



Doing Good While Doing Well – Why SRI is Booming

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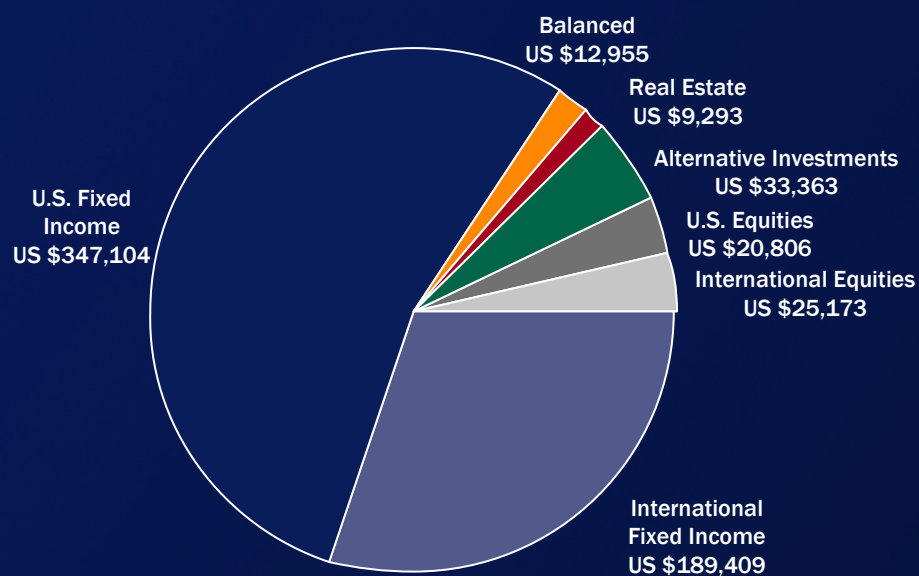
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Introduction

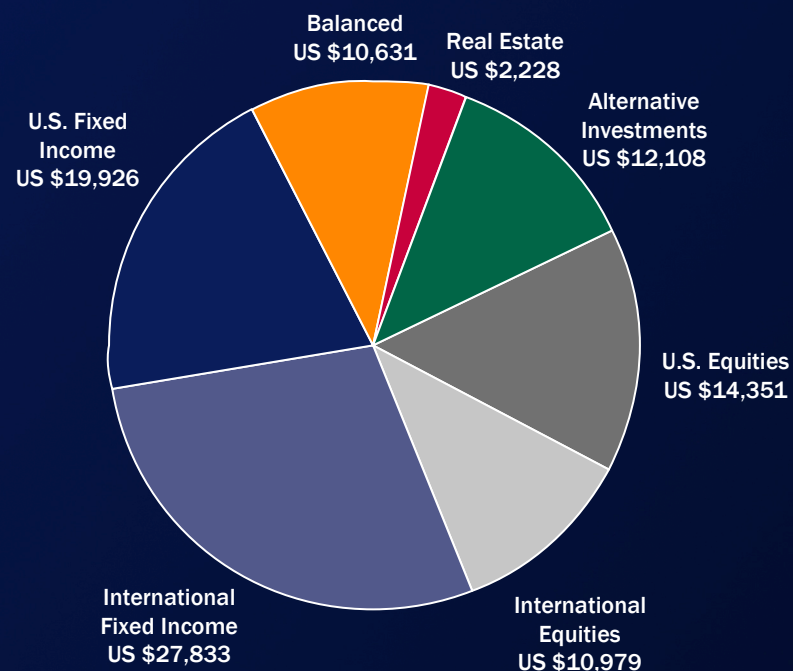


Introduction

Total Assets Under Management US \$638.1 billion as of 30 September 2006



Client Assets Under Management US \$98.1 billion as of 30 September 2006



Dollars in millions.

Total assets under management include approximately US \$540.0 billion of AIG affiliated assets, including those managed by joint ventures and certain other AIG investment adviser subsidiaries, but do not include assets sub-advised to third party managers.

Today's Agenda

- Why all the fuss over SRI?
- What do we mean by SRI?
 - Why ESG?
- Approaches to SRI
- SRI and fiduciary duty
- Managing an SRI fund – Japan as an example

Did You Know?

- In Europe... SRI AUM tops €1.0 trillion.¹
- In the U.S.... SRI assets grew faster than the entire universe of managed assets during the last 10 years.²
- In the U.S.... \$2.29 trillion in total assets under management employ one or more of the three core socially responsible investing strategies - screening, shareholder advocacy, or community investing.²
- 75% of Institutional Investors believe... “Environmental, social and corporate governance factors can be material to investment performance.” (surveyed by Mercer Investment Consulting)³
- PRI... Asset managers representing USD 4 trillion have adopted the Principles of Responsible Investment.⁴

1. Source: Eurosif, European SRI Study. Data as of 2006.

2. Source: Social Investment Forum. Data as of 2006.

3. Source: Mercer Investment Consulting, “2006 Fearless Forecast.” Data as of 2006.

4. Source: UNEP Finance Initiative. Data as of 2006.

Why Now?

- SRI origins date to the 1920's in the UK.
 - Vietnam, South Africa, labor and environmental movements
- Corporate scandals and bankruptcies
- Climate change
- Supply chain risk
- Active ownership and engagement as fiduciary duties
- SRI research industry
- Management and auditing tools
- NGOs and United Nations leadership

What Are We Talking About?

- Active incorporation of environmental, social, and corporate governance (ESG) factors within investment decision making and share ownership.
- Concern with specific issues
- A tool for gaining a clearer picture of corporate culture and management
- A tool to influence corporate behavior

SRI Philosophies and Implementation

<u>SRI Philosophy</u>	<u>SRI Implementation</u>
Ethical/Values-based	Exclusionary screening Negative screening Norm-based screening
Best-In-Class	Positive screening
Theme-based	Clean Tech/Green Funds
Active Engagement	Proxy voting, Shareholder proposals, company contact

SRI in Practice

<u>Asset Class</u>	<u>Forms of Investment</u>
Listed Equities	Positive/Negative Screened Universes of Public Companies
Fixed Income	Positive/Negative Screened Corporate Funds; Sustainable Sovereign Ratings
Private Equity	Clean Tech Funds
Hedge Funds	Socially Responsible Hedge Fund of Funds
Other Alternative Investments	Emissions Trading; Climate Theme Funds
Real Estate	Energy-Efficient Portfolios; Brownfields Recovery Projects

Driving Factors

- Make Money
 - Identify social, governance, and environmental criteria that may affect financial performance and share price.
 - Long-term investment philosophy – suited to most pension funds' horizon
- Alignment of ethical values with portfolio decisions.
- Channel investable assets in a manner consistent with sustainable development.
- Recognition of weak regulatory and market discipline on corporations in certain markets.

Why ESG? Hypothesis and Evidence

- Environmental (E), Social (S), and Corporate Governance (G).
- Hypothesis: Attention to environmental, social and governance issues will enhance shareholder value of companies and the risk/return profile of investment portfolios.
 - Downside Protection: Application of ESG criteria in investment decision-making can reduce portfolio risk by identifying material, often overlooked issues.
 - Balance Sheet View
 - ESG performance as an intangible asset.
 - Most CSR issues lead to a liability rather than an asset.
 - Proxy indicator of overall risk levels and general management quality.
- Companies with better ESG performance can increase shareholder value:
 - By better managing risks related to emerging ESG issues,
 - By anticipating regulatory changes or consumer trends, and
 - By accessing new markets or reducing costs.

Why ESG? Hypothesis and Evidence

- “Robust evidence that ESG issues affect shareholder value and the impact of ESG issues on share price can be valued and quantified.” UNEP Finance Initiative, *Show Me The Money: Linking Environmental, Social and Governance Issues to Company Value*, 2006.
- “[S]ustainability is an independent return-driving factor that can have a positive impact on shareholder value beyond the influence of value, growth and size components.” West LB, *Insurance and Sustainability, Playing with Fire*, March 2004.
- “There was agreement that environmental, social and corporate governance issues affect long term shareholder value. In some cases, those effects may be profound.” UNEP FI, *The Materiality of Social, Environmental, and Corporate Governance Issues to Equity Pricing*, 2004.
- “Companies in the oil and gas industry with the best track record of social responsibility and a long-term vision about a low-carbon future dominate the market share of strategic projects, a key determinant of business success.” A. Ling, J. Waghorn, S. Forrest, M. Lanstone, *Goldman Sachs Energy Environmental and Social Index*, February 2004.

Growing Importance of ESG to Investment Performance

Percentage of managers who feel that following factors
will become or will remain material in five years
(Rank of factors within the geography shown in parentheses)

Factor	Australia	Canada	Europe	Singapore	UK	US	Global	Total Average
Adherence to corporate conventions	22% (4)	13% (7)	17% (6)	11% (4)	11% (6)	8% (8)	20% (8)	14% (11)
Climate change	33% (3)	30% (3)	57% (3)	22% (3)	42% (3)	22% (6)	51% (2)	37% (4)
Corporate governance	67% (1)	40% (2)	61% (2)	56% (1)	53% (1)	62% (2)	46% (3)	55% (1)
Employee relations	56% (2)	20% (6)	30% (5)	22% (3)	32% (4)	32% (4)	24% (7)	31% (8)
Environmental management	67% (1)	25% (4)	57% (3)	33% (2)	47% (2)	24% (5)	41% (4)	42% (3)
Globalization	56% (2)	53% (1)	65% (1)	22% (3)	53% (1)	65% (1)	61% (1)	53% (2)
Health issues in emerging markets	22% (4)	23% (5)	17% (6)	22% (3)	32% (4)	22% (6)	37% (5)	25% (9)
Human rights	22% (4)	10% (8)	13% (7)	33% (2)	21% (5)	11% (7)	20% (8)	19% (10)
Sustainability	56% (2)	23% (5)	48% (4)	11% (4)	47% (2)	24% (5)	32% (6)	34% (6)
Terrorism	56% (2)	25% (4)	30% (5)	22% (3)	32% (4)	49% (3)	15% (9)	33% (7)
Water (use of/access to clean water)	33% (3)	30% (3)	48% (4)	33% (2)	32% (4)	32% (4)	46% (3)	36% (5)

Source: Mercer Investment Consulting, "2006 Fearless Forecast: What do investment managers think about responsible investment?" March 2006.

Traditional and emerging ESG issues in different sectors

<u>Sector</u>	<u>Traditional Issue</u>	<u>Emerging Issue</u>
Oil and gas	<ul style="list-style-type: none"> ▪ Oil spills ▪ CO2 emissions 	<ul style="list-style-type: none"> ▪ Socio-economic impacts ▪ Government relations; revenue sharing
Food industry	<ul style="list-style-type: none"> ▪ Food safety ▪ Brand/reputation risk 	<ul style="list-style-type: none"> ▪ “Functional food” regulation ▪ Nutritional value
Pharmaceuticals	<ul style="list-style-type: none"> ▪ Bio-safety ▪ Animal welfare 	<ul style="list-style-type: none"> ▪ Role in national healthcare systems ▪ Patent rights ▪ Environmental impact of compounds
Automotive	<ul style="list-style-type: none"> ▪ Safety Requirements ▪ CO2 emissions 	<ul style="list-style-type: none"> ▪ Mobility and socio-economic impacts ▪ Low emission regulations

Arthur D. Little and Business in the Community, Speaking the Same Language, 2003, reprinted in The Global Compact, “Who Cares Wins – Connecting Financial Markets to a Changing World.”

SRI and Fiduciary Duty

Why Care?

In an increasingly complex and interconnected world, the importance of actively managing risks and opportunities related to emerging environmental and social trends, in combination with rising public expectations for better accountability and corporate governance, presents a new set of challenges with far-reaching financial consequences for corporations. This is true both at the level of companies and at the level of investment portfolios.

The Global Compact, “Who Cares Wins – Connecting Financial Markets to a Changing World.”

As an investor, we must actively manage the risks and opportunities related to climate change and other environmental trends. The information gathered by the Carbon Disclosure Project helps us to do this. On the opportunity side, AIGGIG is allocating new private equity to GHG mitigating investments.

Win Neuger, CEO, AIG Global Investment Group

SRI and Fiduciary Duty

A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment, Freshfields Bruckhaus Deringer, October 2005:

Query:

Whether the integration of ESG issues into investment policy is "voluntarily permitted, legally required or hampered by law and regulation," in seven major jurisdictions -- the U.S., the U.K., Germany, France, Italy, Spain, and Japan.

Conclusion:

"The links between ESG factors and financial performance are increasingly being recognized. On that basis, integrating ESG considerations into an investment analysis is clearly permissible and is arguably required in all jurisdictions."

SRI and Fiduciary Duty – The UK View

- In all investment decisions, there must be a constant and real focus on the benefit to beneficiaries.
- Select investments with a particular ESG profile as part of a balanced and properly diversified portfolio.
- Screen investments expected to yield attractive/poor returns by virtue of their ESG credentials
- Wider interests of beneficiaries may be considered so long as reasonably determined to have no or negligible impact on financial returns of portfolio as a whole.

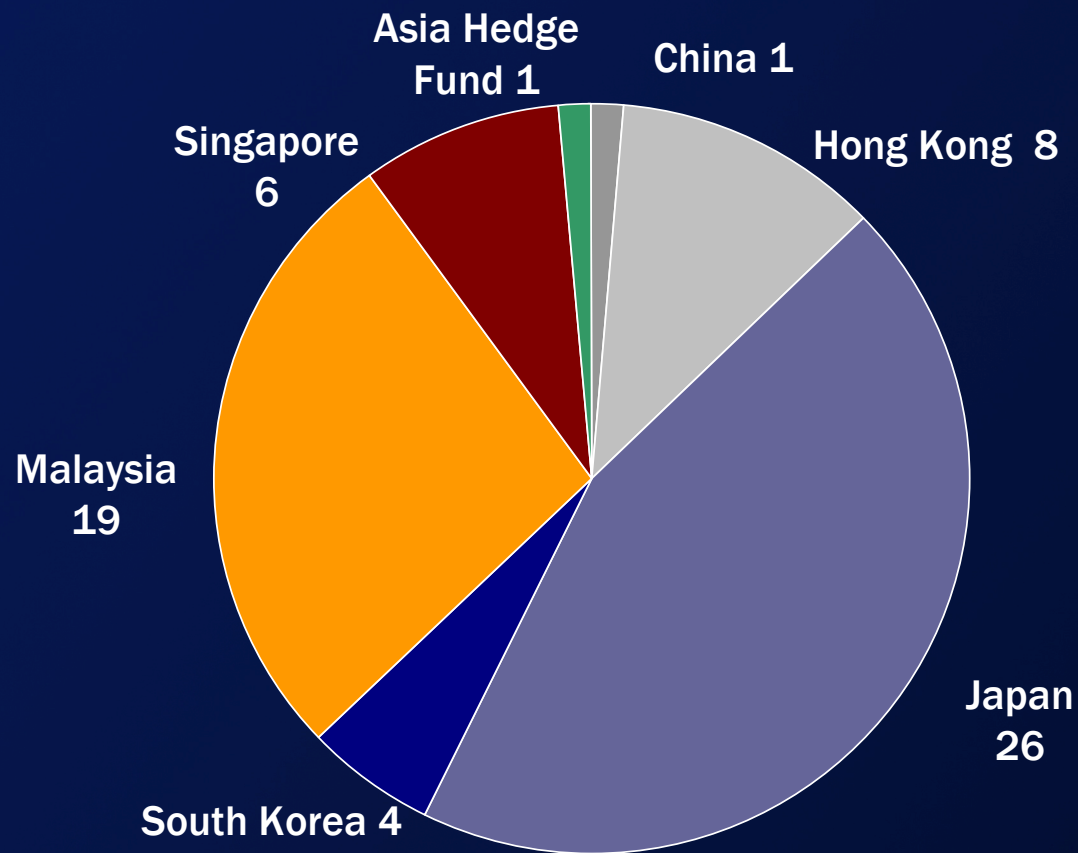
SRI and Fiduciary Duty – The US View

- Do ESG considerations violate the prudent investor rule?
- ESG considerations may be considered as long as motivated by proper purpose and do not adversely affect the financial performance of the entire portfolio.
- ERISA fiduciaries may consider “collateral benefits” such as those offered by a socially-responsible fund in a fiduciary’s evaluation of a particular investment opportunity. *Letter from Department of Labor to William M. Tartikoff, Senior Vice President and General Counsel of Calvert Group Ltd. (May 28, 1998)*
- Pension funds may engage corporations on issues that are likely to enhance the value of the company.

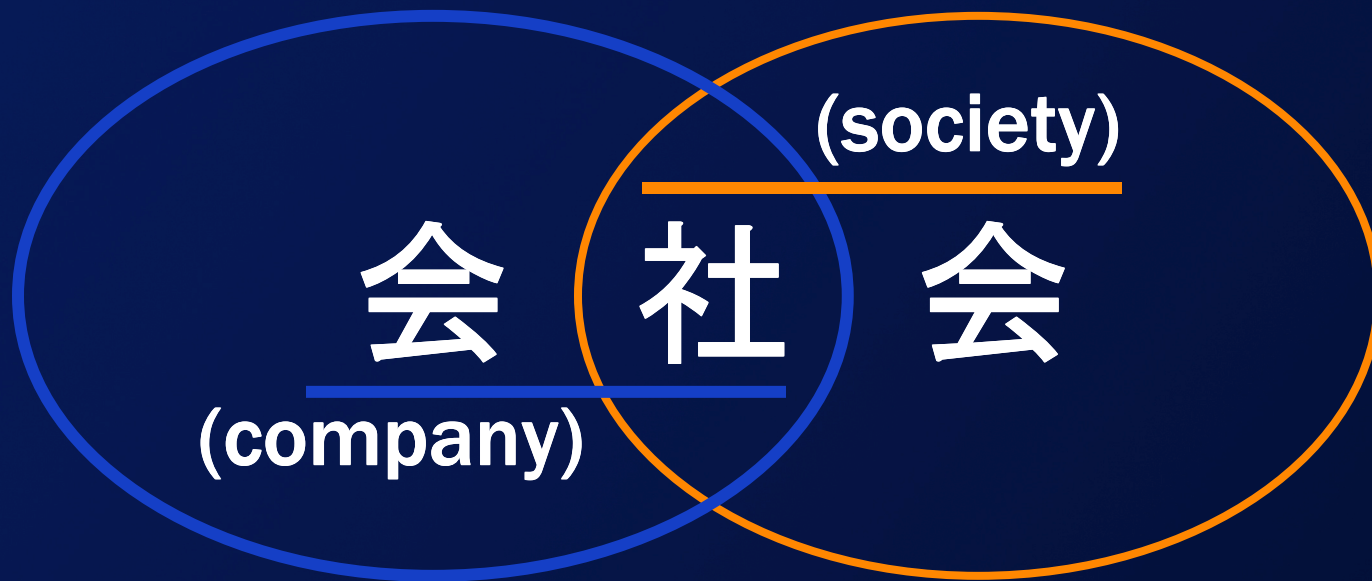
SRI in Japan

First, SRI in Asia

Total Number of SRI Funds in Asia
as of 30 September 2006



SRI is NOT Lost in Translation



In Japan, the notion that corporations & society reflect one another is rooted in language and culture.

But An Interpreter Can Help

- Values are not necessarily common across borders
 - Performance indicators must be tailored for Japan
 - Who are the stakeholders? In which order of priority?
- Assessments only as good as the research
 - Independence
 - Objectivity
- The challenge of disclosure

Corporate Social Responsibility Reflects Culture

“Western-Style” CSR	“Japanese-Style” CSR
“7 Deadly Sins”	Shame culture, not a sin culture.
What are “anti-social activities”	Penalize “anti-social activities.”
Financials in foreign languages?	Communication with non-Japanese shareholders important.
No “peak season” for shareholders meetings	70-80% of companies hold meetings within five days of “Peak Week” in June
Supplier relations and human rights.	Supply chain issues only beginning to be reviewed.
Animal testing	CSR is for people
Broad conception of “minorities” and minority rights.	Notion of a “homogeneous” society still prevalent. Opportunities for women main focus.
Privacy not a priority.	Compliance with privacy laws has become a focal point.

Catalysts for SRI in Japan

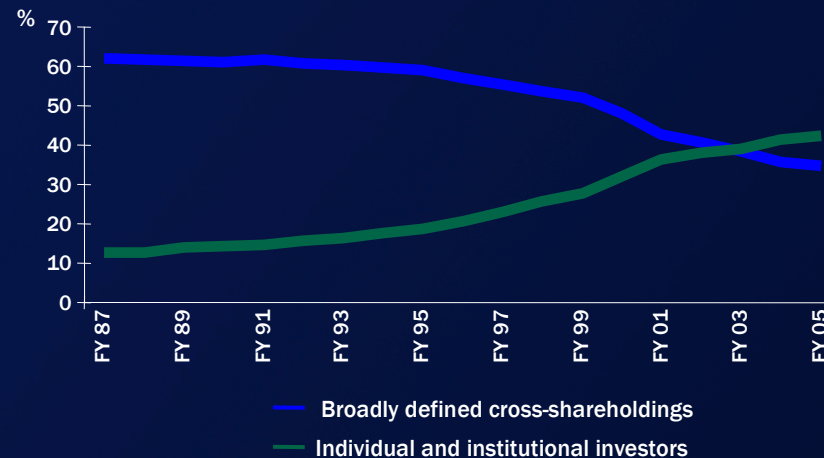
- Started as a retail phenomenon and extending to pension funds
 - Over 20 domestic retail funds with AUM of JPY 246 billion as of September 30, 2006.¹
 - Early SRI was “Eco-focused”; recent broadening to ESG.
- Spurred by corporate scandals -- Kanebo, Snow Brands, Seibu, Livedoor
 - CalPers and Pension Fund Association corporate governance funds
 - Unwinding of cross-shareholdings and increase of foreign ownership raise free float and shareholder influence
 - Corporate Social Responsibility boom in corporate Japan

Source: Lipper

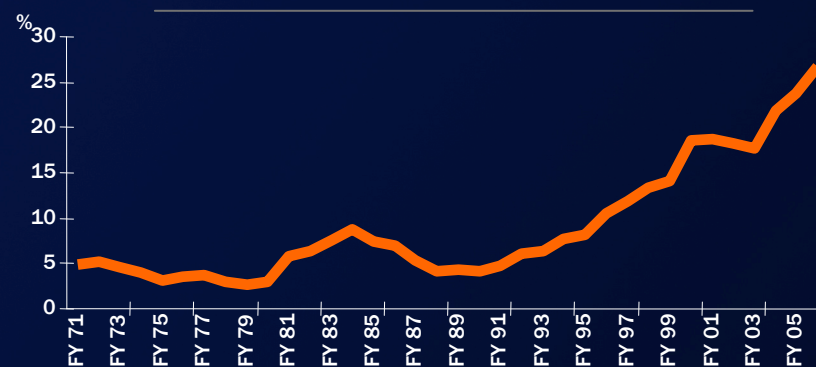
Opportunity to Influence Corporate Behaviour

- Unwinding of cross-shareholdings
- Rise of foreign ownership
- Engagement among large institutional shareholders is growing
- More active proxy voting

Unwinding of Cross-Shareholdings



Rise in Foreign Ownership



Socially Responsible Companies CAN Outperform



Toyota Motor Corp

- Well established corporate governance structure
- Highly respected for environmentally friendly products
- Community contributions (Lead sponsor of 2005 World Expo)

Mitsubishi Motors

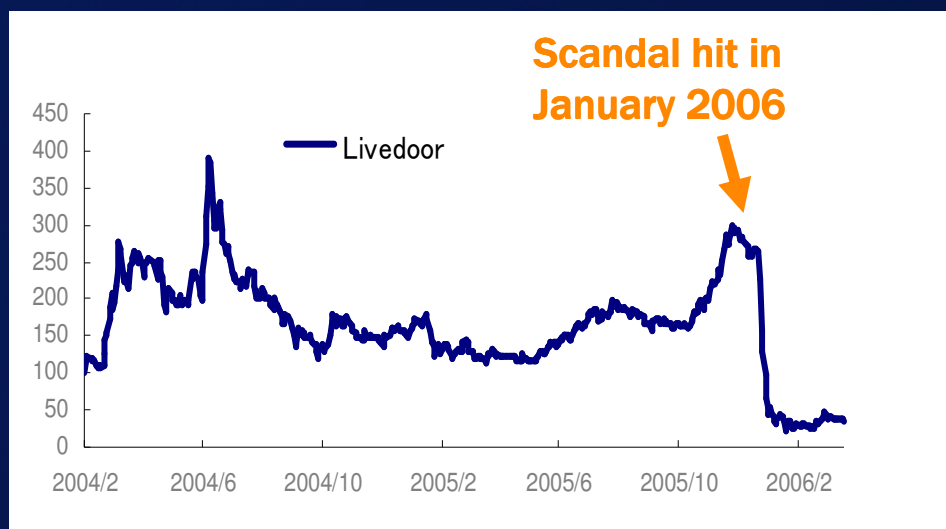
- Clutch defect contributed to accidents and fatalities
- Failed to recall vehicles
- Filed false safety reports with regulators

SRI as Downside Protection

- Japan is becoming more shareholder oriented
- Companies are more ROE-conscious
- Dividend payouts are increasing

...BUT a focus on short-term profits can also lead to shortcuts and scandals which undermine shareholder value

Livedoor



- CEO's dynamic personality and flair for acquisitions overshadowed non-transparent governance and poor disclosure
- Livedoor executives, including President and CFO, arrested in January 2006 for security fraud
- Stock delisted from Tokyo Stock Exchange on April 14, 2006

Source for text: Nikkei: Institutional Shareholder Services

Data source: Bloomberg, as of September 2006. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

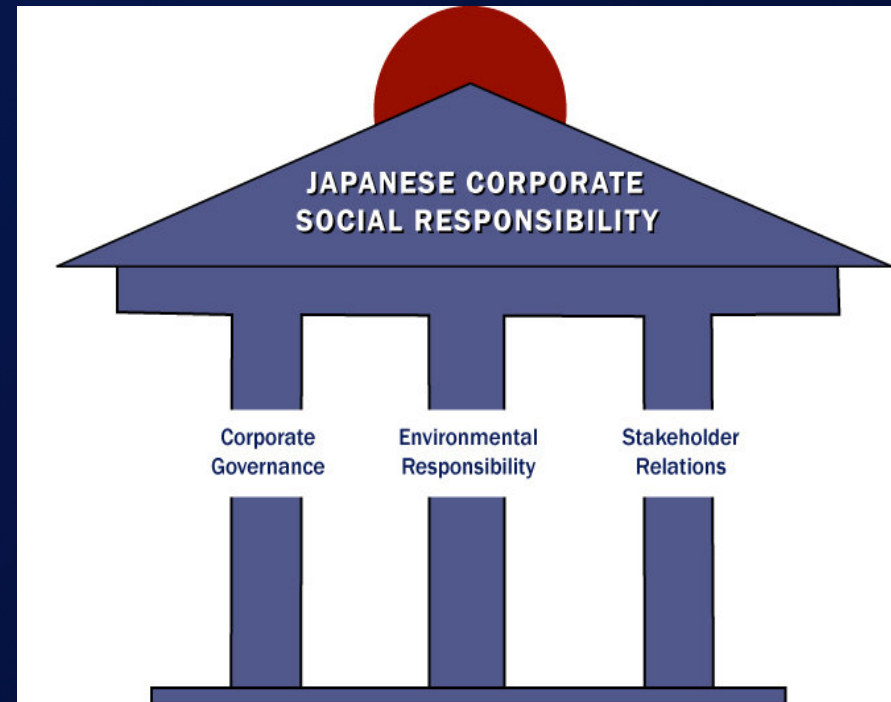
AIGGIG's Approach to SRI in Japan

We believe there are three pillars to a company's social responsibility...

- Corporate governance structure
- Environmental policies and performance
- Relationship with stakeholders

... and that a successful SRI approach must incorporate

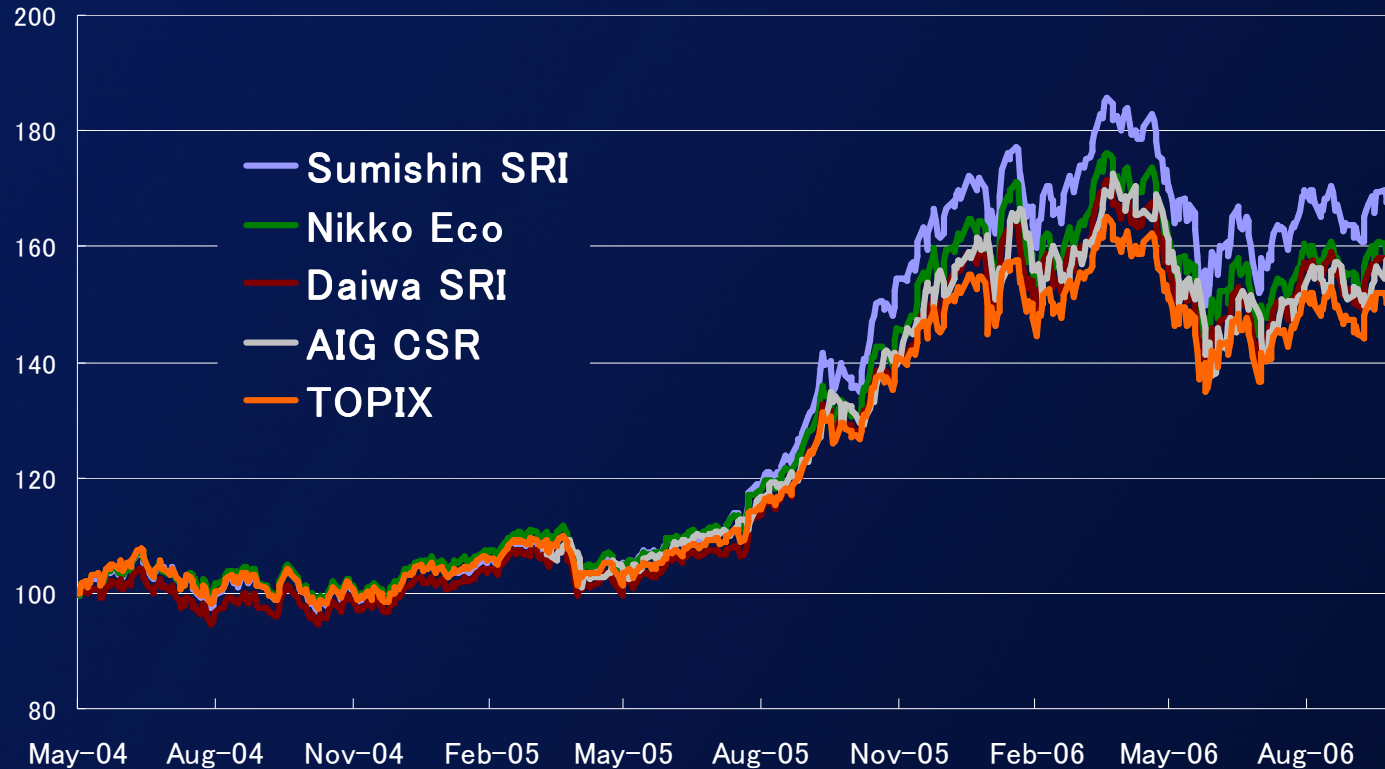
- Objective research
- Evaluation criteria relevant to the Japanese market
- Positive screening techniques
- Active portfolio management



Sample Investment Process



SRI Funds Performance in Japan



Full names of funds shown: Sumishin SRI Japan Open; Nikko Eco Fund; Daiwa SRI Fund; AIG/Resona Japan CSR Fund.

Data source: Bloomberg, as of October 2006. For illustrative purposes only. All Funds and TOPIX includes dividends.
AIG/Resona Japan CSR Fund started in March 2005. We are not soliciting or recommending any action based on this material.

Final Thoughts - Challenges for SRI

- Empirical data on outperformance is mixed
- Difficult to place an accurate value on the social benefits of SRI
- Regulations encouraging SRI limited to European markets for now
- Quantity of corporate disclosure over quality of corporate disclosure

Should SRI Focus Only On Value Drivers of Share Prices?

What do you consider “material”?

Conclusion

“The justification for acting is not as important as the action itself.”

Introduction to the UNEP Finance Initiative “Show Me The Money: Linking Environmental, Social and Governance Issues to Company Value.”

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