young recruit does not expect to benefit from his pension for some 35-40 years. What will Asia be like then? Will there be peace and prosperity or will the region be torn by ecological and social conflicts? Bob Monks<sup>17</sup> rightly questions the fundamental purpose of investment that lies at the heart of this discussion.

Harbouring a vision of the world many decades into the future and setting desirable goals are key elements of social responsibility, facilitated by long-term investments. Pension trustees have to honour obligations not simply to existing retirees but to those in the future too. 2050 is within the lifetime of most of our own children and the time when new recruits to companies today will be expecting their pension dues. The prognosis for 2050 is a wake up call. Our overconsumption of natural resources today will affect the living standards not of an abstract "future generation" but of people we already know and care about.

#### 3.1.1. Ecological Capital Management

*If everyone in the world was to have the same standard of living as people in OECD countries, under current systems of production and consumption, then we need at least three planets worth of resources.*<sup>18</sup>

*At the current rate of consumption, the ecological footprint of all humankind will reach twice the regenerative capacity of Earth by 2050.*

Claude Martin, CEO  
WWF International

Environmental destruction for economic growth is not so much a management problem as it is a fundamental design problem.<sup>19</sup> Until businesses, governments, NGOs and researchers begin to 're-design' their practices at the most broad and basic levels, all attempts at sustainability will remain cosmetic.

Humanity's use of natural resources – the so-called ecological footprint – has exceeded the regenerative capacity of Earth since the 1980's and is now about 20% too great.<sup>20</sup> If there is no collective action to halt this trend then during the lifetime of our children, human welfare will go into decline.

<sup>17</sup> The New Global Investors, Bob Monks 2001

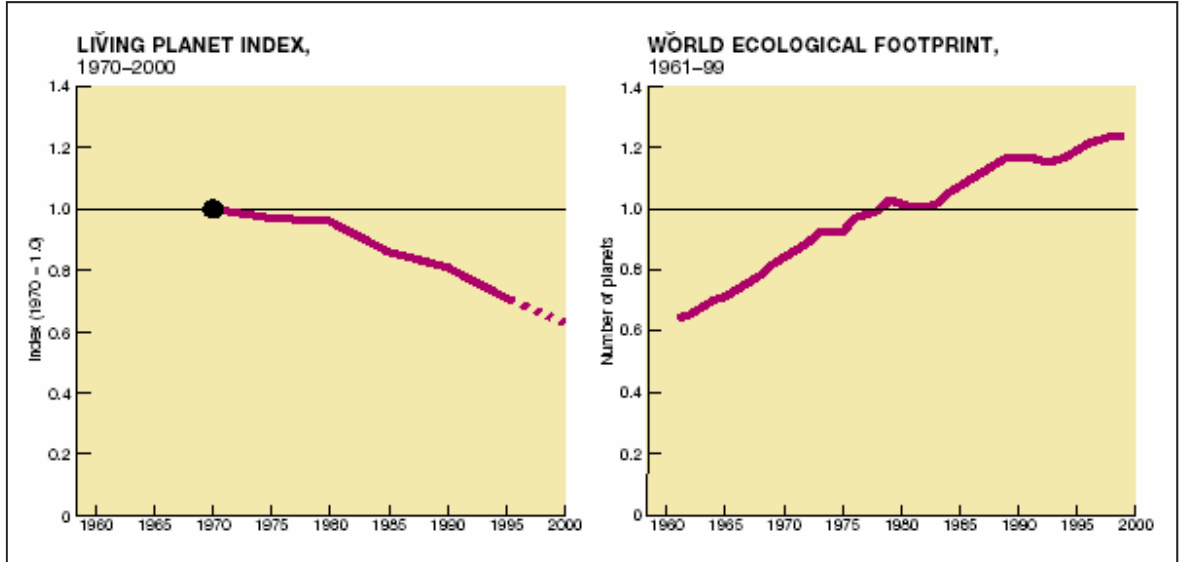
<sup>18</sup> OECD, FoE and WWF studies

<sup>19</sup> The Ecology of Commerce, Paul Hawken, 1993

<sup>20</sup> WWF - Living Planet Report 2002, <http://www.panda.org/livingplanet/lpr02/>

Figure 2: Sustainability measures

Source: WWF - Living Planet Report 2002



This gargantuan over consumption is at the expense of the natural capital of the planet – the forests, the freshwater ecosystems and oceans – not to mention the livelihood of communities that directly depend on these resources. We can already see the effects. Since 1970, the Living Planet Index – a measure of the health of our planet’s ecosystems – has declined by about 35%. Freshwater ecosystems have been especially hard hit and in Asia significantly so.

The Earth has about 11 billion hectares of productive land and sea space, after all the unproductive areas such as ice caps, desert and open ocean are discounted. Divided between the global population of 6 billion people, this total equates to just 1.9 hectares per person. Yet the WWF recently revealed that the ecological footprint of the world average consumer in 1999 was 2.3 hectares per person, or 20% above the Earth’s biological capacity of 1.9 hectares per person.<sup>21</sup>

<sup>21</sup>WWF - Living Planet Report 2002, <http://www.panda.org/livingplanet/lpr02/>

## Ecological Footprint

These calculations are based on two simple facts: first, we can keep track of most of the resources we consume and many of the wastes we generate; second, most of these resource and waste flows can be converted to a biologically productive area necessary to provide these functions. Thus, ecological footprints show us how much nature nations use.

Put another way, the ecological footprint is the ‘total area of the planet that humans require for agriculture, grazing land, timber production, marine fishing and infrastructure, together with the area necessary for absorbing the carbon dioxide produced by burning coal, oil and other fossil fuels’.

At the current rate of consumption, the ecological footprint of all humankind will reach twice the regenerative capacity of Earth by 2050.<sup>22</sup>

As Table 1 shows, people in different countries have vastly different ecological footprints. The average Asian consumer footprint is less than 1.4 hectares in 1999. However, two of the countries with the largest deficits are Asian: Hong Kong (at -6.1 in 1997) and Singapore (at -7.1 in 1997). Given the development needs of the region there is no room for complacency. Asia has a one time chance of developing in ways which ensure its own ecological footprint is not exceeded. Modern technologies and design make this a possibility. In doing so, the region can take advantage of global negotiations and will not have to deal with the difficult and costly measures which more developed countries now face to live within their rightful space.

**Table 1: The ecological impact of select nations ('97 data)**

Updated 1993 list after introducing equivalency factors, new forest productivity and CO<sub>2</sub> absorption (IPCC data) —Nov 20, 1997

Country	Population ('97)	Footprint [hectares/capita]	Available capacity [ha/cap]	Ecological deficit (if negative) [ha/cap]	Total footprint [km <sup>2</sup> ]	Total average capacity [km <sup>2</sup> ]
Australia	18,550,000	9.0	14.0	5.0	1,669,500	2,597,000
China	1,247,315,000	1.2	0.8	-0.4	14,967,780	9,978,520
Hong Kong	5,913,000	6.1	0	-6.1	360,693	0
India	970,230,000	0.8	0.5	-0.3	7,761,840	4,851,150
Indonesia	203,631,000	1.4	2.6	1.2	2,850,834	5,294,406
Japan	125,672,000	4.3	0.9	-3.4	5,403,896	1,131,048
Korea, Rep	45,864,000	3.4	0.5	-2.9	1,559,376	229,320
Malaysia	21,018,000	3.3	3.7	0.4	693,594	777,666
New Zealand	3,654,000	7.6	20.4	12.8	277,704	745,416
Philippines	70,375,000	1.5	0.9	-0.6	1,055,625	633,375
Singapore	2,899,000	7.2	0.1	-7.1	208,728	2,899
Thailand	60,046,000	2.8	1.2	-1.6	1,681,288	720,552
UK	58,587,000	5.2	1.7	-3.5	3,046,524	995,979
USA	268,189,000	10.3	6.7	-3.6	27,623,467	17,968,663

<sup>22</sup> Claude Martin, CEO WWF International, International Herald Tribune, 24.7.02

### 3.1.2. Social Capital Management

When 20% of the world’s people consume 80% of the resources used (Friends of the Earth, UK, Tomorrow’s World)<sup>23</sup>, formulating a sustainable vision of the future involves more than an environmental analysis. It also involves issues of resource access and equity: what rights do all humans have to resources and economic prosperity? Oxfam was one of the first NGOs to recognize that while East Asia is not a big spender in social policy relative to its income, the region does score highly in its efficiency of spending as measured by human welfare outcomes. “The poor in East Asia have benefited from growth not because the gains trickled down to them but because the development of their productive potential has been central to the growth process”.<sup>24</sup>

This is a central message of our analysis. For the sake of economic well-being, if nothing else, there can be no let up in the social transformation to improve the lives of all Asians. The Human Development Index illustrates what Asia has achieved in world terms. However Oxfam also observed that Asia has not been entirely successful, “the poor are treated shamelessly in many countries, evicted from their land, exploited as cheap labour and denied a voice in national affairs”. Appendix 2 summarises the major social challenges still facing the Asia region.

**Table 2: Human Development Index**

Country	Rank (173 countries)	Index
<b>Japan</b>	9	0.933
<b>Hong Kong SAR</b>	23	0.888
<b>Singapore</b>	25	0.885
<b>South Korea</b>	27	0.882
<b>Malaysia</b>	54	0.782
<b>Thailand</b>	70	0.762
<b>Philippines</b>	77	0.754
<b>China</b>	96	0.726
<b>Indonesia</b>	110	0.684
<b>East Asia &amp; Pacific</b>		0.726
<b>Least Developed Countries</b>		0.445
<b>OECD</b>		0.905
<b>World</b>		0.722
The Index is comprised of data for life expectancy, adult literacy, GDP per capita (at purchasing power parity), and education. Source: UNDP Human Development Report 2002		

<sup>23</sup> [http://www.foe.co.uk/campaigns/sustainable\\_development/publications/tworld/one](http://www.foe.co.uk/campaigns/sustainable_development/publications/tworld/one)

<sup>24</sup> Growth with Equity: An Agenda for Poverty Reduction, Oxfam International, September 1997.

Investment can be a powerful tool for the redirection and appropriate employment of capital to address matters of social justice and there are certain precedents now emerging. For example, Sweden's default pension fund has adopted an SRI policy based on core UN conventions. The recent California Public Employees' Retirement System's (CalPERS) decision to withdraw all investments from Indonesia, Malaysia and Thailand has generated much controversy about the inclusion of non-traditional factors of assessment in investment decisions.<sup>25</sup> But CalPERS spokesperson Brad Pacheco insisted that what appears to be a decision based on social concern was in fact driven by fiduciary duties. CalPERS has shown that issues of transparency, labour practices and political stability are relevant to institutional investment decisions. The challenge now is for more appropriate tools, such as the Global Reporting Initiative, to be developed so institutional investors can assess these measures more effectively at the corporate level.

### 3.2. Defining and Practising Sustainable Investment

At the simplest level, sustainability "meets the needs of the present, without sacrificing the ability of future generations to meet theirs."<sup>26</sup> This description captures the essence of the concept and all its varied interpretations today. However, this simplicity cannot mask the urgency of the task at hand. Author Paul Hawken points to the gross inadequacies of action towards sustainability well when he comments,

*Recycling aluminum cans in the company cafeteria and ceremonial tree plantings are about as effective as bailing out the Titanic with teaspoons. While recycling and tree planting are good and necessary ideas, they are woefully inadequate.*<sup>27</sup>

The economic model that shaped many industrialised nations in the west and that now holds court in many Asian economies is the "grow now, clean up later" approach. What is missing is recognition of the fact that some of these high costs of 'economic growth' can only be rectified with the greatest difficulty and at very substantial cost. Air and water pollution damages in China alone, especially the damage of fine airborne particulates to human health, have been estimated to be at least US \$54 billion annually, or nearly 8 percent of GDP in 1995.<sup>28</sup> The real cost to society of extensive coal burning - after health damages are calculated - is 100 percent higher in Beijing than its current price.

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<sup>25</sup> 'Asia backlash on SRI', Ethical Investor, April 2002

<sup>26</sup> Brundtland Commission report "Our Common Future" 1987, as quoted in the United Nations Sustainable Development agenda

<sup>27</sup> Paul Hawken, *The Ecology of Commerce*, p.5

<sup>28</sup> 'Clear Water, Blue Skies: China's Environment in the New Century', World Bank China 2020 series. <http://www.worldbank.org/nipr/china/clarwt-sum.htm>

Why should ‘modernisation’ lead to an impoverishment in the quality of life that Asia’s people enjoy? Hong Kong’s harbour was once pristine, the air in Bangkok, Mumbai and other Asian cities has not always been the current polluted cocktail. Ecological design and clean production must be mantras for the region, especially now when new industrial investment is so dominant. The region has a one time opportunity to invest in industrial infrastructure which fosters eco-efficiency.<sup>29</sup> Furthermore, taking this approach to investment will mean that Asia could leap frog many of the problems faced by more developed economies, thereby putting the region at a strong competitive advantage over time.

### 3.2.1. SRI and Sustainability

The Head of one of the UK’s leading SRI fund managers describes SRI as investment in companies that are perceived to be sustainable in their business

“The corporate view that sustainability means sustained access to cheap and docile labor, cheap resources, and a regulatory-free environment, must give way to a conception of corporate responsibility that welcomes competition, accountability, internalisation of external social and environmental costs, and transparency to the public gaze”.... “the public is, ironically, both the cause and solution to the problem of sustainable development in Asia, this report advocates its key role in the process”.

#### **Sustainable Development in Asia, ADB, 2001**

By supporting the provision of SRI options for pension funds and other savings plans, the ADB can directly affect the degree to which individuals participate with their own savings in creating sustainable Asia.

practices.<sup>30</sup> Her approach and that of numerous other fund managers and trustees worldwide constitute a global SRI movement, in which investors and financial intermediaries are moving from strictly financial considerations to integrating financial and social/environmental/ethical considerations in company analysis. This ‘triple bottom line’ approach addresses the present inadequacies of corporate behaviour and aims to redirect capital towards “sustainable and responsible enterprises of the future”.

Appendix 3 summarises the policies of some of the lead SRI groups globally. It also illustrates the different approaches to SRI, including exclusion of unacceptable activities, portfolio weightings towards favoured ‘industries of the future’ and engagement with companies on key issues. Please also refer to the *World of SRI* box in section 2.

Japan has been at the forefront of sustainable investment initiatives in Asia. Nikko Asset

Management and Daichi Life were the first to launch eco funds in Japan in the spring-summer of 1999. Since then, around eleven eco funds have been established in Japan, with more than US\$900 million worth of assets under management.<sup>31</sup> From the eco-funds of Japan to the ethical funds of Australia, the emerging focus of SRI in Asia is in sectors identified as ‘industries of the future’ as well as companies in other sectors which are ‘best in class’ from a sustainability perspective.

<sup>29</sup> United States—Asia Environmental Partnership, <http://www.usaep.org/policy/framing1.htm>

<sup>30</sup> ‘Will Socially Responsible investment (SRI) take hold in Asia?’ FinanceAsia, April 30, 2002.

<sup>31</sup> For details, please visit the ASrIA web listing of SRI funds in Asia – [www.asria.org](http://www.asria.org)

**Industries of the Future** fit best with the objectives of sustainable economic development. The companies tend to be involved in the efficient use and re-use of resources (e.g. water and waste), in core features of human betterment (e.g. health and education) and in shifting modern economies into less materially intensive modes of operation (atoms to bytes). These sectors include companies active in:

- water management
- waste recycling, pollution control
- eco-efficiency
- ‘clean’ and renewable energy
- communications and multimedia
- healthcare and nutrition
- education and training
- mass transit systems
- multimedia and telecommunications

The signs of change are visible across Asia. Advanced communications and information technologies, and mass transit are growing sectors in Asia today. In the Far Eastern Economic Review’s (FEER) annual company survey 2001, Hong Kong’s Mass Transit Railway (MTR) secured the number one position for Overall Leadership (growth and management) in the Hong Kong poll. Infosys Technologies, Samsung Electronics, and Taiwan Semiconductor Manufacturing were ranked number one in India, South Korea, and Taiwan respectively. In the 2001 Asian business innovation awards presented by FEER (to honour companies and individuals in Asia who come up with new ideas, methods or technologies or apply existing knowledge in a way that improves quality of life and enhances productivity), the prize-winning innovations included an all-fuel catalytic converter that pre-treats fuel for clean combustion to reduce the heavy air pollution in Indian cities, manufacturing and distributing lightweight, artificial limbs for free in Thailand, using coconuts as a viable renewable energy source for entire villages in the Philippines, energy-efficient metal recycling machinery in Japan, and other ideas that highlight Asia’s move towards industries and solutions ‘of the future’.

### Industries of the Future in China

“Public investments in research and development targeted on more efficient industrial boilers and renewable energy are critical for bringing new technologies to the market. Public investments in mass transit systems can pre-empt the emergence of an auto-based urban transportation system that will lead to congestion and heavy pollution. Finally, public investments in wastewater systems, financed through greater cost recovery and improved pricing, are critical for conserving water resources and for cleaning China’s rivers, lakes and coastal waters”.

China 2020, World Bank

<sup>32</sup> [http://www.feer.com/review\\_news/01HongKong.html](http://www.feer.com/review_news/01HongKong.html)

<sup>33</sup> [http://www.feer.com/aia/aia\\_2001.html](http://www.feer.com/aia/aia_2001.html)

**Best in Class** analysis, the other feature common to many SRI funds, involves selecting companies with the least exposure to perceived risks and the best policies and practices on sustainability issues which will vary from sector to sector. This analysis is fundamental to most of the SRI indices which now exist, especially the Dow Jones Sustainability and FTSE4Good Global series.

**3.2.2. Financial Returns from SRI**

In the early days of SRI, many pension trustees and fund advisers were concerned that SRI strategies would be in conflict with their fiduciary duty to maximise financial returns. Like most investment strategies, SRI is not a silver bullet formula. Indeed many SRI funds have suffered, along with other fund categories, in the market fluctuations of the last two years, especially where they were overweight in information technologies. However, this short-term record is not a reason for writing off SRI strategies overall.

**Table 3: Comparative Performance**

<b>Comparative Performance (as at June 30, 2002)</b>	<b>Three years</b>	<b>Five years</b>
FTSE4GoodGlobal Index to FTSE All World	- 2.4%	+ 8.0%
Domini 400 Social Index (US) to S&P500	- 6.4%	+ 0.9%
Dow Jones Sustainability Index to Dow Jones Global	+1.9%	+ 5.1%
Median SRI fund (Australia) to S&P ASX 300 Acc.*	+ 0.9%	+ 1.4%

*\*Source: Corporate Monitor & Ethical Investor Magazine  
The FTSE and DJ Indices include backtested data*

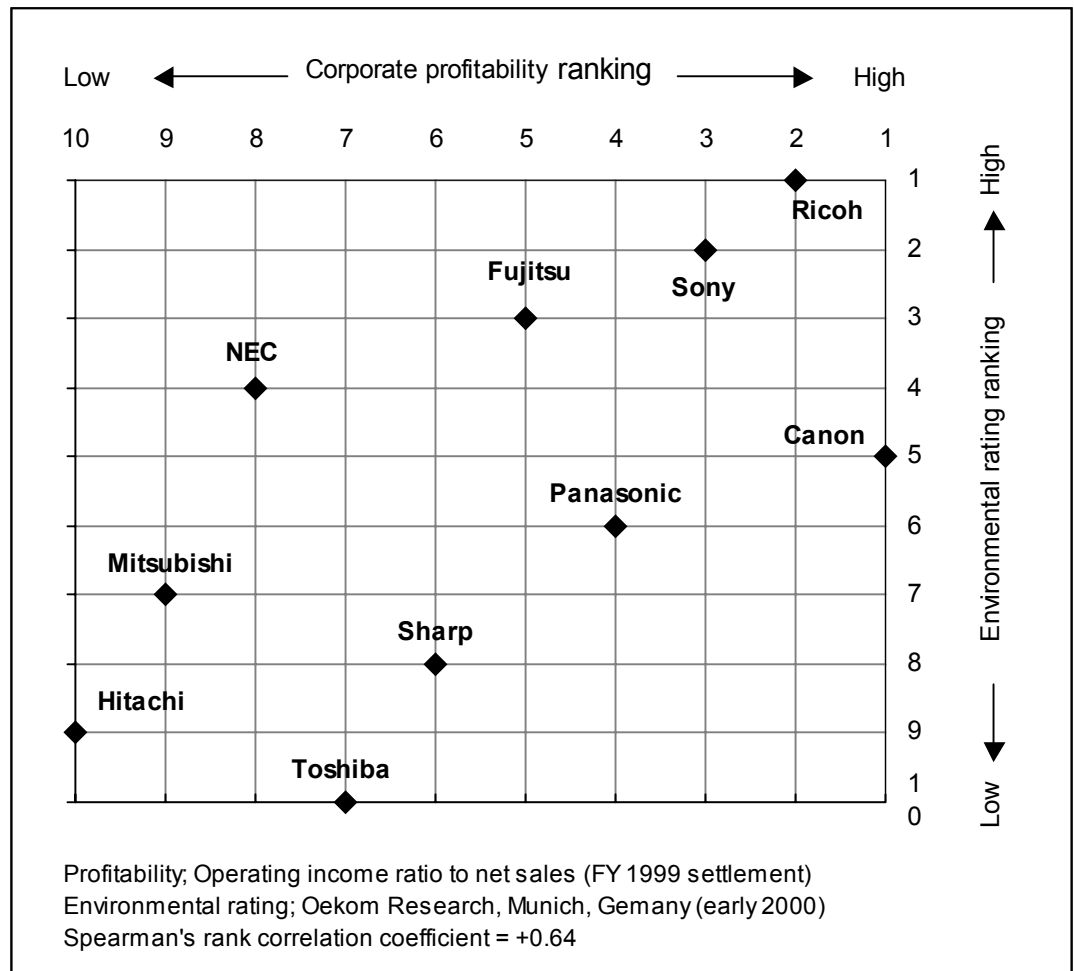
Overall, performance of SRI funds will depend on the underlying investment strategy. Where a fund has strict and comprehensive company avoidance criteria, the performance is likely to be more volatile relative to market indices, at times generating significant outperformance and at others falling to bottom quartiles.<sup>34</sup> On the other hand, SRI funds which take a less restrictive approach and evaluate environmental and social factors as part of overall company analysis are likely to generate more consistent outperformance and have lower benchmark risk. In essence they can be seen as spotting and taking advantage of market anomalies where environmental and social risks are insufficiently factored into share price.

<sup>34</sup> Green with Envy, Commerzbank 18.3.02

The positive correlation between corporate environmental performance and corporate profitability of Japanese corporations is shown in Figure 3.<sup>35</sup>

**Figure 3: Positive correlation between environmental performance and corporate profitability of Japanese corporations**

Source: The Japan Research Institute Ltd.<sup>36</sup>



For long-term investors such as pension funds, SRI offers a compelling case for generating less risky and more predictable returns. This fact is being noticed by regulators.

<sup>35</sup> 'SRI in Japan', presentation by Eiichiro Adachi (the Japan Research Institute Ltd) at ASrIA workshop, May 9, 2002.

<sup>36</sup> ibid

### 3.2.3. Alternatives to Stock Market investment for Sustainability

While the main focus of this report is on investment in listed equities, it is important to recognise the other opportunities for SRI. These include private equity, alternative investments (such as community finance), property and bonds.

Private equity financing with social and environmental objectives is being driven, with increasing confidence, by multilateral finance groups such as the International Finance Corporation and specialist divisions of the World Bank.<sup>37</sup> Their lead follows years of haranguing by public interest groups

concerned with the destructive nature of the original investment policies. Other private equity groups (including several ASrIA members) are also coming to the fore. The 'new energy' package of investment opportunities has been a particular focus for several funds and is likely to continue to grow rapidly.<sup>38</sup>

One of the best known micro-finance initiatives has Asian origins. The Grameen Bank was established in Bangladesh in the early seventies to lend money, at reasonable rates, to the poorest of the poor who traditionally have no access to capital. The success of Grameen and others has spawned a global industry. A few of the mainstream SRI groups have dedicated investment to this area, notably the Calvert Group US, which has recently established a Foundation to provide a channel for other financial institutions who want to support these efforts. All Calvert mutual funds dedicate a small percentage of their assets to this 'high social impact investing'.

#### Walking the Talk: It's a Tight-Rope

The Asian Development Bank (ADB) has been a pivotal agency in determining the course of Asia's economic change. Along with other multilateral lending institutions, it has been severely criticised for the environmental and social impacts of the projects it has financed. In recent years it has begun to take heed of the sustainability imperative which it sees as a balancing act between economic, social, and environmental benefits. It seeks to finance projects that will not enhance one type of benefit at the cost of others.

Even still the ADB was severely criticised earlier this year for the unsustainability of an investment project - the Samut Prakarn Wastewater Treatment Project - in Thailand. The issue highlights the challenges of shifting to sustainable enterprise not just in project selection but also in the way mega projects are carried out. Nevertheless the internal processes have begun and it is hoped that the Bank's project finance record rapidly improves in the coming years.

There has been less development of SRI products in other asset classes such as bonds (a few funds exist), property and even hedge funds. The scope in Asia for sustainable buildings with low energy use is substantial, essential and deserves proper consideration by large institutional investors.

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<sup>37</sup> The Carbon Prototype Fund for example.

<sup>38</sup> <http://www.energy-base.org>

### 3.3. Relevance of SRI to Pensions Provisions in Asia: Investing for Sustainability

#### 3.3.1. Pension Funds and Corporate Governance

With the events of the last year, beginning with Enron’s collapse and since then Tyco, Worldcom and the restating of accounts for many other US corporations, the belief in free and fair capital markets is under siege. Corporations and their market makers are not trusted. It is increasingly clear that high corporate governance standards are crucial for protecting and enhancing shareholder value. Institutional investors, who have a direct interest in maintaining the integrity of global capital markets, and ensuring that investment outcomes have a reasonable degree of predictability, are understandably concerned with the risks inherent in current business practices. As a result, concerned pension fund groups such as SGOP (a group of Dutch Pension Funds), LAPF (a group of UK Pension Funds), PPI (Pacific Pensions Institute) and CII (a group of US Pension Funds) have come to the fore. The Council of Institutional Investors (CII), for example, was founded in the USA in 1985 for large pension funds to address investment issues affecting the size or security of plan assets. While they do not claim any title to being ‘socially-oriented,’ their member resolutions reveal a high degree of social responsibility and corporate accountability.

*“I come here as an individual who believes passionately in the strength of our free market system... In my lifetime, American business has never been under such scrutiny. To be blunt, much of it is deserved”.*

Henry M. Paulson, Jr.  
Chairman and CEO  
Goldman Sachs Group  
June 5, 2002

**Table 4: Size of pension funds worldwide**

	Asset value		
<b>Global Pension Funds</b>	US\$15 trillion <sup>39</sup>		
<b>300 largest pension funds in the world, 1999</b>	US\$5.2 trillion <sup>40</sup>		
	<b>UK</b>	<b>USA</b>	<b>Australia</b>
<b>Country pension assets as % of national GDP</b>	62%	45%	18%

These figures only acknowledge the obvious: control over such vast resources makes pension funds a force for corporations to reckon with and a major influence in the way the global economy develops. Leading corporate governance activist Bob Monks argues that the increasing economic clout of pension funds and their global reach affords them the opportunity to effect widespread societal change. “By exercising their fiduciary duties to increase the wealth of their beneficiaries, they (pension funds) can literally change the world, since so much of the world is theirs”, he says. Pension funds wield

<sup>39</sup> World Pensions Association, Statement with the publication of 2002 Annual Directory. Total Pension assets are US\$8.5 tn in North America, US\$2.8 tn Europe (1.4 UK, 0.4 Netherlands, 0.4 Switzerland); 1.9 tn Pacific area and 0.2 tn Latin America. ASrIA reviewers’ comment: With market falls over the last year, this estimate is likely to have dropped substantially and there may be some double-counting. A global figure of US\$10 to 12 trillion is more likely.

<sup>40</sup> P&I Top 300, 1999 [http://www.ragm.com/library/global\\_pension.html](http://www.ragm.com/library/global_pension.html)

substantial power and influence not only in their distributions but also through the impacts of their investment policies.

Furthermore pension funds are among the most time-consistent institutions in existence and can therefore play a decisive role on issues such as climate change where the inherent time inconsistency of most governments (they have to be elected every four years) precludes much political progress.

### 3.3.2. Shareholder Activity

Many claim that corporate accountability rules have become so lax and corporations so greedy because shareholders have abrogated their ownership responsibilities. It is easier to be unaccountable to ‘absentee owners’ who simply trade stock, who never vote their shares and take little or no interest in long-term corporate strategy. So the spotlight is shifting to include investor governance too. The Myners Report 2001 from the UK provides a comprehensive critique of financial institutions and the marketplace and provides guidance to Trustees on measures to reduce the systemic risks that pension funds may be exposed to. These risks may be financial, environmental or social.

Just as corporate governance, which may also embrace environmental and social concerns, lays expectations on the corporate world to behave responsibly and be accountable to society; so investor governance prompts similar expectations of the investing community. After all, the decisions of institutional investors have real impacts on the world in which we live and the choices we have as citizens. Progressive pension funds, including many members of CII, LAPF, and others, are already joining together to give record support for shareholder initiatives. The Investor Responsibility Research Centre (IRRC) has established a system of tracking votes on shareholder proposals to the 2000 leading US public companies. It reports that in the first “post-Enron” annual meeting season in 2002, shareholders have been sending out loud and clear messages to corporations on responsible practice, gaining high support - at or exceeding 15 percent of shares voted. Historically, relatively few social resolutions have met or cleared this threshold; just 13 to 14 of the 150-plus proposals that came to votes in each of the last two years did. Yet at the time of writing this year, with preliminary or final vote results available for about 100 proposals so far, 17 already have cleared this threshold, at much higher levels than high-scoring proposals in past years. The resolutions attracting most support were focused on human rights, equal employment and global warming.

Exercising voting rights is emerging in Japan too, making people more aware of their position as shareholders. Such behaviour is not naturally embedded in Japanese institutional culture. However, the voting activities in Japan of some international institutions such as CalPERS have triggered interest. The Pension Fund Association has released “Working Guidelines for the exercise of voting rights” which calls for fund managers to exercise their rights and report

*“Because, in many markets, pension investors are substantial shareholders, simply walking away from an under performing company is seldom an option. Improvement by engagement is increasingly the order of the day”.*

Alan Pickering  
Chairman  
National Association of  
Pension Funds, UK

on their activity as part of their fiduciary duty, and the Pension Fund Association for Local Government Officials, which has Yen 13 trillion under management, has added exercising of voting rights to its pension management policy statement.

### **Pension Fund Shareowner Initiative to Abbott Laboratories, Raised at the Annual Meeting on April 26, 2002**

In response to the HIV/AIDS epidemic and the state of the emergency particularly in sub-Saharan Africa (75% of the world's 36.1 million people with HIV/AIDS), pension fund shareholders submitted a resolution recognising "effective prevention, care and treatment strategies will require increased availability of, and nondiscriminatory access to, vaccines, sterile injecting equipment, drugs, including anti-retroviral therapy, diagnostics and related technologies, as well as increased research and development." The shareholders requested the Board of Directors of Abbott Laboratories to "develop and implement a policy to provide pharmaceuticals for the prevention and treatment of HIV/AIDS, TB and Malaria in ways that the majority of infected persons in African nations can afford." It was resolved that "a report of the development and implementation of such a policy (omitting proprietary information and at reasonable cost) would be sent to shareholders six months after the 2002 annual meeting."

Source: IRRC

### **3.3.3. Precedents in Pensions Law**

The UK set a new precedent for investor governance, with its recent amendment to the 1995 Pensions Act. UK Pension Funds have assets of some £800bn.<sup>41</sup> Not surprisingly, their adoption of SRI policies, starting in 2000, is beginning to influence the UK financial market. The first sign has been the recruitment of SRI specialists by many more investment firms.

#### **Text of the Amendment to the UK Pensions Act, Effective July 2000**

The matters prescribed for the purposes of section 35(3) (f) of the 1995 Pensions Act (other matters on which trustees must state their policy in their statement of investment principles) are –

- a) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realization of investments; and
- b) their policy (if any) in relation to the exercise of rights (including voting rights) attaching to investments.

<sup>41</sup> *ibid*, p.3

In the wake of this legislation, The UK Social Investment Forum (SIF) conducted a survey of pension funds to find out if they were adopting SRI policies.<sup>42</sup> The survey covered 171 pension funds in the UK, together holding £302 billion in assets and covering 6.4 million members.<sup>43</sup> The main conclusions of the survey were:

- 59% of funds were incorporating SRI principles into their investment process, either via the fund manager, or through engagement, or both. These funds represent 78% of the assets surveyed
- 48% of funds had requested that their fund manager takes account of the financial implications of environmental, social and ethical concerns when investing, and this represents 69% of the assets surveyed
- Larger pension funds were more likely to take SRI considerations into account than smaller funds
- Only 14% of funds clearly stated that they would not take environmental, social and ethical concerns into account; and because these funds tended to be the smaller funds, they only represented 4% of the assets surveyed

The survey clearly demonstrated that the UK's major pension funds are concerned about the implications of social, ethical and environmental issues. A significant proportion want their fund managers to understand these issues and take them into account.<sup>44</sup> More recently in July 2002, however, JustPensions UK conducted a survey of 14 large UK Pension funds that manage about 20% by value (£170Bn) of the assets held by pension funds in the UK. In its conclusions, the report notes that while SRI assessment by pension funds is encouraged by the recent legislative amendment, at the individual fund level there is disappointing poor practice. The report urges trustees to actively monitor their fund managers in assessing social, environmental and ethical performance, to keep SRI implementation in line with the newly stated policies.

Other countries have already followed the UK example. Australia has a mandatory superannuation system, with assets of US\$263 billion that are expected to grow to US\$600 billion by 2015.<sup>45</sup> Several studies on Australian Superannuation funds in the late 90's revealed that companies like the major banks, mining companies and companies like News Corporation dominated the list of fund shareholdings. Most of these companies received environmental ratings of 'poor' or 'very poor', and none of the 27 companies that appeared in the four funds surveyed had 'good' or 'very good' environmental ratings. The

*"Our view, which we believe has widespread support throughout the pensions community, is that provided certain safeguards are observed, trustees are free to use a screening method to ensure that they do not make investments which they believe are not in their members' long term interests. But old style ethical investment is not the focus of Government Policy in respect of institutional investors. Our focus is on engagement, corporate governance, sustainability and the environment."*

Former UK Pensions Minister Jeff Rooker 1999

<sup>42</sup> UK-SIF, Briefing on "Response of UK Pension Funds to the SRI Disclosure Regulation" Report, October 2000

<sup>43</sup> ibid

<sup>44</sup> ibid, p.2

<sup>45</sup> Green, D. 2001, A Capital Idea: Realising Value from Environmental and Social Performance, p.20, as cited in Kerr and Zubevich, 2002, p.7

investment techniques of the surveyed funds are not unique, many fund managers closely follow indices such as the S&P/ASX 200. So the findings reveal a worrying pattern of social and environmental corporate performance fostered, even if unintentionally, by the market.<sup>46</sup>

Consequently, the Australian government passed legislation that gave pension investors and superannuation fund managers special powers and responsibilities regarding corporate social and environmental performance.

It is known that other EU countries and Japan are now considering this option.

Asian investors have for long been stereotyped as being interested in returns alone. However the social and environmental consequences of an unimpeded path of 'modernisation' are only too clear today, and there is interest in what SRI could hold as a more comprehensive investment strategy for Asia. Given the size of the assets they control and the impact they have on society, institutional investors could have a significant impact in spearheading the development of socially responsible and sustainable investment in Asia. Pension funds can help broaden the understanding of other players in Asia's financial markets to involve retail investors and investment firms in the incorporation of SRI principles. As Marshall and Chung note in their article on SRI in Hong Kong<sup>47</sup>, "in the Mandatory Provident Fund (MPF), Hong Kong appears to have the perfect vehicle to promote SRI. The MPF, by its very nature as a retirement and savings scheme, is a long-term investment vehicle, which should surely be attracted to sustainable enterprises and to sustainable and responsible investment."<sup>48</sup> The authors comment that this fact has not been lost on NGOs. Mei Ng, Director of environmental protection group Friends of the Earth Hong Kong, tried to find an MPF fund that incorporates SRI principles for her staff. To her dismay, only one out of 20 pension fund providers she wrote to could identify an SRI fund.

### **Australia's Financial Services Reform Act 2001**

On 11 March 2002, The Financial Services Reform Act 2001 came into force. Pursuant to this Act, the providers of investment products, such as superannuation products, are required to disclose in a Product Disclosure Statement the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment. This disclosure requirement will apply immediately to all new investment products. Older investment products will have two years to come into line with the new legislative requirements.

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<sup>46</sup> Kerr and Zubevich, March 2002, p.14

<sup>47</sup> Marshall and Chung. 'SRI: Knocking on Asia's Door?' Company Secretary, August 2001, Vol 11 No.8

<sup>48</sup> *ibid*, p.7

### 3.3.4. Precedents in Pensions Policy

A group of pension funds are setting new standards in investor governance. They include CalPERS, the US Teachers Fund TIIA-CREFF, the UK Postal Workers Fund Hermes and others. Hermes has explicit environmental and social policies relating to its investment strategy and this November is holding a two day seminar in London to share best practice on the implementation of such policies. All these funds have informative websites providing information on the policies and decisions made.

Earlier this year another precedent was set when Sweden's default pension scheme adopted UN Conventions as the basis for its own SRI strategy. Clearly environmental and social factors are being integrated into the overall governance of these funds. This trend can only increase.

#### **Swedish State Pension Scheme Takes SRI Lead**

Sweden is among Europe's most dynamic pension markets. The state funds have a single overall objective expressed in the government bill as follows: "There shall be no economic policy or other economic political objectives. Investment activities shall take environmental and ethical considerations into account without lowering the overall objective of a high return".

#### **Companies that Break UN Conventions are Top of the Avoidance List**

The main part of the state pensions system has been radically reformed. There are now four main AP funds (totaling over SEK550 billion) with global balanced mandates. At least 10% of assets must be outsourced to external managers. The smaller part of the new state pension system, the PPM system, is a defined contribution plan. Members have a choice of over 400 funds from more than 100 investment managers, both domestic and foreign. The default fund, AP7, manages the investments of members who do not make a choice. Its equity exposure is a high 90%, mostly in foreign equities.

Recent mandates awarded by the AP7 default fund required the managers to screen out 27 companies that have violated UN human rights, child labour, International Labour Organisation and environmental conventions, as well as the convention against bribery and corruption. The companies included Coca Cola, Sears and General Motors.

Source: AP website and Financial Times 3.6.02

### 3.3.5. Conclusions and Recommendations to the Pensions Industry

The commonality of interest between SRI and Retirement Planning, described in this report, provides the basis for realistic solutions which should be considered further. While increasing private pension schemes will help to relieve the fiscal burden of governments; accumulated individual savings invested through pension funds will boost local capital markets. Moreover, having SRI pension options ensures investment with a long-term interest in corporate performance and Asia's enduring prosperity.

The following recommendations are made:

- For Asian governments, especially those with the more developed pensions systems to make Statements of Investment Principle (SIPs) which embrace the SRI dimension, a legal requirement of occupational and private pension schemes
- For pension officers, trustees and their advisers to familiarize themselves further with SRI and to consider the long-term responsibilities of their investment strategy in relation to national and global environmental constraints
- For pension trustees to request information on SRI policies appropriate for pension funds and to select options appropriate for the fund
- For DC plan sponsors to offer an SRI option, and to consider making this the default option when no selection is made
- To consider surveying the views of plan beneficiaries with regard to their long-term investment objectives and views of SRI
- To provide information for beneficiaries on the Fund's corporate governance and SRI policies and practices
- To collaborate with other like-minded pension funds to build understanding and best practice

*"Let us choose to unite the power of markets with the authority of universal ideals. Let us choose to reconcile the creative forces of private entrepreneurship with the needs of the disadvantaged and the requirements of future generations. Let us ensure that prosperity reaches the poor. Let us choose an enlightened way forward towards our ultimate, shared goal: a global marketplace that is open to all and benefits all" <sup>49</sup>*

— UN Secretary General Kofi Annan

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<sup>49</sup> Secretary-General Kofi Annan's address, "Markets for a Better World" to the World Economic Forum, January 31, 1998.

## APPENDICES

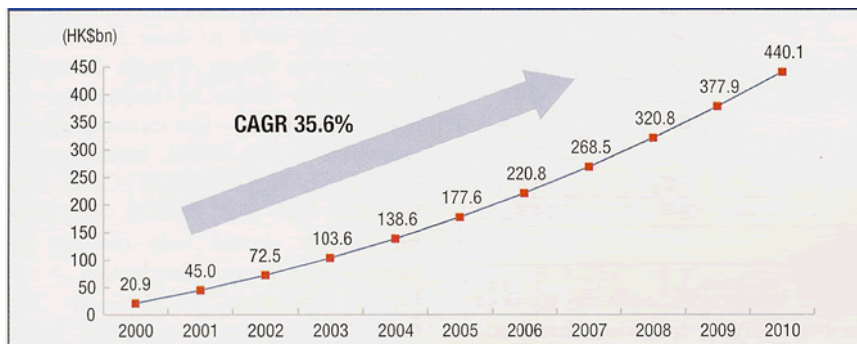
### Appendix 1: Individual Country Pension Schemes

#### HONG KONG

Hong Kong enacted the Mandatory Provident Fund (MPF) Schemes Ordinance in 1995 that calls for “the establishment of an employment-based, privately managed, defined-contribution retirement savings scheme”.<sup>50</sup> Unlike other comprehensive savings schemes that perform all three primary social security functions of saving, redistribution and insurance, the MPF system is simply a mandatory saving scheme. The operation of the scheme commenced in December 2000. The estimated annual MPF contributions are expected to amount to HK\$10 billion in the first few years of operation and in about 30 years, mature and expand to as much as HK\$60 billion.

**Figure A.1: Estimated MPF assets growth through 2010**

Source: PensionsAsia supplement, July 2001



In the MPF system, a typical employee is required to contribute 10% of his/her earnings to a pensions investment fund, 5% of which is paid by the employer and 5% by the employee him/herself. While this is intended to increase the savings rate of the economy, the actual effects on national savings are contingent upon how much workers’ borrowing simultaneously increases (mounting credit card bills, for example, will offset increased apparent savings). The MPF system is designed so as to have the government play the role of regulator, while investment decisions are left to the private sector. This setup is advantageous in developing Hong Kong’s capital market, with minimal adverse effects on the labour market.

However there are still areas for reform and change within this system. Forcing young workers to save for retirement, when they are faced with liquidity constraints and other pressing needs, may be counterproductive. It might be wise to make their retirement contributions optional until a certain age. Being a minimalist long-term savings programme for retirement, the MPF does not guarantee returns on investments, has no annuity option and allows for a lump-sum withdrawal. It does not address issues of redistribution and insurance, making workers therefore bear the burden of all the risks in the investment process. Prudence would call for employees to purchase life and disability insurance, along with saving more than the mandatory rate. For all practical purposes however, employees are left to bear the risks of their insurance needs and pension investment decisions in the private sector. In addition, Hong Kong’s CSSA (Comprehensive Social Security Assistance) system provides a safety net for the needy, but could also offer disincentives for low and medium income workers to contribute to MPF schemes. While the old-age CSSA programme is necessary for the support of the current aged population, it may unravel due to the lack of public support if increasingly opportunistic behaviour is observed in the system. The government could consider advance funding of its CSSA old-age obligations to work with this potential problem.

<sup>50</sup> Siu, Alan. ‘MPF: An Unfinished Business.’ August 2001. [www.tdctrade.com/econforum/hkcer/010702.htm](http://www.tdctrade.com/econforum/hkcer/010702.htm)

**Table A.1: Breakdown of MPF investment categories**

(HK\$ mn)	Feb – 01	
Aggregate NAV of All Schemes	11,560	
Capital Preservation Fund	1,689	14.6%
Money Market Fund	273	2.4%
Guaranteed Fund	2,479	21.4%
Bond Fund	80	0.7%
Balanced Fund	5,349	46.3%
Equity Fund	1,690	14.6%

Source: PensionsAsia supplement, July 2001

Of the twenty odd MPF providers in Hong Kong today, Kingsway Fund Management is the only one with an SRI option. The Hong Kong government has vowed to incorporate sustainable development into their policy making process. They could take the lead by offering their 182,000-strong civil service an SRI pensions option.

**Table A.2: The top 5 providers have an estimated 80% market share**

	No. of registered Employers	Market share (%)	No. of registered Working population	Market share (%)	Sales channels
<b>HSBC/HSB</b>	70,000	35	700,000	37	364 branches, 3000 intermediaries
<b>Manulife</b>	30,000	15	240,000	13	2000 intermediaries
<b>BOCI/Prudential</b>	28,000	14	240,000	13	359 branches, 3000 intermediates (2000 from banks and 1000 from Prudential)
<b>AIA/JF</b>	20,000	10	200,000	10	3000 intermediaries
<b>BCT</b>	15,000	8	150,000	8	250 branches, 3000 intermediaries
		82		80	

Source: PensionsAsia supplement, July 2001

## JAPAN

Japan is currently the most rapidly aging country in the world. This aging reflects a very low total fertility rate of approximately 1.3, and high life expectancy of 77 years for men and 84 years for women. Projections indicate that the proportion of the population aged 65 and older will increase from about 15 percent in 1995 to 27 percent by 2025 and the absolute size of the Japanese population will begin to decline in the next five years.<sup>51</sup>

Japan has a complex and unusual social security system, involving different plans for different segments of the population. It is one of the few countries to provide a universal pension to the aged, not based on having worked. Public and private pensions in Japan are estimated to hold around US\$3 trillion, making that system the second largest globally after the United States.<sup>52</sup> Apart from the UK, Japan is the only other country to have a traditional social insurance system with the option to opt out, allowing workers to reduce their mandatory contributions to Social Security in exchange for contributing to a private sector plan.

<sup>51</sup> Ministry of Health, Labor, and Welfare, 1999; Miyatake, 2000, as quoted in Clark & Mitchell, 'Strengthening Employment-Based Pensions in Japan'. Pension Research Council Working Paper, The Wharton School, 2002.

<sup>52</sup> Clark & Mitchell, 'Strengthening Employment-Based Pensions in Japan'. Pension Research Council Working Paper, The Wharton School, 2002.

Japan's Social Security system was reformed in 1986 to introduce a two-pillar set up. The first pillar- the National Pension Plan (NPP) – pays a “flat-rate universal basic pension benefit to every resident.” The NPP is a mandatory pension scheme for all Japanese residents between 20 and 59 years of age, including university students. It is financed by contributions from the covered population and by a government subsidy. Every member of the covered population, including the unemployed, must pay a flat-rate monthly contribution (13,300¥ in 1999). Citizens with very low or no income are exempt from contributing, but are only entitled to one-third of full benefits. The government's contribution subsidises one-third the cost of the benefits as well as covering all the administrative costs.

The second pillar – five Employees' Pension Plans (EPPs) – pays an earnings-related benefit to private sector employees. The largest of these five plans – the Employees' Pension Insurance (EPI) – covers private sector workers. The EPI benefit formula is now 0.75 times the average indexed (or revalued) earnings, not including bonuses, times the number of covered years.<sup>53</sup> These plans can be contracted out but this has to be a collective decision made by the firm and not by individual employees. The choice to contract out is available to firms with at least 500 full-time employees and to smaller employers who join an employers association where the association decides to contract out. The decision usually requires a favourable vote by half or more of the firm's full-time employees and must be a defined benefit scheme. In terms of payment and coverage, Social Security pension plan benefits accounted for 64 percent of the total income of elderly households in 1998.<sup>54</sup>

Both pillars of Japan's pensions system – the EPPs and NPP - are defined benefit plans. Due to the poor investment environment, returns have been sluggish in recent years making it difficult for corporations to cover the deficiency. Under these plans, 8.5 persons supported one pensioner in 1970 as opposed to 4.3 persons per pensioner in 1995. In 2025, only 2 persons will be able to support a pensioner.<sup>55</sup> From Y2000, companies have been obliged to report their pension liabilities by market value and disclose the funded status of their pension schemes in financial statements. Corporate pension funding was estimated to have reached ¥80 Trillion and it seems inevitable that increases in contributions, a decrease in pensions benefits or a further extension of payment age will be required.

A Japanese version of the US 401 (K) defined contribution plan started in January 2001 for corporate schemes and from March 2001 for private ones. This presents a major opportunity to give Japanese savers an SRI option for their pension plans.

It is worth noting that prior to the launch of the first eco-funds in the late spring/summer of 1999, people said SRI would not be popular because retail investors ‘only care about maximising returns’. Quite the contrary. When Nikko launched their Eco Fund, plenty of Japanese investors recognised this opportunity to maximise returns in line with their values. The fund was expected to attract US\$50 million in the first six months, but swiftly attracted US\$1 billion. Nikko representatives comment that the clients were different from the typical unit trust buyers. First, many were first time fund buyers. Second, there were many more women and many more people in the 30-40 age range. This is typical of the profile of SRI retail investors in other parts of the world, but is not typical of the profile of a Japanese investor who is generally male, above 40 years old and regularly invests in the stock market. The Nikko Eco Fund had tapped a whole new pool of funds. In response to the greater choice in personal pension planning, Nikko Cordial Securities have announced they will include an SRI product in the menu of mutual funds available to DC investors.

In theory, any onshore or offshore SRI mutual fund is available to Japanese institutional pension fund investor. They can purchase this fund by asking their pension trustee to place an order for this product. As yet there is little aggressive marketing of SRI products into the DB pension market.

## SINGAPORE

Singapore, along with Malaysia, is the only south east Asian country to have a long-standing provident fund with

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<sup>53</sup> *ibid*, p.3

<sup>54</sup> Watanabe 2002, as quoted in Turner, 2002.

<sup>55</sup> International Pension Funds and their Advisers 2000

a meaningful pool of savings. The Central Provident Fund (CPF) that was set up in 1955 dominates pensions and other social security provisions. The CPF is a compulsory DC system (for all except foreign workers—around 20% of the workforce—and part-time workers) based on individual accounts. There are two other small schemes for the armed forces and government employees.<sup>56</sup>

Contributions to the CPF are divided into the Ordinary account—for housing and investments (75%), the Medisave account—for health insurance premiums and unreimbursed medical expenses, and the Special account—specifically for retirement (only 4% of total). Over half of the withdrawals in recent years has been for housing, and pre-retirement withdrawals make up about 84% of the total.<sup>57</sup> Contribution rates towards the CPF were lowered during the financial crisis as part of the government’s cost-cutting measures, but are now back up to 40% with a maximum contribution of S\$2,400 per month. In 1999 the retirement age was raised from 60 to 65 years, along with reducing the contribution rate for older employees, thereby decreasing the cost of employing them and making them more attractive to employers.<sup>58</sup> The joint employer-employee contribution rate for workers aged 55-60 is 16.5%, for those aged 60-65 is 9.5%, and for those aged 65+ is 7%.

Most of the funds in the CPF are invested in government bonds that pay a low rate. CPF members receive a market-related interest rate on their CPF savings, subject to a minimum rate of 2.5% per annum as stipulated in the CPF Act. Funds in the Special and Retirement Accounts also earn an additional 1.5%.<sup>59</sup> However, in Singapore, for the period 1987-1997, the real return on the CPF was approximately zero.<sup>60</sup> This low rate, according to Turner, “constitutes an implicit tax on the pension funds of workers, with the government benefiting by obtaining financing at below market rates.” Although CPF investment scheme contributors can access equity products, total equity exposure through CPF savings is estimated to be less than 2%. Around US\$275 mn of CPF money are estimated to be investments in predominantly equity-based mutual funds.

The total assets of the CPF had reached S\$90 bn (US\$50 bn) or 30% of GDP by the end of 2000. In that year alone, withdrawals from the system marginally exceeded contributions at S\$14.55 bn versus S\$14.09 bn, respectively. The fund’s growth was primarily because of interest accumulation at the rate of S\$2.38 bn. Coverage remains high compared to other Asian countries. Contributors as a percentage of the workforce peaked in 1984 at around 72%, but have declined to around 65% today.<sup>61</sup> The contributors-to-member ratio has also fallen from 51.5% in 1983 to 44% today.

Singapore’s main challenge will be in instituting policies and regulatory frameworks to ensure the NPF pensions savings are invested in a way that yields good investment returns. Necessary reforms include improved corporate governance by investee companies and improved financial disclosure.<sup>62</sup>

## **TAIWAN**

The Taiwanese government seems serious about passing useful reform that will create a tax incentive driven DC scheme covering all employees. For fund managers and insurance companies, this could make Taiwan the region’s most appealing market over the next decade. And if all the present talk translates into effective action, the reform could translate to an annual US\$10bn of new investments into mutual funds and annuity products.<sup>63</sup>

Presently, there are four government pension funds, all providing DB schemes—the US\$7.3bn Labour Standards Law Pension Fund (LPF), the US\$14.9bn Labour Insurance Fund (LIF), the US\$75.4bn Post Service Savings Fund (PSSF), and the US\$5.5bn Public Service Pension Fund (PSPF). The present setup excludes many workers including the 5 million bankers, exporters, office workers, entrepreneurs, engineers and high-tech employees,

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<sup>56</sup> CSFB, p.23

<sup>57</sup> Ramesh 2000, as quoted in Turner 2002.

<sup>58</sup> Turner, p.9

<sup>59</sup> CPF Annual Report 2000

<sup>60</sup> Asher 1999b, as quoted in Turner, p.7

<sup>61</sup> Turner, p.5

<sup>62</sup> *ibid*, p.7

<sup>63</sup> ‘Taiwan gets to Work,’ PensionsAsia, p.14

most of whom work at small companies while still making up the bulwark of Taiwan's economy. Any private company with less than 10 employees does not have to provide retirement benefits. For other private sector workers (at larger and public companies), there is a mandatory contribution of between 2 and 15% of their salary towards a pension scheme, the exact amount of which is fixed by the company. The LPF outsources all of its management to the Central Trust of China, under the MoF. The Trust has reported 6-8% returns p.a. until last year, but this is said to be dwindling now. Even though companies can designate a private fund manager, hardly any do.

Though everyone is covered in theory, the average worker needs to turn 55 after 15 consecutive years of service or work there for 25 years and retire before the age of 55. Older employees though are often sacked, and it is not uncommon for owners to dissolve the company before it gets old and found a new one, hiring everyone back but turning their pension clocks back to zero. Given that these practices are common knowledge, the Taiwanese justifiably have some of the highest savings rates in Asia. According to the Council of Labour Affairs, only 6% of employees ever meet the conditions to get Central Trust benefits. The few companies that do end up having to match and pay retirement benefits (usually the largest or public ones) find themselves with such a huge bill that their operating budgets may be hit. The company's viability is at risk in such times, and if the company goes bankrupt, then again workers end up without pensions.

In 2000, in an attempt to support the stock market, the Taiwanese government legalised discretionary asset management not just for the four big pension funds, but for any public and private institution. The PSPF has since outsourced NT\$30bn to local fund managers, while the other three funds are expected to follow suit. PSPF is also laying the groundwork to invest offshore, but it will have to work with the existing capital outflow restrictions. Following the outsourcing reform, a more systematic and comprehensive revamping of the pensions system is now needed. A move from DB to DC is seen as the logical next step, maintaining that DC will additionally keep assets committed to Taiwan. From initially favouring a Singapore style provident fund system, the Taiwanese government is now looking to Japan's example for pensions system reform.

The LPF will be the only pension provider to adopt DC and the new scheme will have some important new features including raising employer contribution rates from 2% to 6% over three years, allowing employees who match these contributions up to 6% to be tax exempt until benefits are paid, for the investment funds management to be outsourced to third parties other than the Central Trust, for a new 'monitoring commission' to be set up, and for the scheme to be portable. The proposal has been approved and the legislation passed in 2002. In the foreseeable future, 50% of DC assets are expected to be allocated to stocks, while further on, workers are expected to be able to choose their own asset allocations based on individual risk appetites. With 5 million eligible employees earning an average salary of US\$1500, a 12% joint contribution from employers and employees will ensure an annual flow of US\$10bn to DC schemes. The imminent pension prospects look encouraging for Taiwan's economy, its workers, companies, and for investment managers.

From an SRI perspective, the introduction of DC schemes will give Taiwanese choice in their savings plans and many are likely to be attracted to SRI. Many Taiwanese work in the caring professions, they are active in environmental or community groups or other NGOs, or they are involved in faith-based organisations. These are the characteristics of SRI investors in markets the world over. There are as many as 4.9 million Buddhists in Taiwan, and at least 15 very active environmental groups. The country has an environmental misery index, which ranks the views of Taiwanese people on their concerns about the environment.<sup>64</sup> There is a high level of awareness amongst Taiwanese people about the environmental problems that the country faces and strong indications they want to do something about it.

## **MALAYSIA**

The Employee's Provident Fund (EPF) in Malaysia — a compulsory scheme for the private sector — established in 1951, dominates the pension industry and accounts for 65% of the total assets. According to BNM, Malaysia's total pension assets at the end of 2000, were RM286 bn (US\$ 75 bn). This estimate is substantially higher than

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<sup>64</sup> Sizing the Market for SRI in Taiwan, ASrIA publication, November 2001

other studies that place the value at US\$52bn. This translates to 57-80% of GDP. EPF assets are stated at a book value of US\$49bn.<sup>65</sup>

In terms of contribution, employees contribute 11% while employers contribute 12% of pay. The EPF then annually declares the interest rate credited to workers' accounts, normally exceeding the minimum rate of 2.5%.<sup>66</sup> The EPF provides several different types of benefits, dividing each worker's account into three parts. The primary account (Account 1) holds 60% of the member's total balance and can only be withdrawn upon retirement at age 55, or later, or upon death, disability, or permanent emigration.<sup>67</sup> However, since the benefits are paid out in a lump sum on retirement, retired people are not protected against the risk of outliving their incomes. This problem is common to other national provident funds in the region as well.

Currently 34% of the EPF's money is required to be invested in Malaysian government securities, reduced from the previous requirement of 70% in 1995. The EPF's investments include development projects, including a substantial loan to help finance the new airport in Kuala Lumpur. EPF coverage extended to include 4.31 mn contributors in 1997, who made up 52% of the total work force. The coverage rate today is estimated to be around 60% of the total work force. Default rates peaked in 1993 at 20% of employers (45,344 out of 223,142) but the rates are now down to about 5% of the 318,000 employers currently registered.

Contribution rates have been on the rise, more than doubling from 10% in 1974 to around 23% today. Net contributions to the EPF are along the lines of 2% of GDP (roughly 5% in, 3% out). Recent studies have shown that the current levels of savings will afford a replacement rate between 20 and 25%. However, with a GNP per capita of about US\$4140, 20% of the final salary pension is unlikely to be sufficient retirement income. In terms of allocation, at the end of 2000, the EPF had about 21.2% or US\$10bn of its assets in equities, a significantly larger proportion than the initial value of 2% at the start of the 1990s.

## SOUTH KOREA

Korea implemented a social security (defined benefit) system in 1988 called the National Pension Scheme (NPS). The NPS is both compulsory and universal. It is publicly managed and dominates the industry, controlling about 90% of total assets. Both employers and employees contribute 4.5% of pay each to the scheme (total of 9% contribution rate). After 20 years of contributions, the NPS will pay full pension benefits and so the first full benefits will not be paid until 2008. There are exceptions in which the contribution is lower. At present reduced benefits are available to those contributors aged 45-59 at the time of the commencement of the scheme. The target replacement rate is 60% after 40 years of service. South Korea extended coverage to all self-employed workers in 1995 by obliging farmers, fishers, and the rural self-employed to contribute 3% of earning, which is increased by 3% every 5 years until it reaches 9%.<sup>68</sup> Apart from the NPS, there are also some private-employer sponsored pension plans, a limited government safety net, and pension funds for the military, teachers, and civil servants.<sup>69</sup>

As the NPS is relatively immature (a high ratio of contributors to pensioners), there is a current surplus (incoming contribution exceeds outgoing payment) of more than 1.5% of GDP each year. The annual surplus, set aside as reserve, amounts to almost 10% of GDP currently and will keep growing, at least for the next decade or so.<sup>70</sup> The equilibrium contribution rate - that which will make the PV (present value) of future contributions equal the PV of future liabilities - is estimated at 20%<sup>71</sup>, almost twice the actual contribution rate (9%). Yet, contributions will far outweigh benefits on a cash flow basis until 2040. Reserve accumulation will therefore skyrocket in the next two decades, accounting for 40% of GDP by 2020.

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<sup>65</sup> CSFB, p.22

<sup>66</sup> Bateman and Piggott, 1998, as quoted in Turner, 2002.

<sup>67</sup> Turner, p.11

<sup>68</sup> *ibid*

<sup>69</sup> CSFB, p.26

<sup>70</sup> 'Pensions in Asia' World Bank report

<sup>71</sup> CSFB, p.26

Only a small portion of the pension fund reserve is being invested in market-based securities. Nearly two-thirds of the reserve is directed by the Ministry of Finance and Economy towards public sector projects that earned below market rates of return. In an effort to attract long-term investors to the country's languid stock market in October 2000, the government lifted its previous restrictions on pension funds buying stock.<sup>72</sup> Only three out of Korea's 75 pension funds - the National Pension, the Korea Teachers Pension, and the Government Employees Pension - invest directly in the stock market, and that too with a 10% ceiling on any individual stock. These three invest only 5.3% of their resources in stocks, which is a miniscule amount when compared with the US and the UK who invest 50-80 % of their pension assets in stocks. The size of pensions money invested in stocks in 2000 was estimated to be around W7 trillion out of a total fund pool of about W170 trillion. The aggregate assets of Korea's 75 pension funds have expanded by nearly W100 tn a year (US\$ 77 bn), and stand at a whopping W500 tn today.

In view of the burden of reserve accumulation, Korea is concerned about its mounting pension assets and about finding the right financial instruments to invest in. President Kim Dae-jung himself, in an address in February stated, "We need to expand major pensions' investment in stocks to W25 tn, or 20% of their assets, so they can become a prop for the Seoul stock market, just like pensions in developed countries."<sup>74</sup> Analysts support this position and claim that if pensions and other public funds invest in stocks, they will get relatively high returns and help the Seoul stock market's stability. What remains is for the legal regulations to follow suit and for the opposition Grand National Party to support the bill on the expansion of stock investment by pensions and other public funds, in parliament. Once the independence and transparency of the operation of pensions is guaranteed, the opposition says it will withdraw its opposition to the legal reform. Substantial equity investments in the near future are therefore most likely.

**Table A.3: Comparison between pensions' stock investment in select non-Asian and Asian countries (US\$ billion)**

	U.S	Britain	Hong Kong	S.Korea
Aggregate assets of pensions	7,200	990	26	61
Percentage of stock investment in pension's portfolio	65%	80%	51%	5.3%
Percentage of stock investment represented by pensions	40%	35.8%	2.9%	0.4%
Aggregate value of listed stocks	9,000	1,660	180	236

Source: 'Pension funds are eyeing stock market' JoongAng Ilbo, April 30, 2002

## THAILAND

Thailand runs a social security system similar to that of Korea, with the primary implementing agency being the Social Security Office. Since its inception in 1991, the scope of coverage has increased both in terms of people and benefits provided. The Social Security Old Age Pension first received contributions in 1999. Employers and employees each contribute 3% of pay while the government contributes an additional 1%, bringing the total contribution rate to 7%. With a set replacement rate of about 15% after 15 years of service, an additional 1% is provided for every year worked from the age of 55 onwards. Though benefit eligibility is based on 15 years of contributions, actual benefits are only based on the final five years of earnings, which gives workers incentives to overstate earnings those years and understate them in all other years.<sup>75</sup>

Private pension fund provision has also increased in the past few years. Since 1998, all Bol (Central Bank)-approved companies, all government companies, and all companies listed on the stock exchange had to set up private pension funds, the size of which is estimated to be around US\$5bn today. However, workers'

<sup>72</sup> 'Korea raises money from pensions for market stabilization fund' FinanceAsia, October 17, 2000.

<sup>73</sup> 'Pension funds are eyeing stock market' JoongAng Ilbo, April 30, 2002.

<sup>74</sup> *ibid*

<sup>75</sup> Turner, p.14

participation in the fund is optional, which differs from other countries in Asia where participation is mandatory and the fund is managed by the government.<sup>76</sup> Additionally, reform has also hit the Government Pension Fund (GPF) that is the largest funded system in Thailand managing about US\$3.5bn for civil servants and military personnel. The GPF was set up as a DC scheme to replace the previously existing pay-as-you-go system.

## PHILIPPINES

Like Thailand and Korea, the Philippines operates a Social Security System (SSS), defined as an old-age benefit scheme. Established in 1957, the system runs on an employer-employee contribution of 5.07% and 3.33% of pay respectively. Replacement rates are high, of over 70% for retirement starting at age 60 for workers who have contributed 120 months of service.<sup>77</sup> The benefit system is formula-driven and provides a minimum pension benefit for workers after ten years of service, and a higher minimum for those with at least 20 years of service. Workers who do not work long enough to qualify for either of the above receive a refund of their contributions plus interest.

Even though the pensions system is relatively immature, benefits payouts have caught up with contributions. The publicly managed reserves, standing at 7% of GDP (US\$5bn), are the only source of income and are completely inadequate. Even though the official payroll tax contribution is at 8.4%, workers can easily manipulate the system. In order to maximise gains from his/her participation, a worker could contribute the minimum required for 10 years - totaling 10,800 pesos - and collect 2,400 pesos a month for life, thereby receiving twice his/her contributions back as benefits in the first year of collecting benefits.<sup>78</sup> Such abuse and pervasive contribution evasion results in a very low effective coverage rate, and is obviously causing serious problems. While in theory coverage should be universal, the SSS in 1997 had 6.3 million members out of a workforce of 30.3 million - only 21%. Even excluding those who are not eligible to join, the coverage ratio would only have risen to 28%.

There is also a Mandatory Retirement Pay (MRP) programme that obliges employers to pay retiring workers one-half of a month's pay for every year of service. This translates to a lump sum of 20 months salary, after for instance, 40 years of service.

Larger private companies have their own private funds (Tax Qualified Occupational Pension Plans - TQOPP), estimated to have total assets worth US\$2bn. A separate system - the Government Service Insurance System (GSIS) - provides pensions for government employees. The reserves of GSIS amount to about 6% of GDP (US\$4bn). Employees contribute 9% of salary up to a threshold and then 2% above that, while the government contributes 12% of salary, including 4% for life insurance. GSIS is a slightly more mature system than SSS. Yet coverage ratios are still low. Even in this scheme, there are only 1.6 million members out of a public sector workforce of 2.2 million, or 73% benefiting. All GSIS and SSS members have to undertake a compulsory contractual savings scheme - the Pag-IBIG, or home development mutual fund - that goes to finance home loans.

In terms of cash flow, the income from reserves and contributions just about cover the SSS payments. There are about nine contributors per beneficiary; yet benefit payouts are about equal to contributions. Total payouts are expected to exceed total income by 2020, while reserves are expected to be depleted by 2026. At this point, the contribution rate will have to rise to 13% from the present 8.4%, while by 2060 the rate will have to rise to 28%.

## INDONESIA

Indonesia, Asia's third largest country, after China and India, has three separate provident funds - for the military (ASABRI), civil service (TASPEN), and the private sector (JAMSOSTEK). As can be expected, the retirement benefits provided by the funds for the military and the civil service are significantly more generous than those given out to private sector retirees.<sup>79</sup>

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<sup>76</sup> Ramesh, 2000 as quoted in Turner, 2002.

<sup>77</sup> *ibid*, p.14

<sup>78</sup> Turner, p.14

<sup>79</sup> Turner, p.8

JAMSOSTEK, the largest private sector pension fund, replaced ASTEK - the prior system - in 1992. The fund has 18.8 million members, 9.3 million of which are active. Participation is compulsory for private sector employees of firms that employ more than 10 people. The fund provides insurance for accidents as well as lump sum benefits on retirement at the age of 55. These benefits are based on contributions of 5.7% of earnings, the employer paying 3.7% (plus 0.3% for death benefits) and the employee paying 2%.<sup>80</sup> The fund size is about US\$1.2bn (~US\$130 per active member). Equity investments are about 3-5% of total investments.

JAMSOSTEK, however, covers a mere 10% of the labour force, primarily because of the large informal sector in Indonesia, but also owing to high contribution evasion. Contribution rates are very low with comparably low benefits, partly caused by the low returns ultimately received by workers. The administrative costs of the pension fund mechanism are very high and the transparency of investment funds, minimal. While some staff enjoy very expensive office buildings, it is widely believed that the government uses part of the investment funds for political purposes.<sup>81</sup> Besides, the government does not credit all returns received on the funds to workers, while also taxing the minimal credited returns.

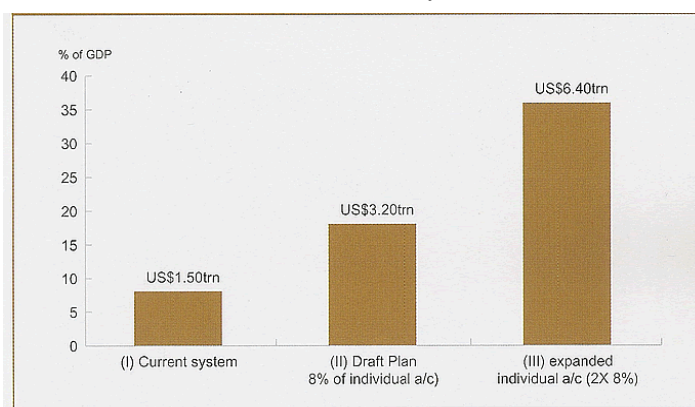
The civil servants' pension fund (TASPEN), established in 1963, is chronically under-funded with a substantial negative cash flow.<sup>82</sup> With about 4 million members, this is a defined benefit scheme, with employees contributing 4.75% of salary in return for a 75% replacement rate of their final salary varying with length of service. It is estimated that by 2020, 66% of the government's wage bill will be spent servicing these pension fund obligations. The military pension fund, ASABRI, has only around 0.5 million members.

## CHINA

China established a pay-as-you-go DB pension system in 1995 that is now "on the verge of bankruptcy, largely because of the rapidly aging population."<sup>83</sup> The current system mandates that about 20 percent of the enterprise wage bill and 8 percent of personal wage should go towards Basic Old-age insurance.<sup>84</sup> The present pension liability is about US\$600 billion to US\$800 billion, with assets at only US\$15 billion.<sup>85</sup> Reform is therefore critical to both the fulfillment of the state's obligation to its non-working aged population, and also as a critical stimulus for the development of China's emerging primary and secondary capital markets. Pension funds in China currently hold a minimal 1% of personal financial assets, compared with 6% in Hong Kong, 28% in Singapore, and 37% in the U.S.A.<sup>86</sup>

**Figure A.2: China's accumulated pension asset**

Source: PensionsAsia, July 2001



<sup>80</sup> Ramesh 2000, as quoted in Turner 2002.

<sup>81</sup> Turner, p.9

<sup>82</sup> CSFB, p.24

<sup>83</sup> 'Pensions pose problems' SCMP, April 22, 2002.

<sup>84</sup> 'China Issues White Paper on Labor, Social Security', People's Daily, April 30, 2002.

<sup>85</sup> Yulanda Chung, p.8

<sup>86</sup> Emmanuel Pitsilis, David von Emloh and Yi Wang, Mckinsey & Company, April 2002

The study<sup>87</sup> notes that China faces several possibilities to address this looming crisis. One way would be to turn presently state-owned enterprises into publicly traded ones, to bridge the pensions funding deficit. Almost two thirds of China's top 500 companies are as yet unlisted. Current estimates predicts that equity issues will reach US\$200 billion by 2005, US\$80 billion of which is expected to come from large-capitalisation companies. An alternative way would be through the sale of presently non-tradable state-owned shares through secondary-market offerings. These were worth US\$387 billion at the end of 2000, 67% of the market capitalisation of all listed companies in China. This however remains a controversial possibility in China. The government could also fund the deficit through further debt issues but this solution is not sustainable. Modernising the domestic government debt market and making it more efficient could help the process.

Yet the problem of public pension assets is a management challenge, in addition to merely a financial one. Therefore, a more fundamental institutional change is called for if the pensions provision system is to sustain itself in the long term, without periodic infusions of already frugal government systems-support.

Moving from a DB model to the increasingly popular defined contribution system, China is considering the Singapore system as a possible model pensions system. Such a setup involves contributions from both employer and employee to a designated fund, and the benefits depend on the contributions and on the fund's performance. A gradual transfer of the management of pension funds from the government to domestic and foreign financial institutions will ensure long-term returns. Such an increase in the total equity holdings in China will allow Chinese investors to pay greater attention to their asset mix and their risk-return profile, and they will be in a position to demand and choose from a wider range of financial products and services. The introduction of open-end mutual funds since September 2001 in China will be the first step towards the establishment of competitive, demand driven, low cost mutual fund operations in China's developing capital market. With the terms of China's WTO accession, foreign fund managers will gradually be able to participate in the Chinese market through joint ventures.

Institutional asset managers are expected to grow with more retail equity investment flowing into mutual and pension funds. Presently retail investors dominate China's equity markets. Institutional investors undertook only 20% of all trading in 2000, compared with 49% in Hong Kong and 58% in the U.S.A. The study predicts that by 2005 institutional investors will account for 30% all trading, and the total accumulated public pension assets in professional funds should be worth US\$23 billion – 37 billion, compared with almost nothing today. Such a leap in the capital market's activity will give Chinese investors much more experience and skill that might enable them to scrutinise and monitor the market better over time.

These reforms therefore, of a shift to defined-contribution plans and the bridging of the pensions funding gap, will make China's domestic equity market the most important one in Asia outside Japan. At the same time, the size and structure of China's population will also make it the fastest-growing pension fund market in the world in the next 20 years. The World Bank estimates China's pension fund reserves to rise to US\$1.6 tn by 2030.<sup>88</sup> While pension funds are restricted at present to investing their funds in bank deposits and government paper, imminent changes hold vast potential for investors in China and both domestic and foreign fund managers.

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<sup>87</sup> Emmanuel Pitsilis, David von Emlah and Yi Wang, McKinsey & Company, April 2002 article

<sup>88</sup> CSFB, p.26

## Appendix 2: Environmental and Social Challenges for the Region

### A. The Environmental Crisis

*Economic development and poverty reduction efforts are increasingly constrained by environmental concerns, including degradation of fisheries and forests, scarcity of freshwater, and poor human health as a result of air and water pollution.<sup>89</sup>*

Intensified crop and livestock production combined with misdirected incentives have contributed to increased production of chemical and organic wastes (and accompanying health risks), natural resource and biodiversity loss, and soil erosion. By 1985, countries in the region had already lost 70-90 percent of their original wildlife habitat to agriculture, infrastructure development, deforestation, and land degradation (MacKinnon and MacKinnon 1986). The most severe losses have been in Bangladesh, India, Indonesia, Philippines, Sri Lanka, and Vietnam. The Philippines and Vietnam have lost about 70 and 50 percent of their mangrove forests, respectively, and 75 percent of the Asia and Pacific region's marine protected areas are considered to be under high potential threat from coastal development (WRI 1998). Tropical forests are of particular concern because of high rates of species richness and endemism. Wilson (1998) estimates that roughly 40 percent of land that can support closed tropical forests is now devoid of forest cover, primarily as a result of human actions. Forest cover is declining at a rate of approximately 1 percent per year.

**Pressure on the land** in Asia is the most severe in the world. Particularly affected are the region's rural poor who are dependent on agriculture and its ancillary activities. Many countries in the region already face an acute shortage of productive land resources that can support its growing population. In 1990, approximately 850 million hectare (ha) had some degree of land degradation, representing more than 28 percent of the region's land area. According to the United Nations Environment Programme (UNEP), there are 350 million ha of degraded land in India, Pakistan, and People's Republic of China (PRC), most of which are grasslands (UNEP 1999). About 1,320 million people, or 39 percent of the region's population, live in areas prone to drought and desertification (UNEP 1997).

**Lack of an adequate supply of clean water**, the most severe environmental problem in many parts of the region, impacts human health and slows the development of economies. The explosive growth in populations and economies has had the greatest impact on the region's freshwater resources. Freshwater withdrawals increased more in Asia during the past century than in any other part of the world, and these withdrawals have resulted in water supply and water quality problems. Water utilisation rates will increase further in many other parts of the region in the next quarter century as populations and economies grow. Subsidies exacerbate the problem by encouraging the expansion of inefficient supply systems and by discouraging demand-side behavior that would improve water delivery services.

In addition, water quality has been steadily fouled by sewage, industrial effluent, urban and agricultural runoff, and saline intrusion (see Box below). Levels of suspended solids in the region's rivers almost quadrupled since the late 1970s (ADB 1997), and rivers typically contain four times the world average and 20 times the Organisation for Economic Cooperation and Development (OECD)-recommended levels of suspended solids (UNEP 1996). Biochemical Oxygen Demand, a key indicator of overall water quality, is 1.4 times the level recommended by OECD. The fecal coliform level, an indicator of the health risk from human waste, is three times the world average and 50 times higher than the level recommended by the World Health Organization (WHO). As a result, one in three Asians has no access to a safe drinking water source that operates at least part of the day within 200 meters of the home. Access to safe drinking water is worst in South and Southeast Asia, where almost one in two Asians has no access to sanitation services and only 10 percent of sewage is treated at a primary level (ADB 1997).

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<sup>89</sup> Asian Environmental Outlook 2001, Asian Development Bank <http://www.adb.org/Documents/Books/AEO/2001/default.asp>

**Joint Statement by the Ministerial Delegations of Ten Asian Nations**

May 22-23, 2002, United Nations Conference Centre, Bangkok

Involving the nations of Thailand, Myanmar, Cambodia, Indonesia, Lao PDR, Malaysia, Nepal, Philippines, Sri Lanka and Viet Nam

***Water priorities in Asia that we wish to bring to the attention of future global forums on water resources***

In anticipation of the forthcoming World Summit for Sustainable Development, the Third World Water Forum, and other international forums on water, we request international attention about and action on the following matters that are of special importance to Asia:

- The need for more investment in development of infrastructure for irrigation, drainage, hydro-power, water supply, sanitation, water treatment and flood mitigation;
- The need to reduce water pollution;
- The need to protect catchment areas and other fragile ecosystems;
- Sustainable development and management of wetlands;
- The need to mobilise funding for water resources development and management from local communities, governments and other sources;
- The need to find and apply measures to mitigate harm caused by water-related problems, such as flooding, drought, pollution, and diseases;
- Institutional development and capacity building for integrated water resources management (including administration of water rights, decentralisation and irrigation sector reform) and
- Means to maximise productivity and social and economic benefits from water resources.

**Air pollution levels** in the region's large cities are among the highest in the world and climbing, causing serious human health impacts. Of the 15 cities in the world with the highest levels of particulate matter, 12 are located in the Asia and Pacific region. Of the 15 cities in the world with the highest levels of sulfur dioxide, 6 are located in Asia. In most of the region's large cities, pollution levels exceed WHO guidelines by wide margins. The region's emissions of sulfur and nitrogen oxides in 2030 are projected to be three to four times their 1990 levels (UNEP 1999). Unlike the effects of water pollution, which are borne mainly by the poor, no resident of any major city in the region is safe from the effects of air pollution. However the poor are disproportionately exposed to air pollution, living along roads and the industrial areas, thus suffering the highest concentration of air pollutants.

The Asia and Pacific region is by far the world's largest consumer of wood fuels, accounting for nearly 44 percent of global consumption (FAO 2000). Wood fuels pose a number of air quality and human health problems. According to WHO, indoor air pollution from biomass smoke is one of the largest environmental risk factors for ill health of any kind. Four to five million deaths among children are attributed to acute respiratory infection each year. Studies in India, Nepal, and Papua New Guinea show that nonsmoking women who have cooked on biomass stoves for many years exhibit a higher prevalence of chronic lung diseases than nonsmoking women who do not cook on biomass stoves. These studies also revealed a 50 percent increase in stillbirths in women exposed to indoor smoke during pregnancy in Western India (World Bank 2000).

**Climate change** is also affecting the livelihoods of many Asians. In January 2001, the UN Intergovernmental Panel on Climate Change (IPCC) stated that human evolution - economic development and population growth - is contributing to a change in climate that is both significant and presents dangerous changes in our natural environment. Since 1750 (pre-industrial revolution) there has been a 31% increase in the atmospheric concentration of carbon dioxide, the 1990s was the warmest decade of the millennium, and since 1940 there has been a 40% decrease in the thickness of arctic ice. In addition the IPCC increased its prediction for the global average surface temperature to rise between 1990-2100 from a previous maximum of 3.5°C to 5.8°C. These climate changes represent extreme weather events and global damage on an unprecedented scale - for example the flooding of small islands and coastal urban areas, and the destruction of flora and fauna unable to migrate to new habitats. The magnitude and rates of change or numerous global climate phenomena - such as the El Nino effect which directly impacts South-East Asia - are unprecedented.

Table A.4: Per capita CO<sub>2</sub> emissions

	Per Capita (Metric Tonnes Carbon Only)		Share of World Gross Total
	1980	1998	1998% Share
Hong Kong	0.88	1.47	0.15%
Japan	2.15	2.45	4.79%
Singapore	3.4	6.46	0.35%
Taiwan	1.27	2.63	0.88%
Malaysia	0.55	1.54	0.51%
South Korea	0.9	2.15	1.54%
Thailand	0.23	0.87	0.81%
Philippines	0.21	0.28	0.32%
Indonesia	0.17	0.31	0.99%
China	0.41	0.68	13.13%
Group Average	1.02	1.88	23.47%
OECD	3.5	3.2	50%

Source: CDIAC [http://cdiac.esd.ornl.gov/trends/emis/em\\_cont.htm](http://cdiac.esd.ornl.gov/trends/emis/em_cont.htm)  
 Indicative Global Per Capita Allowance (up to 2030) 1 metric tonne per person per annum \*  
 Please see more precise details at: <http://www.gci.org.uk>  
 The Global Commons Institute (GCI) Contraction and Convergence calculations for preventing global atmospheric CO<sub>2</sub> Concentrations from rising at rates dangerous to global climate.

In the US alone, over 7 billion pounds of toxic chemicals continue to be released by industry into the environment each year including over 100 million pounds of recognised carcinogens. The equivalent figure for Asia is unknown.

Industrial growth and urban expansion have greatly contributed to and increased the **generation and accumulation of solid and hazardous wastes** in many DMCs, outrunning the collection efficiency and disposal capacity of many municipalities. Kolkata, which generates about 2,500 metric tons of waste per day, has developed effective collection and disposal systems that capture 95 percent of the waste stream. Most cities collect 70-80 percent of solid wastes, leaving an average of about 1,000 tons per day uncollected in cities such as Manila and Jakarta. Cities such as Dhaka and Karachi collect less than 50 percent. The balance ends up in drains and rivers, exacerbating flooding, or in vacant lots or roadsides, where it impacts public health by providing habitat for rodents, flies, and other disease vectors.

## B. The Social Crisis

People in the Asia and Pacific region have paid a heavy toll for the degradation of the region's natural environment, a cost measured in human health and economic terms. Natural resource degradation and pollution have far-reaching impacts on the health and welfare of the poor (Qadri 2000). Urban air pollution exacts a heavy toll on human health and the quality of urban life. For example, fatalities in Bangladesh, India, Indonesia and Nepal account for about 40 percent of the global mortality in young children caused by pneumonia (WHO 1993). Air pollution in South Asian cities causes nearly 100,000 premature deaths per year and over 1 billion work days of lost or reduced productivity. The PRC's two largest cities, Beijing and Shanghai, regularly exceed emissions for multiple pollutants by double the safe amount recommended by WHO. Pollution-related health problems in the region are one of the world's most serious public health problems.

Poverty and income inequality. The region remains home to nearly 278 million people living on less than \$1 a day. If East Asia maintains an average growth rate of 5% annually until 2008, which is equally shared, the number of people living below the poverty line (including China) will fall from 278 million to 72 million. Slower growth of only 4%, and less equal income distribution, will leave more than twice as many - 182 million - in poverty in 2008.<sup>90</sup> As UNFPA Executive Director Thoraya Ahmed Obaid stated in his World Population Day

<sup>90</sup> Jemal-ud-din Kassum, VP E Asia & Pacific Region, World Bank "World Bank Challenges and Opportunities in East Asia in the New Millennium" Credit Suisse conference, Hong Kong, March 23, 2000

2002 address, “men and women stuck in extreme poverty lack real choices, opportunities and basic services to improve their situations.”<sup>91</sup>

**Table A.5: Population below income poverty line**

Country	% Population below income poverty line (1993 PPP US\$) 1983-2000	
	\$1/day	\$2/day
Japan	N/A	N/A
Hong Kong SAR	N/A	N/A
Singapore	N/A	N/A
South Korea	<2	<2
Malaysia	N/A	N/A
Thailand	<2	28.2
Philippines	N/A	N/A
China	18.8	52.6
Indonesia	7.7	55.3

Source: UNDP Human Development Report 2002  
N/A: data not available

**Malnourishment and access to health facilities.** Around 10.6 million children die every year from preventable or treatable diseases, such as measles, diarrhea, and pneumonia (State of the World’s Children 2001, UNICEF). The AIDS crisis in South-east Asia is on its way to match the severity of the epidemic in Africa. Even in the year 2000, between 360 and 400 new patients were diagnosed with HIV every month in Malaysia. Even today the high costs of drugs used to treat patients’ symptoms result in a majority of cases worldwide going untreated.

**Table A.6: An overview of Asia’s health: access, services, resources**

Country	Population using adequate sanitation facilities (%) 1999	Population using improved water resources (%) 1999	Population with access to essential drugs (%) 1999	Per Capita Health Expenditure (PPP US\$) 1998	Physicians (per 100,000 people) 1990-99
Hong Kong	N/A	N/A	N/A	N/A	N/A
Japan	N/A	N/A	100	2243	193
Singapore	100	100	100	678	163
Taiwan	N/A	N/A	N/A	N/A	N/A
Malaysia	98	95	70	81	66
South Korea	63	92	99	470*	136
Thailand	96	80	95	112	24
Philippines	83	87	66	37*	123
Indonesia	66	76	80	8	16
China	38	75	85	40*	162

Source: UNDP Human Development Report 2001<sup>93</sup>  
\* refers to 1999 figures  
N/A: data not available

<sup>91</sup> <http://www.unfpa.org/about/ed/2002/worldpopday.htm>

<sup>92</sup> [http://news.bbc.co.uk/1/hi/english/world/asia-pacific/newsid\\_971000/971428.stm](http://news.bbc.co.uk/1/hi/english/world/asia-pacific/newsid_971000/971428.stm)

<sup>93</sup> <http://www.undp.org/hdr2001/back.pdf>

**Labour rights.** The ILO, in the form of Conventions and Recommendations, lays down certain fundamental standards of basic labour rights: freedom of association, the right to organise, collective bargaining, abolition of forced labour, equality of opportunity and treatment, and other standards regulating conditions across the entire spectrum of work related issues.<sup>94</sup> Corporate and government compliance with these standards and the laws which enforce them are starting to be taken up by pension funds such as CalPERS and the Swedish State Pension Fund.

Human rights and indigenous peoples' rights Human Rights Watch's World Report 2001 begins with a dismal note that "the scope of today's global human rights problems far exceeds the capacity of global institutions to address them."<sup>95</sup> Problems in Asia over the past year include China's continuing suppression of political opposition as well as its disputed role in Tibet; although the positive shoots of democracy in village elections should not be ignored. Tension between Indonesia and Malaysia over the conflict in Aceh, just across the Straits of Malacca; the deportation of thousands of Filipinos from Malaysia owing to the raid into eastern Malaysia by guerrillas of the Abu Sayaf wing from the southern Philippines; militia violence in West Timor; Cambodia's resistance to the establishment of a tribunal to try the Khmer Rouge; widespread child labour in India, Pakistan, Bangladesh and other Asian countries; oppression of all opposition to the military rule and ethnic insurgencies in Myanmar, and many other regional human rights problems such as exploitation of migrant labor, human trafficking, and child prostitution. In an April 2000 op-ed piece in The Times of London, the High Commissioner noted that "global corporations are under pressure to demonstrate social concerns and values beyond straight shareholder return. Human rights are at the centre of this picture. In the last few years, perceived corporate complicity in human rights abuses has damaged corporate reputation and, in some cases, share price."<sup>96</sup>

**Illiteracy.** At the 2001 ACCU-APPEAL Joint Planning Meeting on Regional NFE Programmes in Asia and the Pacific, 19 countries from the region reaffirmed their commitment to achieving Education for All (EFA) as laid down in the Dakar Framework for Action (adopted by the World Education Forum in April 2000). The convened representatives recognised that "a literate environment is fundamental to poverty alleviation, peace and sustainable development." Furthermore, they noted that "the presence of large illiterate populations and people without adequate competencies to learn effectively in an information-based society could lead to further accentuation of the digital divide and undermine all efforts to combat poverty and ignorance." While most East Asian countries have taken enormous strides towards the education of their populations, universal literacy has still not been achieved in many countries. The greatest challenge in the East Asian region is in China, both as a proportion of the population and in absolute numbers (nearly 153 million illiterate persons). Gender disparities persist in terms of access to and completion of education.

### C. Global Sustainability Benchmarks

The UN and ILO Conventions on Labour Rights help to define key social and environmental issues that fund managers and trustees should consider when making their investment choices. In July 2000, global leaders from the world of business, labour and civil society entered a joint initiative called the **Global Compact** in support of universal values (both social and environmental) and responsible business operations. The Secretary-General of the UN had first proposed the Compact at the World Economic Forum, Davos, in January 1999. As was outlined in a summary of the proceedings, the Compact "challenges business leaders to promote and apply within their corporate domains nine principles in the field of human rights, labour standards and the environment. The aim is to help strengthen the social pillars which underpin any market, including the global market. The principles derive from the Universal Declaration of Human Rights, the International Labour Organisation's Fundamental Principles on Rights at Work, and the Rio Principles on environment and development."<sup>97</sup>

<sup>94</sup> <http://www.ilo.org/public/english/about/mandate.htm>

<sup>95</sup> Introduction, Human Rights Watch, World Report 2001, <http://www.hrw.org/wr2k1/asia/index.html>

<sup>96</sup> Business and Human Rights: An Update, Office of the High Commissioner for Human Rights (OHCHR), July 2000  
<http://www.unhchr.ch/businesupdate.htm#TRADE>

<sup>97</sup> <http://www.un.org/partners/business/gcevent/press/summary.htm>

### The Nine Principles of the Global Compact of world business

#### Human Rights

**Principle 1:** support and respect the protection of international human rights within their sphere of influence; and

**Principle 2:** make sure their own corporations are not complicit in human rights abuses.

#### Labour

**Principle 3:** freedom of association and the effective recognition of the right to collective bargaining;

**Principle 4:** the elimination of all forms of forced and compulsory labour;

**Principle 5:** the effective abolition of child labour; and

**Principle 6:** the elimination of discrimination in respect of employment and occupation.

#### Environment

**Principle 7:** support a precautionary approach to environmental challenges;

**Principle 8:** undertake initiatives to promote greater environmental responsibility; and

**Principle 9:** encourage the development and diffusion of environmentally friendly technologies.

**Reporting and verification.** Company reporting has been on the rise this past decade, Many, if not most, SRI funds prioritise non-financial information reporting. In our survey of SRI funds (see Appendix 3) 6 of the 8 funds address corporate environmental reporting. Several ‘corporate accountability’ guidelines exist but all are non-binding and none claim to be comprehensive or completely able to fulfill the task at hand.<sup>98</sup> The **Global Reporting Initiative** (GRI) is the largest global initiative on corporate disclosure. These standardised reporting rules are designed to foster sustainable businesses in every sense: environmental, social and financial. However, as was pointed out in a GRI briefing in Hong Kong, “the value of this information lies in its veracity.” Systematic auditing mechanisms need to be developed to check the veracity of non-financial ‘sustainability’ information. Verification is the next big step towards corporate transparency in Asia and the world over. A significant development in the summer of 2002 was the Johannesburg Stock Exchange’s endorsement of GRI in the King Report on corporate governance. For the first time, GRI is being held as the standard for non-financial disclosure in company listing requirements. Japanese companies are at the forefront of environmental reporting with more companies providing annual accounts every year.

**Table A.7: Number of corporate environment reports in Japan 1989-2001**

Year	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<b>Corporate environmental reports in Japan</b>	1	1	3	3	4	8	17	26	38	56	91	159	208

Source: National Institute for Environmental Studies, Japan<sup>99</sup>

<sup>98</sup> ‘Governments, stakeholders and how to stimulate companies in creating and protecting sustainable societies.’ Pieter van der Gaag, OECD Roundtable for CR, June, 2001

<sup>99</sup> ibid

### Appendix 3: SRI Fund Policies

**Table A.8: SRI criteria and approach of select investment fund**

(Funds profiled are those with information easily available from their website)

Note: The websites formed the basis for these charts with subsequent information provided by the funds as footnotes.

Key:

<b>EX</b>	exclude companies exhibiting egregious behavior on this issue
<b>PW</b>	portfolio weighting towards companies with positive practices on this issue
<b>GA</b>	engage with management on the issue and proxy voting
<b>NP</b>	no policy

Fund (HQ)	Env Reporting	Climate Change	Renewable Energy	Animal Testing	Resource Efficiency	Nuclear Power	Mass Transit	Waste Management (incl. Toxics)	Pollution Management	Fresh-water Scarcity	Biodiversity / Habitat Preservation	GMO release
Calvert (USA)	1	2	3	4			5					6
Domini Social Investments (USA) <sup>7</sup>												
Friends, Ivory & Sims-FIS (UK)	8	9	10	11	12			13	14			15
Henderson Global Investors (UK)			*							*		
Kingsway Fund Management (HK)												
Morley Fund Management (UK)		16	17	EX & GA								
Glebe Asset Management (Australia)												
Jupiter Investments (UK)				EX & PW								
Nikko Asset Management (Japan)												
Total NP (out of 9)	2	2	3	4	0	2	8	2	3	5	6	5

\* indicates sector identified by fund as an 'industry of the future'

<sup>1</sup> Further discussion with Calvert revealed that they also engage with some companies on this issue.  
<sup>2</sup> Calvert notified us that they have PW, EX and GA policies with respect to climate change.  
<sup>3</sup> Calvert informed us that they engage with companies on this issue.  
<sup>4</sup> Further discussion with Calvert revealed that they also have an EX and GA policy with respect to animal testing, as also with resource efficiency, waste management, biodiversity preservation, and pollution management.  
<sup>5</sup> Calvert verified that they have a PW policy regarding mass transit.  
<sup>6</sup> Calvert notified us that they also engage on this issue.  
<sup>7</sup> Domini state: Very active in filing shareholder resolutions on a variety of issues (see the Website), reporting out its voting, etc. In addition, KLD communicates with all companies on the DSI every year through its profiling process. For example, animal rights is covered for all companies in KLD's profiles (sent annually to the company for review and comment).  
<sup>8</sup> FIS has two SRI funds that have different levels of enforcing SRI criteria in investments. The Stewardship Fund (SF) has GA and PW policies regarding environmental reporting, whereas the Balanced SRI fund (BF) has no policy on this issue.  
<sup>9</sup> FIS informed us that its SF also had a PW policy on this issue.  
<sup>10</sup> FIS verified that while its BF had no policy on this issue, its SF has a PW policy.  
<sup>11</sup> FIS' SF has an exclusionary policy on this issue.  
<sup>12</sup> FIS' SF has both PW and GA policies on this issue, while its BF has no policy.  
<sup>13</sup> While FIS' BF has no policy on this issue, its SF has a PW policy.  
<sup>14</sup> FIS' BF engages with companies on this issue, while its SF has a PW policy.  
<sup>15</sup> FIS' BF has no policy on this issue, but its SF has a PW policy.  
<sup>16</sup> Further discussion with Morley revealed that they have EX, PW and GA policies with companies on this issue.  
<sup>17</sup> Morley informed us that they also engage on this issue as well as resource efficiency, mass transit, waste management, biodiversity preservation, and pollution management.

**Table A.8 (contd.): SRI criteria and approach of select investment fund**

(Funds profiled are those with information easily available from their website)

Note: The websites formed the basis for these charts with subsequent information provided by the funds as footnotes.

Key:

- EX** exclude companies exhibiting egregious behavior on this issue
- PW** portfolio weighting towards companies with positive practices on this issue
- GA** engage with management on the issue and proxy voting
- NP** no policy

Fund (HQ)	Poverty/Reduction	Health Provision	Pension Provision	Labour Standards / Rights	Human Rights	Education	Community Participation	Indigenous People's Rights	Minority Rights	Tobacco	Alcohol	Arms & Weapons Production / Retail
Calvert (USA)		18	19	20		21						
Domini Social Investments (USA)												
Friends, Ivory & Sims-FIS (UK)		22	23			24					25	
Henderson Global Investors (UK)		*				*						
Kingsway Fund Management (HK)												
Morley Fund Management (UK)		26		27		28					29	
Glebe Asset Management (Australia)												
Jupiter Investments (UK)												
Nikko Asset Management (Japan)												
Total NP (out of 9)	7	5	8	0	0	4	2	8	3	1	3	1

\* indicates sector identified by fund as an 'industry of the future'

<sup>18</sup> Further discussion with Calvert revealed that they have EX, PW and GA policies regarding health provision.

<sup>19</sup> Calvert is developing guidelines on pensions provision under their corporate governance policy.

<sup>20</sup> Calvert informed us they also have EX and GA policies with respect to this issue, as well as human rights, community participation, indigenous people's rights, and minority rights.

<sup>21</sup> Calvert notified us that they have a PW policy with respect to education.

<sup>22</sup> FIS' SF additionally has a PW policy on this issue, as well as labour standards/ rights and human rights.

<sup>23</sup> FIS analyse the issue in the US, where data is readily available and are starting to ask the question in emerging economies.

<sup>24</sup> FIS' SF has a PW policy on this issue and on community participation.

<sup>25</sup> FIS has an exclusionary policy on this issue for both its funds.

<sup>26</sup> Morley informed us that they have a PW policy on this issue

<sup>27</sup> Morley verified that they also engage on this issue as well as on indigenous people's rights.

<sup>28</sup> Morley informed us that they have PW and GA policies on this issue.

<sup>29</sup> Further discussion with Morley revealed that they have EX and GA policies with respect to alcohol.