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Fostering progress by tearing down and building information asymmetries in SRI-projects

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Abstract

The purpose of this paper is to tackle two problems related to so called "socially responsible investment" by financial intermediaries such as pension funds or insurance companies. Both problems concern information asymmetries at the ends of the value chain of the investment process.
Our analysis is structured as a business case for private pension funds and insurance companies because their decision whether and how to adopt SRI-policy is or should be based on the scrutinising of financial and reputation opportunities and risks of the particular project at hand.
Our material focus is on an actual SRI-project, viz. Portfolio21, but insights and conclusions can easily be exported.
We argue that the management of information asymmetries is pivotal in making progress on all fronts; at some points in the value chain information asymmetries hamper and at other points they foster progress. It is by carefully analysing them and consequently taking adequate management decisions that sustained and sustainable progress may be assured.

Introduction

Investors come in colours everywhere and not all of them are created equal. Sovereign investors invest in view of themselves; such are states and families. All other investors are financial intermediaries: they act on behalf of third parties – beneficiaries, depositors, insurance takers or shareholders. Some of them are mere commercial vehicles, such as mutual funds; others take on additional responsibilities, e.g. to meet future obligations and are thus liability driven, such as insurers or pension funds. Insurers differ from pension funds: the reserves to invest by the first ensue from commercial activity whereas the second have no commercial considerations to entertain because they find beneficiaries-customers through non-commercial channels, e.g. employees of the corporate pension fund.
Sovereign investors are not subject to restrictions in formulating investment policy nor in formulating non-financial policy dimensions, as long as they abide by the law.[1] Intermediaries have to take into account legitimate financial restrictions, whether they originate in law, prudential regulation or in specific purpose; their scope in formulating investment policy is limited. Their responsibility first and foremost concerns financial values, such as liquidity, solvency, return, risk tolerance and so on. These are covered by the investment policy.
Executing investment policy is hard and difficult as it is – in view of current financial turmoil, this statement needs no further warranting. Essentially, all difficulties stem from information asymmetries. All forms of investment, whether granting credit or buying stock, come down to a principal that decides to invest cash in a project managed by another party, the agent. Inherently, the agent is more informed about what he is able to, what his capacities and intentions are and to what amounts of additional capital he may have access to. Also, the agent is very likely to be more knowledgeable about the business at hand than the principal. Yet, recently, financial intermediaries have taken up additional responsibilities; they started practicing "(socially) responsible investing" (SRI). SRI consists in voluntarily, i.e. not by legal obligation, and systematically, i.e. by way of explicit policy, inserting non-financial criteria in investment practice. An example regarding the international financing of large projects is the *Equator Principles*. They stipulate the presence of an impact assessment of the project at hand, with regard to environmental and human rights impacts. Another example of the systematic insertion of non-financial criteria is *Portfolio21*, regarding corporate ethics pertaining to basic worker rights.
It is clear that adding SRI-policy does not eradicate the information asymmetry that pertains to the 'strictly financial' assessment of old. To the contrary, the span of information asymmetry is now

[1] For instance and related to some SRI-discourses, Belgian law prohibits investing in corporations that produce anti personal mines and cluster bombs, for all investors alike.

broadened to the non-financial sphere. Hence the question: why would investors make their jobs more difficult by voluntarily adding non-financial criteria? What is, in other words, the business case of introducing SRI-policy?

This paper addresses that question from the angle of information asymmetry. We identify a number of information asymmetries within the value chain of an actual SRI-project, Portfolio21 (P21), and argue that while some of these asymmetries need to be reduced, a number of them can actually aid the business case.

"Business case" is a tricky term. For our purposes, we take the expression "to make the business case of a project" to refer to the activity of analysing, demonstrating and/or predicting its economic viability. Economic viability presupposes that the project at hand is legitimate and within the scope of purpose. For instance, it would out of scope for a financial intermediary to assume the role of a church and start preaching, even if that would look profitable at some time or other. Economic viability entails positive cash flows or net present value and/or positive effect on corporate reputation, which is supposed to yield a return by improving access to markets. Of course, each and every particular project carries its particular opportunities and risks. Making the business case is construing a coherent approach of those particular risks and opportunities.

The analysis concerns a real world SRI-project, Portfolio21. Its value chain, design and functioning are discussed below. We will find that the value chain is riddled with information asymmetries. We discern five types of information asymmetry:

A. Information about a past fact can be distributed unevenly, for instance when one party was present at the occasion and the other was not. Ultimately, this information gap can only be bridged by trusting the account of the party that was present.

B. Information about intentions and competences of others than oneself is by nature distributed unevenly. Typically, this asymmetry pertains to banking and investing (cf. above). The information gap can never be bridged completely but it can be lessened by gathering information about the past, by having the other party lay out its plans, and so on.

C. Information about what is happening in a particular organisation is distributed unevenly between insiders and outsiders. In principle, this information asymmetry can be overcome by making the organisation completely transparent for outsiders so that only information asymmetry of type B remains. Yet, that objective is, technological developments in communication notwithstanding, nearly impossible to obtain.

D. Information and understanding about the nature of investment processes might be distributed unevenly. For instance, the different position of mutual funds and liability driven investors might not be grasped by the general public. This kind of information asymmetry can be overcome by education and study.

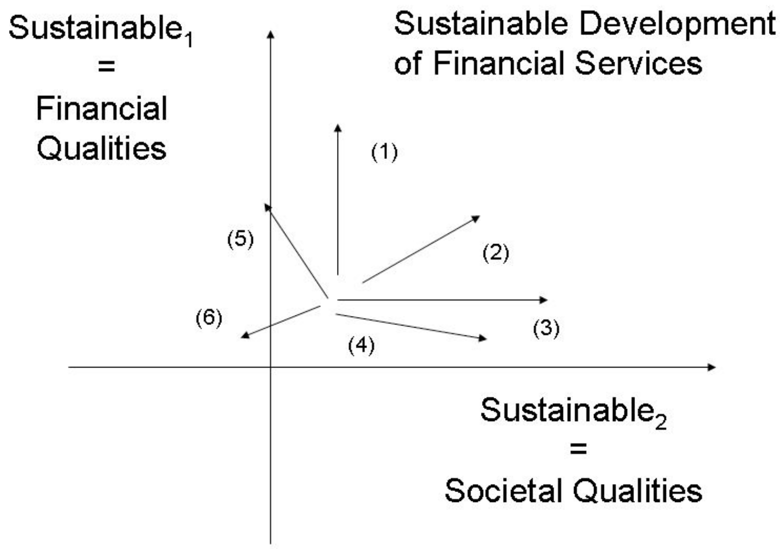
E. Information about the future is distributed unevenly among the parties due to B, C and D but it is also the case that none of the parties has superior access to information about what will actually happen. This means that no party has superior access to the Future and that all predictions are speculations.

The above serves as the setting of context and is to be kept in mind for the particular question of this contribution: what impacts do have information asymmetries on the business case of P21? And, consequently: how should they be managed?

The paper is structured as follows. The first two sections are preparatory. First, we point out five criteria concerning the legitimacy of a SRI-policy for financial intermediaries. The section thereafter plots P21's value chain and identifies 13 information asymmetries within its functioning. Those are described according to the typology above. Then, P21's legitimacy is mustered. The two following sections deal respectively with managing undesired and desirable information asymmetries. We conclude the paper with lessons learned from the P21 business case.

Legitimacy of SRI policy for financial intermediaries

First and foremost, the adoption of SRI-policy can only be legitimate if it does not cause the investment policy as such to miss its mark. It should enhance or at least not hamper the attainment of financial goals. Indeed, financial intermediaries' primordial contribution to 'sustainable development' or any other such ideal is to meet the promises entailed on the liability side of the balance sheet. It is not up to intermediaries to (ab)use their position by promoting some other, societal goals 'on the side' – however attractive they might appear. Indeed, their first and overarching goal, their first and primal societal responsibility, is to contribute to sustainable developments by delivering financial quality. Schematically, this can be presented as follows (graph 1).



A development of type (1) concerns only financial quality but is neutral on the societal dimension, viz. has no discernable real world impacts; for instance the enhancement of the portfolio's liquidity by substituting long bonds with shorter maturities. A development of type (4) presumably has positive impact on society yet comes at the detriment of the financial goals, say a diminishing of diversification or taking on higher risks by excluding whole sectors of the economy. So, without further ado, developments of type (4) are illegitimate for financial intermediaries. SRI-policies that constitute developments of type (2) and (3) are legitimate; as (2) yields also superior financial quality, it seems even obligatory within the intermediaries' framework of fiduciary duties. Developments of type (5) and (6) are illegitimate. An example of (5) is money laundering or fiscal fraud. They might boost yields (for a while) but they infect the integrity of the economy and state finances which are public goods recognised as such by all. In developments of type (6), the reduction of societal quality is coincidental with diminishing financial quality – such developments are clearly unintentional; perhaps we witness them today in the financial crisis. Perhaps we witness them also in discourses pleading for less finance or for a pre-capitalistic economy. Anyway, financial intermediaries should clearly establish which kind of development they envisage when adopting SRI-policy.

Secondly, the SRI-policy should entail criteria, techniques and processes that rely on a very broad if not universal consensus. Such is the observance of basic norms recognised by the international community. Of course, other criteria might be envisaged too, but then it would not be evident to obtain explicit consent from legitimate constituencies; e.g., besides having obvious impacts on investment outcomes, the exclusion of certain industries such as tobacco, alcohol, oil, aerospace, bio-engineering, *foie gras*, to name but a few of the usual suspects, is likely to be more controversial from non-financial perspectives as well. Such policies presuppose ideological homogeneity with constituents that is seldom met in actual practice. For instance, the policy to exclude producers of preservatives might be greeted with consensus by some constituents, yet when communicated to the larger public might meet with severe criticism and fierce opposition. Such would hurt the reputation of the financial intermediary and hence his wider business case.

Thirdly, the application of the criteria should be in scope of the investor function. For instance, as investing is always forward looking, criteria should be applied to current facts and future expectations, rather than to past events. Even apart from considerations about roles and governance in society, philosophical analysis of timeframes in implementation of SRI-policy must conclude to a categorical difference between investing and distributing justice (Leys e.a. 2009).

Fourthly, informed consent by the constituencies of the portfolio is a necessary condition. Again, the portfolio manager has no other mandate than to implement investment policy so as to meet the expectations of his principal. Who is to give consent differs according to situation; in insurance it will

be the board of the insurance company that guarantees outcomes, in pension funds it will be the beneficiaries, in mutual funds it will be the (sovereign) investors.
Fifthly, criteria should be meaningful and coherently applicable throughout the portfolio. If not, the 'policy' is liable to be mere hypocrisy or merely a random process – which would generate distrust.[2] An exception might be the overweighting of some sectors such as environmental friendly technologies. Yet, if this is done solely on the basis of SRI-reasoning and not also based on sound financial considerations, it is not likely to meet the first and the fourth condition for legitimacy.

Design and functioning of Portfolio21 and the information asymmetries that go with it
Among the investment portfolios adhering to the P21-project are the assets built to match the liabilities that originate in writing premiums for car insurance and for future pensions. The entire value chain, from the retail customer who chooses between various car insurances to the ultimate source of revenue to cover the liabilities, sc. worldwide activity by issuers of bonds and stocks, may be presented as follows:

Value Chain: from insurance premium to global activity by issuers of stocks and bonds

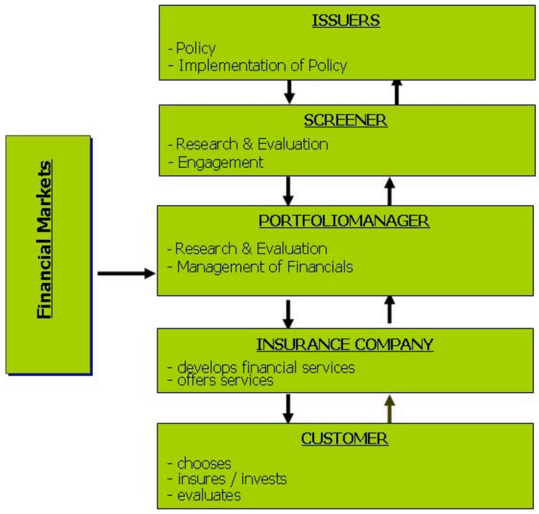


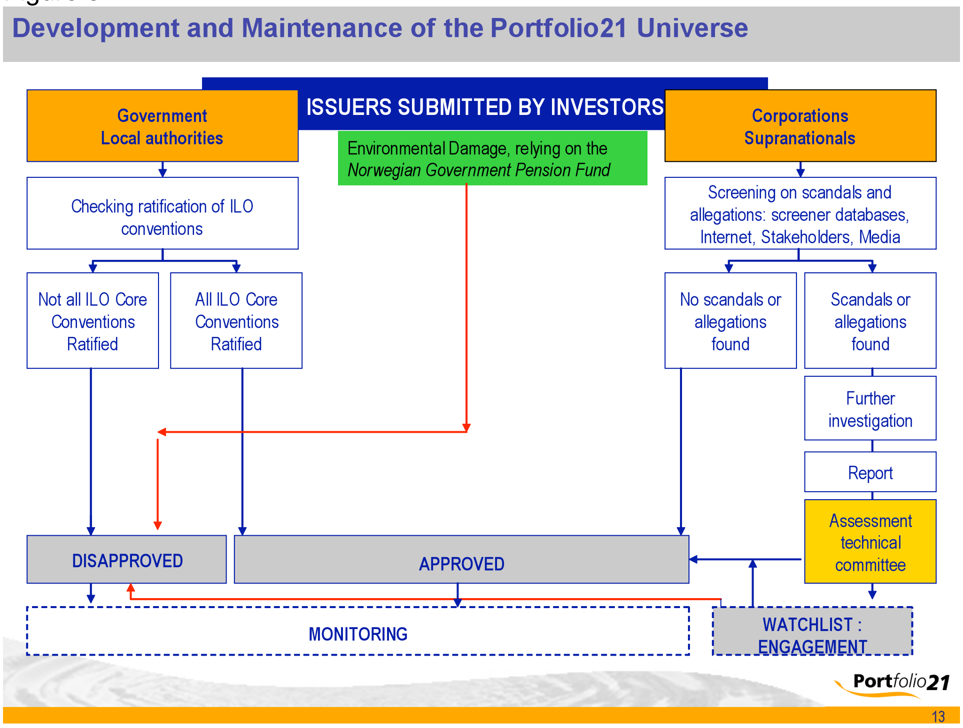
Figure 2: the entire investment chain.

Figure 2 lists all functions that are essential for the process; only one of them is specific for SRI-policy, sc. the screener-function.
The ultimate customer chooses a particular provider of pension; he is not likely to accept financially inferior propositions. Hence, the SRI-policy cannot have negative financial impact (development 4, figure 1) – otherwise, it would hurt the commercial business case of the insurance company or the pension provider.
Before we look into the functioning of the P21-model and list the information asymmetries inherent in the value chain, we also point out that regarding the value chain as such, customers generally are unaware. When buying car insurance or subscribing defined benefit contracts, they do not wonder about the investment policy to be implemented by the insurer. They focus on functional quality (price versus coverage), which is perfectly rational; the ulterior responsibilities or tasks of the insurer remain out of sight. This is to point out that here is a general information asymmetry pertaining to the functioning of insurance (and other financial intermediation) of type D above.

[2] For instance, investing 10% or 25% of the portfolios' stocks allocation in 'best-in-class' corporations is mere hypocrisy inasmuch that any portfolio likely contains 10% or more of 'best-in-class' corporations, whether these be identified by Dow Jones, Vigeo, Eiris or any other provider. Such a policy is empty and vain in that such percentages would actually be realised anyway. For instance, solely observing environmental norms in one industrial sector or in one country is rather random practice if not within the framework of a broader policy.

The participating investors submit all issuers of stocks and bonds in their investment portfolio to an independent screening firm (figure 3). The screener systematically looks for possible allegations re the breaching of the ILO-core conventions.[3]
If and when the screener finds serious and somewhat substantiated allegations he addresses the management and organised labour of the corporation in order to obtain more information about the alleged facts and to receive discourse on the matter at hand.
A report is drafted and submitted to a committee of independent experts in labour law and corporate ethics, the Technical Committee (TC).
When the TC deems the answers by the management of the corporation unsatisfactory, the screener is asked to address the board level. Again, a report is drafted.
At the end of this engagement process, the TC attributes a status to the corporation. Stocks and bonds of the issuing corporation are eligible for investment or not, according to the attributed status. The issuers in the investment universe are continuously screened.
Figure 3 and 4 summarise this process of screening, engagement and attribution of investment status.

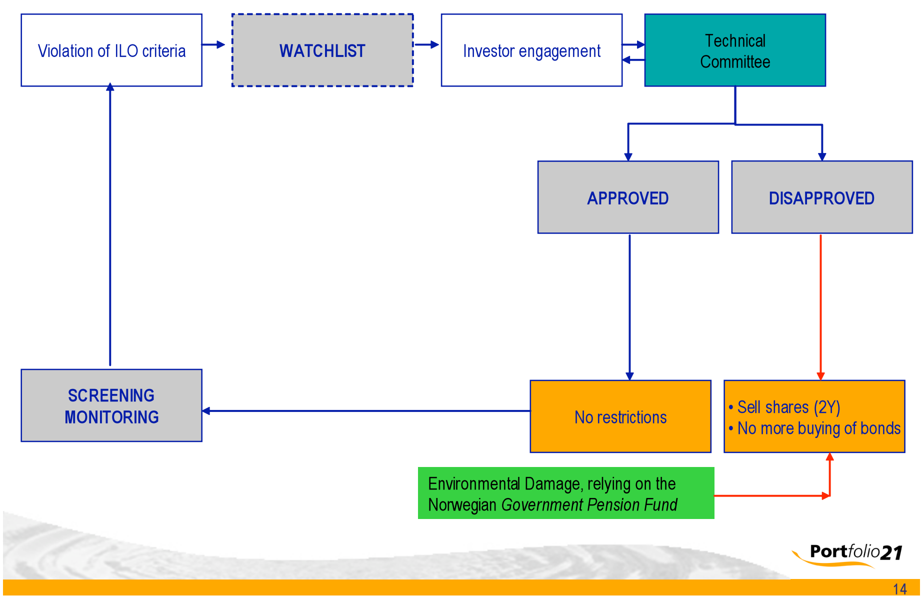
Figure 3



[3] For the screening out of corporations that commit breaches of basic environmental norms and thereby cause grave damages to the environment, the investors rely on the screening of the *Norwegian Government Pension Fund Global*.

Figure 4

Engagement, status attribution and portfolio management



In these processes, we can identify several information asymmetries.
1. The screener looks for allegations by covering a range of pertinent sources. However, he does not know for sure whether the absence of allegations means that there are no ILO-breaches taking place or whether there are simply no allegations. This is an asymmetry of type A.
2. If and when an allegation is found or when different parties bring forward different versions of the alleged facts, the screener has no direct means to discern which version holds true, especially when – as is often the case- controversies concern far-away practices. This too, is an asymmetry of type A.
3. The screener provides no detail of its processes and practices, specificity of databases and so on. This is a type C asymmetry: the investors possess inferior knowledge about the screening process carried out by the specialised firm.
This asymmetry is due to the economics of specialisation. Screening agencies are more efficient than investors in finding and valuating allegations, specific contexts and circumstances.
4. When the screener receives the name of an issuer-to-be-screened, he does not know whether the submitting investor intends to invest or merely wants an appraisal; neither does he know whether the investor subsequently actually invests.
This asymmetry of type C is the reversal of the previous one; it does no harm – the screener works on a need-to-know basis which does not preclude him to discharge his responsibilities completely.
5. In a similar vain, the investee corporation that is addressed by the screener in the course of the engagement process does not know which of the adherent investors is actually invested, for what amount and whether the investment is in bonds or stocks.
This asymmetry, of type C, is caused by engaging a third party, sc. the screener, to conduct enquiries and to deploy the engagement process for a plurality of investors. It goes without saying that the management of the investee corporation does not need to know exactly whom and for what amount is invested, when responding to allegations.
6. The TC that assesses all cases and attributes all statuses, does not know which of the adherent investors is actually invested in the corporations at hand, for what amount and whether this is in stocks or bonds.
Once again, this type C asymmetry does not preclude the TC to discharge its responsibilities completely. In order to assess cases, its members do not need to know whether or whom is invested. Attributing status to corporations depends solely on the cases at hand and not on actual investments.
7. The investors ignore what allegations are brought forward, the cases probed into and finally assessed by the TC.
This asymmetry too is of type C, i.e. due to organisational separation, but it feels rather awkward. Seemingly, the investors are unaware about what is going on and 'blindly' follow the attribution of

status by an external party. Thereby, they seem to install a certain heteronomy that might conflict with their responsibilities as owners and regarding financial outcomes.

8. The screener and the TC have no superior access to information about future allegations and future breaches. This is a type E asymmetry. Nobody knows what the future might bring.

9. Besides the owner of the assets and his appointed external asset managers if any, nobody knows whether day to day portfolio managements effectively observes the rules of the model.

This asymmetry of type C is due to the fact that portfolio management is done privately and not in the public eye. It causes vulnerability to suggestions that investors do nothing but erecting a smoke screen.

10. The general public, beneficiaries and customers of adherent investors included, is not informed about the investment universe or about statuses attributed.

This asymmetry of type C, requires some management, not as much towards the general public as well as towards ‘special interest groups’. The general public is not informed nor interested in the investment universes; the adoption of SRI-policy scarcely makes a difference here. Special interest groups do take a special interest though. We distinguish two kinds. The first kind is made up by competitors of the screener; these are likely to inquire about investment status and when different from their own appreciation, will claim superior screening and valuation services.[4] The second kind is made up by political factions that pursue investors in order to gain moral and political superiority in investment processes.[5] Not solely will they claim that criteria are poor, they will also claim that –as they are not involved in the value chain- procedures are corrupt; they will state that only complete transparency (for them) will be satisfactory (for them). However, when the investors would offer complete or even partial transparency, this would lead to reinforced discussions about criteria and processes and to harassment of other investors. Those groups will pester other investors for like exclusions and pressurise participating investors for more exclusions. The last either because they follow another kind of logic, for instance the logic of ‘punishing investee corporations for past practices’ or follow another kind of reasoning, for instance political reasoning regarding the indirect boycotting of regimes. Corporations deploying activities in Myanmar come easily to mind; yet, being active in Myanmar does not equal non-compliancy with ILO-conventions.

It should also be remarked that it is not up to the management of financial intermediaries to publicly denounce the management of other corporations. Such naming and shaming would not only cause commercial difficulties; it would also be a transgression of corporate responsibility. In democratic society, the authority for such speech acts is with the judge. Of course, NGO’s with no social responsibilities and hence immune for ‘punishment’ for the consequences of their actions also may assume the prerogative – yet, responsible agents, whether businesses or other, may not.

Managing this asymmetry thus poses a serious dilemma. On the one hand, investors wish to be as discreet as possible in order not to stir up conflicts of interest or unnecessary and even harmful public debate. They do not want to be perceived as moral superiors that judge and publicly denounce their fellow managers either. Specifically in current circumstances of financial turmoil, institutional intermediaries are not in a position to take the moral high ground. On the other hand, they want to be able to show and be appreciated for the fact that the SRI-investment process is effectively in place. Solving this dilemma is pivotal in reputation management and we will come back to it below.

11. The participating investors do not have access to information about each others’ portfolio.

This type C asymmetry does no harm whatsoever; investors collaborate without knowledge nor interference in each others’ portfolios.

12. The investee corporations are not informed about the fact that they are being monitored on ILO-compliancy.

This information asymmetry of type C has been brought forward as problematic by a representative of corporate management. Yet, it is not problematic at all. Corporations are constantly being observed by special interest groups of a friendly or less friendly nature. Information about corporate conduct is in the public domain. So, why should investors ‘warn’ investee corporations that they have started

[4] This is rather harmless and even healthy as long is it is not played out on the public fore as a moral competition. In that case, it would cause distrust and scepticism towards all parties involved and the SRI-phenomenon in general. Such is the impact of a commercial NGO offering an investment universe of the best-in-class type, claiming it to be the only one “100% ethical”, not only to discredit competitors but also moving to obtain monopoly by law or to provoke regulation that would expel competitors from the market.

[5] We have refrained from quoting organisations that come up with comments along the lines that follow; who wants to explore this type of ‘dialogue’ may visit www.Netwerkvlaanderen.be or the publications of the RFA (www.financité.org).

systematic monitoring? Especially since the operations of most of them poses no problems at all?[6] Information about mere monitoring should not be mistaken with information about investment status and exclusion. If and when the TC decides to close the engagement process by attributing disapproved-status, the management and the board of the said corporation are duly informed of the fact itself and of the reasoning why.

13.The general public is scarcely educated about the approach and the criteria and more generally about the investor situation.

This is a type D asymmetry that is entangled with the general financial illiteracy, complicated even more by the SRI-dimension. For instance, members of the general public are scarcely knowledgeable about the difference between investing through mutual funds (which they know best) and liability driven investing (which they seldom practice themselves). Explaining that mutual funds are always marked to market whereas insurance assets are in local GAAP and that these differences have implications for divestments, takes a lot of energy and is perhaps even fruitless.[7] Also, in Belgium engagement SRI was and still is unknown. Due to particular market developments in the 1990's, the best-in-class fund under prescriptive policy issued by a monopolistic and thus 'authoritative' NGO, was and even still is paradigmatic. Explaining why 'bad companies' are in the portfolio is necessary when the interested part of the public is only acquainted with best-in-class funds that build up a portfolio from scratch whereas the portfolios that come to adhere to P21 just start screening. Even more so, it is worthwhile to explain that it is irrational to expect all responsible investors to invest solely in best-in-class corporations all of the time, especially large investors such as pension funds and insurance companies – indeed, by its very definition, only a small number of stock quoted companies is eligible for best-in-class whereas all legitimate corporate activities need financing. So, this is the most difficult information asymmetry to bridge for the investors if they want to earn the good reputation that goes with pioneering in SRI.

In this section we have mapped the entire value chain and processes in P21 and we have identified a lot of information asymmetries. One is inherent in investing and the human condition (8). Some are unwilled (1, 2, 13) and are of type A, except for (13) which pertains to the general information asymmetry between the financial sector and the general population. Type A asymmetries, at the far end of the value chain, are to be overcome if the P21-project, or any suchlike project, is to be credible and effective. All other information asymmetries are willed in that they ensue from design, especially the design of functions and organisations (type C). Some of those we deem trivial (4 and 6) and need no further comment. Others contribute to P21's robustness and to the integrity of the functions in the value chain as we will show below. But first, we should muster the legitimacy of the project.

Business Casing: legitimacy of Portfolio21

This section checks the P21 policy against the five legitimacy criteria formulated above.

Before being implemented in 2004, the prospective financial impacts of the criteria and the rule book where thoroughly researched. Research showed that even if the TC where to attribute non-investment status to all issuers that allegedly had compliancy problems with ILO core conventions, financial impacts were negligible. The application of the model has no foreseeable impacts on asset allocation, sector allocation, risk / return features, liquidity and diversification of the portfolio. Of course, the implementation of P21 does have implications at stock picking level – yet, no correlation between stock return and (alleged non-)compliancy with ILO conventions could be found. Hence, the adherence to the P21-project is to be considered a type 3 – development (figure 1).

Besides direct financial impacts, costs of functioning should also be considered. Thanks to the amount of assets and the plurality of investors, they are marginal and impact financial results merely at the subluminal level. However, this is not to say that they are non-existent. Therefore, it should be possible to legitimate them by offsetting them to reputation factors. We discern two: first, the adherent

[6] We refer to www.portfolio21.info that informs about the number of issuers screened and the number of them that pose a problem of some kind (cf. also Vandekerckhove e.a. 2007).

[7] Yet, it explains why stocks and bonds are treated differently in the P21-model. The insurance investor who sells off bonds during holding period either misses the mark set by the structure of liabilities or he incurs fiscal liability. Thus, not solely is the different treatment of bond-holding versus stock-holding explained by the difference in investor prerogatives and responsibilities, there is a particular investor rationale as well. Likewise, the difference between a mutual fund whose assets are always marked to market and can therefore sell off a particular stock without incurring any penalties whatsoever and a GAAP-investor who's results depend on the timing of the sell off warrants the longitude of the divestment period.

investors mitigate their reputation risk by systematically avoiding corporations that have difficulties with basic labour standards. Second: this endeavour might yield commercial advantages such as easier access to markets and customers. These reputation advantages depend on information asymmetries and we will treat them below.

The P21-model does not overstep the social responsibilities of an institutional investor. It belongs to the prerogatives of a bond- or shareholder to assess compliancy risks and to address management or the board of investee corporations about upholding norms. Furthermore, it is an investor prerogative to divest when the management of an investee corporation is indifferent, unable or unwilling to bring about compliancy. Moreover, this is firmly within investor logic: everything else being equal, a management that is indifferent, unable or unwilling to manage litigation and reputation risks that go with the transgression of norms, carries higher risk than a management that is proactive, able and willing to mitigate those risks.[8]

The chosen criteria, viz. compliancy with the ILO-core conventions, are almost universally accepted, although not universally upheld. Contrary to environmental criteria, they are not subject to scientific debate and the ensuing uncertainties; one cannot be mistaken about the norms as such.[9]

Adherence to the P21-project by the individual investors has to be decided according to rules appropriate governance that may differ according to responsibilities and context.

The adherent investors apply the same criteria consistently throughout the whole investment portfolio and can therefore not be accused of hypocrisy or randomness.

We may conclude then, that the legitimacy of the P21-model is beyond doubt. Inasmuch as financial legitimacy depends on actual circumstances in markets, possible financial impacts should be studied continuously and proactively though. It would not pass to inform customers or beneficiaries that liabilities have not been met due to SRI-ing or enhancing ILO-compliancy. Therefore, the responsible investors remain in charge of the application of the criteria and the rulebook. Heteronomy on that level is to be excluded but investor autonomy is not in contradiction with systematic approach and progress.

Business Casing: managing unreliable information at the far end of the value chain

In this section we illustrate some of the information asymmetries at the far end of P21's value chain using two case files. We explain how P21 attempts to lower or move beyond these asymmetries. This section is limited to a discussion of the asymmetries that are not desired, in the sense that they threaten the effectiveness of the endeavour. The asymmetries that are willed and strengthen the business case are discussed in the next section.

But, first we should take consider the basic information asymmetries about facts.

(1) Of course, absence of allegations does not imply perfect compliancy with ILO-core conventions. That gap cannot be overcome by an endless search for allegations. If and when there are no allegations, the benefit of the doubt is in favour of the prospective investee corporations. This is inevitable yet it gives rise to reputation risk for the investors.

By engaging a professional screening agency, they are able to immunise themselves from that risk: they may justly claim to do a best-effort and may also point out that the screening agent is duly incited to look for allegations because the more he is able to spot, the higher his income because he receives a fee for conducting the engagement processes.

(2) When sources of information entail contradictions, the truth of allegations is not easily discerned. In principle, this information asymmetry might be overcome by sending a fact finding mission to the area of concern. Yet, this is very costly. Moreover, controversial allegations often concern past

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[8] As pointed out above, this a priori reasoning is not corroborated by empirical evidence. Stock prices and bond spreads do not correlate with alleged breaching of ILO-core conventions.

[9] Indeed, what is to be considered 'best environmental practice' depends on scientific and technological developments and is therefore subject to discussion and change. We may cite bio-fuels as an instance about which at one time nearly everybody was outspokenly in favour, yet after a short while had to review his opinion because of the effect on food prices: suddenly, allocation of agricultural resources to bio-fuel production became 'a crime against humanity'. So too, it is imaginable that in the near or distant future 'global warming due to CO2 emissions' might be rejected as an erroneous scientific conjecture. It is not up to financial intermediaries to decide which scientific hypothesis has more probability than another and which technology is to be promoted. Of course, one can not be mistaken about gross environmental damages due to negligence or outright transgression of elementary norms either; therefore, in 2007, the P21-model was reinforced by seeking synergy with the *Norwegian Pension Fund Global*'s approach of environmental transgressions.

practices which are no longer observable as facts. Yet, granting the benefit of the doubt in these cases too would render the project void and meaningless. Management seldom admits fault (Vandekerckhove e.a. 2007). The P21 approach, then, is to move away from the contradictions and to focus on management discourse and practice.

In the case of Corporation J (Appendix 1), we meet with of information asymmetries of type A (1 and 2 cf. the previous section), C (2) and B and E (8). The screener found allegations of union busting in public domain sources. However, these are mere allegations. They indicate what might have happened but offer no proof of what has actually happened, nor of what is happening now (2). In order to close these information gaps, an engagement process is started by submitting questions about the allegations to the management of J.

From the answers received, information asymmetry (2) re-emerges: management and the international trade union hold different versions of what has happened. At this point, it is unclear what the factual content is of their respective statements. But what is impossible to deny is that allegations are in the public domain. Rather than sending a 'fact finding mission', the TC continues its evaluation by an analyses of the 'speech-acts' within the engagement dialogue.[10] The TC deems the argument of J's management with regard to the responsibility for respecting ILO conventions as crucial information. Basically, central management asserts it is corporate policy to regard the issue at hand as something of local concern. Yet, the TC remarks, other issues are in the hands of central management, such as output quality and quantity. Abdication of responsibility regarding labour standards is thus rather inconsistent and surely labour standards in local companies are in the sphere of influence of central management. Although nobody has access to the future and the TC had no extensive knowledge of management's intentions and competences, the engagement process allowed the TC to narrow these gaps significantly. The answer by central management shows it to be rather unconcerned with the issues at hand (intentions) and unwilling to implement mechanisms for the central monitoring of respecting ILO conventions (competences). By implication, Corporation J is not carrying out adequate risk reduction and control on these issues and thus shows a systemic failure in addressing the topic; hence, future allegations are more likely than not. Therefore, the TC decided to reject Corporation J.

The case of Corporation N (Appendix 2) differs in important respects but the mechanisms to bridge the information gaps are similar. Corporation N deploys activities in Myanmar. Corporate activity in such zones does not by itself constitute a breach of ILO conventions but the corporation's presence in such zones does entail an increased risk of being involved in such breaches. Hence, presence in Myanmar is deemed a sufficient reason not to exclude but to further investigate by commencing an engagement process in an attempt to bridge information asymmetry (1). The management of N responds by repeating commitment to ethical standards. However, given the risks at hand, the TC deems this communication insufficient. The TC then offers management of N the possibility of closing (1), (2) and (8) gaps by providing information on its specific activities and monitoring mechanisms. Such information could indicate that the risks are of serious concern to management and that the reduction thereof is at an acceptable level. However, Corporation N refuses to provide that information and thus fails to close the gaps. Moreover, it legitimates its refusal to inform by invoking ethically unacceptable reasoning abut disclosing (im-)material information to the investor community and financial markets. Therefore, the TC excludes Corporation N from the P21 Universe.

Thus, information asymmetries of type A that arise in the far end of the value chain are lessened or circumvented by shifting focus from discussions about facts to assessing a future oriented dialogue. This move is perfectly legitimate because the role of investors is not to judge past transgressions but to act forward looking (Leys e.a. 2009). It is not to be denied though, that it is inspired by economic motives, viz. not to spend too much time and money on fact finding. Thus, it is also grounded in the fiduciary duties of the financial intermediaries who are first and foremost to provide optimal financial services. The economic constriction may be lessened in two ways. First, parties internal to the corporation might be more forward coming with information – we refer specifically to organised labour. Indeed, organised labour within the corporation has superior access to facts at lower cost than the screener. Moreover, organised labour has at least a moral if not an economic interest in the upholding of ILO-core conventions. That is why, since inception, P21 always informs organised labour about the allegations and the engagement process taking its course. Rather seldom, though, organised labour

[10] This is also called switching from the factual to the meta-factual level. It means that instead of spending resources to find out whether or not the allegations are true, management is asked to give evidence of monitoring activities that allow to conclude that the risk of alleged practices happening in the future are reduced (see W. Vandekerckhove e.a. 2008).

provides information or a view on things.[11] Second, since its inception in 2004, P21 has been conceived as a collaborative project that is open to likeminded investors. Purchasing power rises the more numerous the investors and the larger the participating portfolios. Costs of fact finding will weigh less and have no significant impact on returns. Evidently, a larger adherent portfolio also entails a stronger position towards management of investee corporations.

Nonetheless, information asymmetries regarding past and current facts will continue to abound. Screeners cannot be everywhere all of the time. Even the largest investor will have to navigate around them and focus on the question whether management is interested, able and willing in managing allegations and avoiding breaches.

Business Casing: managing reliable information at the near end of the value chain

We identified several information asymmetries between the investors and other parties in the value chain. These asymmetries arise by design. In principle, they could be overcome by putting all functions in one hand: by merging screening agency, Technical Committee, portfolio management and ownership. Aside from suboptimal economic outcomes, this would give rise to possible conflicts of interest. The existence of those would negatively impact the reputation of adherent investors and hurt the business case. We will now treat each and every asymmetry of that kind and show how it contributes to the robustness and integrity of the project.

Asymmetry (3) is a consequence of economic considerations. But on top of that, the asymmetry caused by the division of labour is healthy in the sense that it guarantees not solely the quality of the screening but also avoids a possible conflict of interest. The investor, especially when he also offers financial services to other companies, might be inclined to 'overlook' allegations and transgressions. Thanks to separation of function, the issue does not arise and the investor may even point out that the screener is financially incited to find as much allegations as he can because he also earns money for conducting the engagement process. Clearly then, this feature reinforces the reputation of participating investors and the business case.

(5) The fact that investee corporations too are ignorant about whom precisely is holding what assets safeguards the individual investors against undue pressurising. We must underline here that we have not come across even the faintest hint of retaliation during the five years P21 is now functioning. But the point surely is that investors do not even have to fear such discourses or retaliations - of course, the less the more they are.

(7) The fact that the investors are not involved in screening and assessing corporate activity and that they, moreover, blindly accept the verdict of the TC, precludes them from influencing the process and its outcomes. Thus, it shields them from being in a conflict of interest and from being accused of non-integrity. This feature too, strengthens the business case. Yet, this distance also implies a certain heteronomy and an indifference to what is actually going on by way of implementing policy. This dilemma has been alleviated by developing the fiches as in the Appendix. The identity of the corporation involved is not divulged, yet the course of the engagement process and the reasoning by the TC is clearly presented. The fiches are sent to the governing committee of P21 that is composed by the investors (see www.portfolio21.info). Thus, the investors are able to follow up on policy implementation and to send feedback without becoming implied in discussions about *particular* corporations.

(9) As the actual day to day portfolio management is a private matter and not divulged to the general public, to the TC, to the screener or to special interest groups, the investors are liable to be doubted about implementation. That consequence of information asymmetry is easily avoided, yet at a cost. The adherent investors have their portfolio management audited by a certified accountant who assures compliancy with the rule book. This represents the cost of distrust to bear by the investors who want an impeccable reputation and perhaps want to be assured that the external portfolio manager, if any, does indeed comply. Needless to say that the accountant does not assure that the TC has decided rightfully or that allegations were to the point.

(10) The best investors can do to reinforce reputation and integrity of the project is to communicate clearly and assertively what it is and what it is not. Investors need explaining why they do not divulge

[11] At this point, we may only speculate why this is so. Several factors may be at play: confidentiality obligations within the context of industrial relations within corporations such as works councils; lack of resources with trade unions; campaign agendas that have a very different content and timing than the P21 engagement agenda; the fact that trade unions are not inclined to give information to institutions with which they do not entertain close relationships; distrust of investors that are perceived as representatives of capital.

individual cases and take part in naming and shaming as practiced by NGO's. They have to install the difference between following a political route on the one hand and urging for impeccable management practice regarding worker rights on the other. They have to make clear that they do not assume the role of the judge or of government but that they use their position as an investor to have discussions with management and to divest if these discussions are unsatisfactory. Hence, the communications by the investors on the website. Hence too, the creation of the fiches in Appendix that will be posted on www.portfolio21.info. Typically, all these communications are far more read and commented upon by parties that come up with negative criticism and strive to move the goalposts than by customers or positively inclined parties.

(13) So, the investors remain vulnerable to moral attacks, the more so when the general public and the customer base are uneducated in investment matters and in SRI. For members of the general public, abrupt divestment seems 'more ethical', especially in Belgium as indicated above. A customer might find it unethical to be invested in corporations that allegedly disrespect workers rights – yet, this is an intrinsic effect of having one's portfolio screened. For others, it seems contrary to common sense that to divest corporations involved in child labour does not hurt financial values, child labour being cheaper to procure.

Overcoming these misunderstandings requires a lot of communication. They are part of a wider information gap currently referred to as "financial illiteracy". This is to say that the task surpasses the P21-investors. But it also brings us back to what we said about priorities in investor responsibilities: here too, financials come first. It is much more important that people become more knowledgeable about pensions and investing future pensions than that they grasp subtler features of SRI. To understand what it is to be confronted with funding gaps is much more relevant than it is to understand why certain practices lead to divestment and others do not.

Conclusion

The business case for an investor driven SRI-project that focuses on compliancy with widely recognised norms is a sound one, even for liability driven financial intermediaries such as pension funds and insurers. It does not impact investment policy and financial values, except at stock picking level and that impact is negligible and anyway unpredictable. On the financial plain, solely costs incurred by participating in norms driven SRI-projects are to be a matter of attention. It is reputation aspects that largely dominate in the assessment of the business case for investor-participants that also deploy commercial activities and whose management holds a position that is equivalent to that of the management of investee corporations.

It may be reasonably assumed that reputation aspects have been a stumbling block for financial intermediaries for taking initiatives in the SRI-dimension and to make use of investor prerogative. This vulnerability of reputation is typical; sovereign investors are immune. This may explain, for example, why financial intermediaries in their investor capacity were not that eager to sign up to the *PRI* (www.pri.org). Indeed, their business case meets with a lot of obstacles and difficulties that go with information asymmetries. On the one hand, they may never be sure to be effective because of the lack of reliable and timely information. On the other hand, they are likely to be accused of window dressing or to become unduly pressurised.

In view of that, we have analysed a particular SRI-project and identified the information asymmetries it has to struggle with. We have argued that information asymmetries about facts can and should be overcome by focussing on attitude towards possible future allegations or breaches. We have shown that careful use of information asymmetries that go with the separation of functions and organisations, reinforces the position of the project and the adherent investors. Building information asymmetries in the SRI-project renders the investors immune for systematic distrust and undue pressurising. Regarding type D asymmetries, safeguarding and even building superior reputation in order to have easier access to markets and customers demands superior communication skills and efforts. The results thereof are not guaranteed, as more general information asymmetries tend to obscure what investing is all about and as parties liable to loudly voice negative criticism take a more vivid interest than the general public or the customer base. Responsible investors, however, do not let that be the preponderant factor in deciding whether or not to contribute to progress.

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Appendix

CASES

For various good reasons, the Investors have decided not to disclose individual cases that have been treated by the Technical Committee.
In order to enhance understanding and to make clear how the engagement process takes its course and what are driving principles in decision making, the Investors and Vigeo Belgium present some cases without divulging the identity of the corporations involved.

Corporation J: several cases of union busting

The Vigeo Belgium screening yields many references to incidents of union busting, including unlawful dismissals of trade union leaders and members, using security guards to violently suppress trade union actions, and refusal to engage in collective bargaining.

Consequently, Vigeo Belgium addresses the CEO of the said corporation.

Corporation J responds to the engagement letter by stating that the top management of the corporation has put responsibility for labor negotiations in the hands of the local management teams. It claims that none of the dismissals of trade union members and leaders was in any way related to their union activities and that all social conflicts within the corporation have been solved trough negotiations with trade unions.

The reply also contains a brief statement on each of the occurrences mentioned in the engagement letter.

An international trade union federation, when confronted with Corporation J's reply, contradicts the claims of Corporation J. The federation states that Corporation J has on several occasions shown a hostile attitude towards social dialogue. To back up this statement, the federation sends some documents by way of warranting the claim that at least some of the claims of Corporation J do not reflect reality.

The Technical Committee accepts Corporation's J rendition on some of the cases.

It also finds that in some cases the Corporation seems to act in disrespect of the employees' rights to freedom of association and social dialogue and that J seems not to be able to provide credible and convincing argumentation that demonstrates the corporation's efforts to ensure compliancy with the ILO core conventions. More specifically, the delegation of responsibility for managing local labor conditions can not entail the delegation of the responsibility to respect or to disrespect ILO core conventions. Top management delegates responsibility for obtaining predefined desired output quality and quantity; it also delegates the responsibility for meeting preset business targets to local management. But targets and norms on quality, quantity and overall profitability are being set at corporate headquarters. Similarly, basic norms on labor conditions should be set by corporate headquarters and not be left to the discretion of local management. Either way, top management should intervene when basic labor norms are not being met.

Accordingly, the Technical Committee changes the status of Corporation J in the Portfolio21- universe from 'Watchlist' to 'Disapproved'.

Vigeo Belgium informs the said corporation of the decision by the Technical Committee and its consequences.

CASES

Portfolio21-cases

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Corporation N: Disclosure on compliancy with ILO core conventions of corporate operations in Myanmar.

Vigeo Belgium finds that Corporation N mentions on its public website that it runs operations in Myanmar.

Myanmar is infamous for its wide-spread violations of human rights, including violations of ILO core conventions. Thus, Myanmar is a high risk zone for corporations.

According to the criteria of Portfolio21 regarding high risk zones (see http://www.portfolio21.be/upload/images/Portfolio21_EN.pdf), the Technical Committee starts an engagement process with the said corporation.

A customized questionnaire is sent to the CEO. The questionnaire is designed to obtain information on the type of corporate activities in Myanmar and on how Corporation N manages prevention of involvement in breaching ILO core conventions.

The Corporation answers through its Investor Relations department:

Corporation N is firmly committed to the highest ethical standards

The corporation places considerable emphasis on compliance with guidelines published by a number of international organizations, including those of the ILO.

The corporation monitors the human rights situation in Myanmar very carefully

The former subsidiary in Myanmar has been dismantled and all business activities are now managed by the Thai subsidiary of the corporation

The corporation refers to documents such as its Business Conduct Guidelines and its Corporate Responsibility Program

Corporation N does not fill out the questionnaire completely or even partly.

The Technical Committee is not satisfied by this information, because:

1) mere commitment by itself does not imply effectiveness,
2) mere emphasis does not equal implementation,
3) no information is provided on the monitoring of observing the codes,
4) it is immaterial whether the corporation directly owns a subsidiary in Myanmar or whether operations are managed by a subsidiary that is based in another country. Both are within the sphere of influence of Corporation N, irrespective of legal structuring,
5) in high risk zones, corporations are held to be open about preventive measures that ensure compliancy with Business Conduct Guidelines,
6) specific and pertinent questions are left unanswered

Thus, the Technical Committee pressurizes for disclosure on the number of employees working in Myanmar on behalf of Corporation N and on disclosure of the nature of the activities deployed.

The management of Corporation N confirms its previous statements and adds that no further information will be provided.

The Technical Committee concludes that it has not received satisfactory answers to its questions from operational management. Thus, it decides to take the next step in the engagement process. The request for information is now addressed to the President of the corporation.

This time too, Corporation N responds through its Investor Relations department. It replies that the Corporation can not provide precise answers to the Portfolio21 questionnaire, because it has “to follow strict policies regarding fair disclosure to the capital market”.

The Technical Committee rejects Corporation N’s reasoning for not providing the requested information:

Either the information is not material; then it can be disclosed without further ado.
Either the information is indeed material; then it should be disclosed to all investors alike and at the same time.

Therefore, the Technical Committee finds that Corporation N is unwilling to disclose information.

The Portfolio21-criterion for activities in high risk zones is that they should be accompanied with policy and compliance measures in order to minimize the risk of becoming involved in norms breaching. Most likely, this is not the case for Corporation N, otherwise it would be able and willing to disclose.
The Technical Committee changes the investment status of Corporation N from “watchlist” to “disapproved”.

Vigeo BELGIUM informs the said corporation of the decision by the Technical Committee and of its consequences.