Socially Responsible Investing in a Student-Managed Investment Fund: A Case Study

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Abstract

Effective incorporation of socially responsible investing (SRI) into student-managed investment fund (SMIF) programs is discussed in the context of a case study. The experience of the example SMIF suggests some techniques to enhance the learning experience. These include: students developing their own SRI policy; team-based discussion to draw out a range of viewpoints, and capture the values of the students and broader society; integration of SRI into investment analysis and decisions, whilst limiting reliance on environmental, social and governance (ESG) ratings; and fostering awareness of the context in which the SMIF operates, including the SRI policy of the sponsoring university and how SRI intersects with reputation risk. Focus on sustainability can be enhanced by setting long-term objectives, establishing key values that are linked to grades, and adopting an overlapping student cohort structure where seniors instruct juniors. A central theme is that embracing and directly addressing the subjective nature of SRI provides opportunities for deep learning by students.

Keywords: Socially responsible investing, ESG, student-managed investment funds

JEL Codes: A13, A20, G11, G23, I23

Key Highlights

- Incorporation of socially responsible investing (SRI) into student-managed investment fund programs is discussed in the context of a case study – the Student Managed Fund of the Australian National University.
- Recommendations include: students developing their own SRI policy; team-based discussion; integration of SRI into investment analysis and decisions; giving consideration to the university's SRI policy and reputation risk; and structuring to maintain and reward a focus on the long term.
- The subjective nature of SRI should be embraced and directly addressed as an opportunity for deep learning by students.

Socially responsible investing (SRI) has become mainstream. A global survey by Philips, Ovalle and Zhao (2021) indicates that 80% of investment managers were signatories to the United Nations-supported Principles of Responsible Investment in 2021, with around 90% including environmental, social and governance (ESG) considerations in their processes. Of interest is how SRI might be incorporated in student-managed investment fund (SMIF) programs to enhance both the investment process and the learning experience, and ultimately cultivate graduates that are better prepared for a financial market career. Against a background where SMIFs vary considerably in the context, scope and implementation of their activities (see Bruce, 2020; Abukari, Oldford and Willcott, 2021), this article draws on insights from the progressive adoption of SRI by the Student Managed Fund (SMF) of the Australian National University (ANU). The first aim is to convey how the SMIF learning experience can be enhanced by requiring students to engage with SRI. The second is to identify features that improve the effectiveness of incorporating SRI within SMIF programs, and perhaps even investment organizations more broadly.

A number of themes emerge from the experience of the ANU SMF, most of which relate to students coming to recognize and embrace the subjective nature of SRI evaluations and the consequent need to exercise judgment. The students discovered that SRI issues are rarely black-and-white, and can give rise to considerations that extend beyond investment effects to potential interactions with personal values, social values and reputation risk. They found that SRI is more effectively addressed by integrating SRI considerations into investment analysis and decisions, while placing limited reliance on ESG ratings. Another theme is that there are considerable learning benefits in requiring students to design their own SRI policy and evolve it over time; and then implementing that policy in a team context. Indeed, group discussion has proven an effective mechanism to draw out a range of viewpoints and insights, and capture the values of both the students and broader society. The central message is that the subjective nature of SRI should be embraced as an opportunity for deep learning. Finally, the experience of the ANU SMF suggests some features that can help sharpen the focus on sustainability. These include: setting long-term objectives; basing assessment around working towards a set of key values rather than fund performance *per se*; and structuring the program around overlapping student cohorts where seniors instruct juniors.

This article contributes to the growing literature on SMIFs as successful form of experiential learning (Kolb and Fry, 1974) that has become increasingly common within the university sector. Abukari, Oldford and Willcott (2021) provide a recent review of the extant literature. Two directions they highlight where further research is required are analysis of SMIFs outside of the US and examination of innovations, including the incorporation of ESG. This article helps fill these two gaps. In doing so, this article adds to a small number of studies that have addressed the application of SRI or ESG in the context of SMIFs. Saunders (2008) surveyed SRI practices in religiously affiliated colleges and universities. Clinebell (2013) describes the investing process of an SRI-focused SMIF being run in parallel with an investment-focused counterpart. Saunders (2015) describes how one SMIF implemented certain shareholder engagement activities, including proxy voting and writing a shareholder proposal. Incorporation of ESG ratings into SMIF investment processes is described by both Ascioglu, Saatcioglu and Smith (2018) and Ghosh, Gilson and Rakotomavo (2020); while Brune and Files (2019) discuss the use of biblical screens by one SMIF. Ascioglu and Maloney (2020) discuss deeper ESG integration in the context of one SMIF, where ESG ratings are supplemented by further analysis. Closest to this article is Oldford, Willcott and Kennie (2021), who argue for including ESG considerations within SMIF programs for the pedagogical (i.e. learning) benefits. These authors describe the ESG framework of one SMIF, including student development of the framework, integration of SRI considerations into stock analysis and recommendations, and group discussion. In addition to providing further support for the value of these aspects, this article highlights the benefit of embracing subjectively as a learning opportunity, giving consideration to the context in which the SMIF operates, and structuring the program to support a sustainability focus.

This article commences by outlining some notable features of the ANU SMF, before describing its SRI policy, including its initial development and ongoing evolution. The manner in which SRI considerations are integrated into the analysis and selection of investments is then discussed. This is followed by selected examples that draw out the broad-ranging nature of the SRI issues identified and analyzed by students, and how this contributes to learning. Each section describes the situation and issues arising. A summary offers some final reflections.

KEY FEATURES OF THE ANU SMF

The ANU SMF manages a small slice of the University's endowment fund, with assets under management (AUM) of around A$800,000 (about US$575,000) as of late-December 2021. The Fund is perpetual, and pays a distribution of 4.5% per annum in support of a scholarship for disadvantaged students. The ANU SMF is set up as a two-semester (i.e. one-year) course for credit, under the supervision of two convenors who effectively act as mentors and advisers. Students propose investment recommendations to an Investment Advisory Committee (IAC) comprised of industry practitioners. Recommendations that are endorsed by the IAC are implemented by the Fund Convenor, who holds the delegated authority to trade on behalf of the Fund. The governance structure ensures that the students effectively manage the portfolio and make all investment decisions, without having direct control over the assets.

The ANU SMF has some distinguishing features that are relevant in the current context. The Fund is structured as an asset owner, comprising four sub-teams that are led by a student Chief Investment Officer. The Active Australian Equities Team invests around half of the AUM in a concentrated portfolio of Australian stocks. The Asset Allocation Team manages the other half of the AUM by investing in asset class based ETFs, which facilitates shifting the Fund's overall asset weights relative to a reference portfolio comprising 80% in growth assets (equities) and 20% in defensive assets (cash and fixed income). The Risk and Compliance Team is responsible for risk oversight, compliance with investment policy, performance measurement and evaluation, and monitoring for signs of behavioral biases. The Risk and Compliance Team is the primary custodian of the SRI policy, and includes a dedicated SRI analyst among its ranks. Finally, the Relationship Team handles external engagement and reporting.

Three aspects of the Fund's structure encourage a focus on long-term outcomes and hence sustainability. First is the long-term nature of the investment objective and processes. The investment objective is to maintain the real value of the corpus and thus distributions while limiting the risk of permanent loss of capital. This objective implies targeting a real return of 4.5% per annum over the long run, in line with the specified distribution rate. Stock selection emphasizes long-term cash flows and value creation, with valuations based on discounted cash flow (DCF) techniques. SRI considerations are integrated into the investment process at the stock filtering, company analysis and then security selection and portfolio construction stages. Asset allocation references 10-year capital market return assumptions across assets, which are estimated using DCF-based models that capture projected cash flows and discount rate trajectories across a range of macro scenarios. The emphasis on long-term outcomes and avoiding permanent loss encourages giving close consideration to issues of sustainability.

A second aspect is the Fund's five key values of 'legacy', 'contribution', 'team', 'objectives' and 'long-term'. Student grades are primarily based on the pursuit of the key values rather than fund performance over their enrollment period, thus establishing an incentive system that encourages undertaking actions to improve long-term outcomes. For example, students are rewarded for undertaking activities that leave a legacy for the future (such as training juniors; improving the Fund processes); contributing to the team effort; and working towards the Fund's objectives while maintaining a long-term perspective. The key values and their link to incentives has supported a solid culture focused towards achieving the Fund's ongoing mission.

The third aspect is overlapping student cohorts. Students learn the ropes as a junior in their first semester, then take on a senior role in their second semester that explicitly involves teaching and mentoring the new juniors. This feature was initially introduced to support organizational knowledge transfer, but has also encouraged students to take on responsibility for furthering the Fund's ongoing mission in their senior semester. The overlapping cohort structure has acted in combination with the key values to encourage and reward a sustainability mindset with respect to the SMF and its investments, as the students come to view themselves as transient stewards within an organization that has a long-term purpose.

The ANU SMF is a team-based operation, with every investment recommendation and policy proposition being subject to team discussion and voting. The team culture has proved particularly relevant for getting the most out of the discussion of SRI issues, as is also noted by Oldford, Willcott and Kennie (2021). Canvassing viewpoints from all team members enriches SRI discussions through drawing out additional insights and helping unearth all the key issues. Group discussion can also reveal the values of the student team, and reflect on the values of society at large. This is particularly relevant given that community expectations may impact on social license to operate, and can have implications for reputation risk. Buy-in is also enhanced by applying an SRI policy in a team context, as all students feel part of the process.

DEVELOPING THE SRI POLICY

This section describes how the ANU SMF SRI policy has been developed over time, transitioning from mimicking the University's approach, to the students ultimately crafting and continuing to evolve their own SRI policy. The main takeaway is that student involvement in the development and implementation of their own SRI policy can provide an opportunity for deep learning through exposure to the subjective nature of SRI and its various nuances and challenges.

The University's SRI Policy – The Starting Point

Given that the ANU SMF manages a slice of the ANU endowment funds, maintaining consistency with the University's SRI policy is a minimum requirement. The University's 'official' SRI policy is framed in general terms, and includes four main conditions. These can be paraphrased as: (a) avoid investments considered likely to cause substantial social injury; (b) favor investments that support socially beneficial outcomes; (c) achieve a significant reduction in the overall carbon intensity relative to industry benchmarks; and, (d) invest where the greatest return is achievable for the greatest social good.

The ANU itself uses external managers, making it necessary to translate the University's SRI policy into manager mandates. At the time that the ANU SMF was established in 2017, the University was employing an active quant manager in Australian equities. This manager was given a mandate to exclude companies deriving more than 20% of revenues from coal, gambling, tobacco or pornography; ensure that the portfolio had 30% less carbon intensity than the S&P/ASX200 index benchmark; and deliver a 10% improvement in the overall portfolio ESG rating relative to the benchmark. The SMF initially constructed its Active Australian Equities portfolio subject to these conditions coupled with the undertaking not to actively invest in any stock that was deemed 'likely to cause substantial social injury'. Thus the portfolio was initially formed under a combination of industry exclusions, quantitative constraints and a subjectively-applied condition related to social injury.

Subsequent Development of the SMF SRI Policy

It didn't take the students long to discover that simply mimicking the University's SRI policy was insufficient for the Fund's purposes. First, the use of ESG ratings and the related 10% target improvement versus the benchmark were found to be unsuitable for reasons that will be discussed further below. This led to recognition of the need to delve deeper into ESG analysis and integration. Second, as instances of potential 'social injury' started to be encountered, it was unclear to the students how to proceed in determining what might constitute a contravention and how it should be handled. There was also the challenge of maintaining consistency over time as the student team rolled over. It thus became apparent that a set of clear principles and procedures was required. Third, team members had their own views on what activities should be supported or avoided under the SRI policy, i.e. they wanted the portfolio to reflect their own values, not just the University's. These three realizations indicated that the ANU SMF needed its own SRI policy.

The task of proposing an SRI policy was taken on by two students who were members of the Risk and Compliance and Equities teams. A comprehensive SMF SRI policy document was drafted after undertaking research, consulting with industry experts and seeking input from the rest of the Fund. The policy was put to a team vote and subsequently endorsed by the IAC as a sub-component of the Fund's Investment Policy Statement in April 2020.

A foundational task was to set out the aims of the policy, which are summarized in Exhibit 2 further below. Here the general tenor was to balance 'profit' and 'purpose' by addressing the implications of SRI considerations for portfolio returns while reflecting SRI values in the portfolio. This took the SMF policy beyond that of the University by requiring students to directly address the implications of SRI matters for risk and return, thus paving the way for SRI integration.

As well as establishing general aims, core requirements were set out that the students would be required to deliver. These are listed in Exhibit 1. The first three requirements reflect the exclusionary elements of the University's policy, including industry exclusions, a carbon intensity target and the catch-all requirement to avoid companies that are likely to cause an unacceptable level of social injury. The main adjustment to the exclusionary components was to expand the industry exclusions to include armaments and exploitative lending practices. The latter was added after researching and discussing a company that was involved in a form of payday lending. The policy retained a general requirement to favor investments that create social benefit, in line with the University's policy. However, the students decided to make the constructive elements of the policy more targeted and tangible by adding a fifth requirement nominating a set of sustainable business practices that they wanted to support under 'E', 'S' and 'G' headings. These included E: climate change action; S: equity, diversity and inclusion; and G: corporate trustworthiness. The incorporation of additional industry exclusions and supported business practices operate as mechanisms to reflect the values of the students involved, helping to engender buy-in. The intention is to review both excluded and supported practices at least one per year.

EXHIBIT 1
SRI Policy of the ANU SMF – Core Requirements (2021)

Requirement	Notes
1. Exclude companies that derive more than 20% of revenues from adult entertainment, alcohol, armaments, coal, gambling, tobacco or exploitative lending practices.	Industry exclusions are expanded beyond those identified in the University's policy
2. Hold an active equity portfolio with 30% less carbon intensity than the S&P/ASX 200.	In line with the University's policy
3. Avoid investments that are likely to cause an unacceptable level of social injury.	Applied in forward-looking manner and by exercising considerable judgment
4. Favor investments that create social benefit.	May impact on decisions at the margin; main focus is activities listed under requirement 5.
5. Preference companies engaged in selected sustainable business activities and practices, as determined by the Fund: E. climate change action S. equity, diversity and inclusion G. corporate trustworthiness, including transparency, compliance and accountability	Aimed at targeting the social benefit element towards activities that the student team wishes to actively support

A major advantage in formulating a comprehensive SRI policy relates to the creation of a policy document that addresses matters of governance and procedures, in addition to the core requirements of the policy as outlined in Exhibit 1. The other matters addressed in the SRI policy document are listed in Exhibit 2. The policy document itself spans 20 pages in total, with the official policy set out in the first three pages followed by 17 pages of appendices that provide guidance and direction on how the policy should be implemented. The official policy includes: a description of the policy aims; scope of application; core requirements; the use of ESG ratings; responsibility and accountability; management of breaches; reporting requirements; and policy review procedures. The appendices detail the University's SRI policy; estimation of metrics, such as carbon intensity; SRI processes at the candidate stock identification phase; guidance on use of ESG ratings; methods for integrating SRI considerations into stock analysis, valuations and recommendations; SRI-based ETF review procedures and criteria; and policy compliance checklist and procedures. (Some matters are covered by other Fund documents, such as voting procedures.)

EXHIBIT 2
SRI Policy of the ANU SMF – Matters Covered in the Policy Statement

Matter	Main Points

Policy aim	• Enhance the search for opportunities that are both 'profitable and purposeful', and prudently reflect SRI values in the portfolio • Support business practices that are beneficial and sustainable, while discouraging those that may cause social injury • Address implications of SRI considerations for portfolio returns
Scope of application	• Applies to active stock positions within the equities portfolio • Intention to transition to SRI-focused ETFs within the asset allocation component. Substitute ETFs should be sufficiently aligned with the Fund's SRI policy and representative of the asset class; and listed on the Australian stock exchange.
Core requirements	• Detailed in Exhibit 1
Use of ESG ratings	• ESG ratings to be monitored but not targeted • Low ratings viewed as flagging need for further investigation
Responsibilities and accountability	• Risk and Compliance Team has primary responsibility for policy oversight, monitoring and compliance • Active Australian Equities Team to ensure that SRI considerations are taken into account in stock analysis and selection • Asset Allocation Team monitors for SRI-based ETFs
Breach management	• When a possible breach of the policy occurs, it is declared as either a 'clear breach', 'potential breach' or 'no breach' • Any 'clear breach' requires remediation as soon as possible • If ambiguity exits, a 'potential breach' is declared. A review is undertaken to decide between a 'clear breach' and 'no breach'.
Reporting	• Reporting requirements are detailed, including to the University
Policy review	• Procedure for undertaking reviews and revisions to the policy
Appendices	Implementation guidance and references, coving the following: • University SRI policy and its implementation • Estimation of metrics, e.g. carbon intensity • Process for conducting SRI reviews of candidate stocks • Use of ESG ratings, including key items to consider • Methods for integrating SRI considerations into stock analysis, valuations and recommendations (including direct incorporation into cash flows, running scenarios, or adjusting the discount/hurdle rate) • SRI-based ETF review procedures and criteria • Policy compliance checklist and procedures

The experience of the ANU SMF highlights the numerous advantages in students formulating their own comprehensive SRI policy document covering core principles, governance and procedures. The policy has proven invaluable for providing direction and maintaining continuity as student team members change over time. More importantly, the act of formulating the policy and then implementing and keeping it under review has been a valuable learning experience. It has given students exposure not only to SRI, but also the role of governance and the importance of process. In addition, formulating their own policy provided a sense of ownership.

Experiences with Implementing the Policy

Implementing the SRI policy was a journey of discovery and learning, especially with regard to building appreciation for the subjective nature of SRI and the importance of due process. While a sense of these experiences is provided through the examples presented further below, two aspects are worth highlighting at this stage: the challenge of grappling with the concept of social injury, and the role of a breach management procedure.

The concept of ‘likely to cause an unacceptable level of social injury’ has proven the most contentious component of the policy, spurring the most wide-ranging discussions and greatest disagreement. The students have discovered that it is not always straightforward whether an action has caused social injury, or whether any apparent injury has reached an ‘unacceptable’ level. Another issue is whether injury should be weighed up against any social benefit created by a company. Furthermore, the words ‘likely to cause’ imply that the policy should be applied in a forward-looking rather than backward-looking manner. That is, identifying that injury has occurred in the past is not sufficient to preclude an investment if the problem has been addressed and future injury of a similar nature is unlikely. The students have needed to come to grips with these grey elements of the policy and form their own judgements. The examples below illustrate how grappling with the ambiguous nature of social injury provided some deep leaning experiences.

The need for a breach management procedure became apparent after the Fund started encountering SRI issues *after* the purchase of a stock, as a consequence of subsequent company actions. In such instances, whether a breach has occurred is not always immediately apparent. A procedure for managing breaches was needed that created space for investigation and discussion before taking any action. The ANU SMF SRI policy accommodates this by immediately declaring any possible breach that is detected as either a ‘clear breach’, a ‘potential breach’ or ‘no breach’. If a potential breach is declared, a SRI review is commenced with a view to assigning either a clear breach (the position is then liquidated) or no breach (position is retained). The analysis and discussions are summarized in a SRI Review report. The breach management procedure has proven effective by not only clearly setting out what needs to be done, but also creating the space to identify and discuss the key issues, thus providing further opportunity to learn.

ONGOING EVOLUTION OF THE POLICY

The previous section described the transition from following the University’s SRI policy to a student-formulated SRI policy that established aims, reframed the requirements, and introduced a governance structure and procedures. This section outlines how the policy and its implementation continued to evolve in response to experiences that generated new insights or highlighted shortcomings. The main message is that keeping an SRI policy under review can enhance both the policy and the students learning experience.

One development was transition towards a closer working relationship between the Active Australian Equities and Risk and Compliance teams when evaluating of the SRI credentials of candidate stocks. The motivation was a couple of instances where equities analysts had put considerable effort into analyzing a stock, only to see a buy recommendation voted down by the SMF team on SRI grounds. This drove home the message that SRI needed to be incorporated at the vanguard of stock analysis, especially when the SRI status of a company is unclear. Importantly, the situations where a stock was rejected did not involve equities analysts ignoring SRI considerations. Rather, the problem was differing interpretations being placed on the SRI issues by members of the broader team. Risk and Compliance now gets involved early in the process to provide both SRI analysis support and an independent opinion, prior to engagement over the key issues with the broader team. This development has not only improved the SRI process, but also deepened the learning experience through bringing forth a range of views informed by analysis that is undertaken independently.

Another development (currently in train) is the formal incorporation of reputation risk into the SRI policy. Reputation risk was already recognized within the Fund's foundational governance statement ('Charter and Governance Structure') as a key risk for which there is low tolerance. SRI discussions into whether a company might have caused social injury ultimately drifted into considerations of whether holding the stock might give rise to reputation risk. The question was whether the Fund and hence the University might be perceived as endorsing an activity that ran contrary to community values or expectations, being cognizant of the role that the university sector plays in broader society. For example, the SMF team struggled with a stock that had been involved in asbestos production and egregious corporate governance abuses in the 1990s, with one team member noting that the company was still being used as an example of appalling behavior in his law subjects. The Woodside example further below expands on how reputation risk associated with SRI considerations was influential in the ultimate decision not to proceed with a stock that otherwise appeared to be an attractive investment. Such experiences led to the conclusion that the connection between SRI and reputation risk needed to be acknowledged within the SRI policy, along with guidance about how it is to be treated.

Finally, the team has recently been discussing whether the SRI policy should be extended to engagement activities. This was triggered by a realization that social injury and reputation risk might be better tackled through engagement rather than avoidance. The concept is that engagement can contribute toward addressing SRI issues (as against passing on the responsibility), while putting the Fund on the front foot from a reputational perspective by being seen to be doing something about problems. It also aligns with the industry trend away from divestment towards active engagement, thus providing the opportunity to gain experience in an area of increasing importance. While engagement is currently an idea in its early stages, the team intends to investigate proxy voting, engaging directly with management and collaborating with SMIFs at other Australian universities. The account of Saunders (2015) confirms the feasibility of SMIFs getting involved in engagement.

INTEGRATING SRI INTO STOCK SELECTION

The shift towards integration was prompted by the realization that the requirement for a 10% improvement in ESG ratings was imposing a significant constraint on the portfolio, while proving ineffective in achieving the goal of aligning the portfolio with sustainable business practices. A key issue was a size bias in ESG ratings. The students were finding value in smaller stocks where ESG scores are typically lower (see Doyle, 2018), in part because smaller companies do not have the resources to address all components included in the ratings. The Fund was also encountering smaller companies without ratings. More poignantly, some of the smaller companies with low ESG ratings appeared to have solid SRI credentials, while important SRI issues were emerging for larger companies with relatively high ESG scores (see Rio Tinto and Westpac discussion further below). It became apparent to the students that ESG ratings could not be relied on as a comprehensive indicator of a company's SRI credentials, and that it was necessary to delve deeper to identify and understand the key issues. Other considerations encouraging a move away from relying on ESG ratings included their backward-looking nature in light of a forward-looking policy, differences in scores across providers; and the difficulty of discerning their value-relevance. It was decided that ESG ratings would be relegated to a reference point and a flag of potential issues, and replaced with integration of in-depth SRI analysis into the investment case.

Brune and Files (2019) describe a similar transition in the use of biblical screens by a faith-based SMIF.

The ANU SMF commences its SRI analysis at the candidate stock identification phase of its process. After applying industry exclusion and other filters, the team arrives at a group of stocks that may be of interest. At this stage, the Risk and Compliance and Equities teams collaborate to identify and investigate any SRI issues, which are then presented and discussed with the broader team. An evaluation is made at this stage on whether a company is likely to cause an unacceptable level of social injury, and hence should be precluded as a potential investment.

Having passed the initial SRI hurdles, the next challenge is incorporating ESG considerations into the company model and valuations. The SRI policy provides guidance by suggesting three approaches: incorporation into forecasts where ESG factors have likely and identifiable cash flow effects; scenario analysis where ESG effects amount to potential rather than likely outcomes; and adjusting the discount rate where important ESG considerations are evident that are inherently difficult to translate into identifiable cash flows. SRI issues, analysis and any conclusions are included in stock recommendation reports and presentations. An SRI risk matrix is also compiled by the Risk and Compliance team, and included in the appendix of stock reports.

EXAMPLES

We now present accounts of how the ANU SMF student team addressed SRI for a selection of stocks. The aim is to convey the breadth and depth of the discussion, and hence give some sense for the learning gained through grappling with fuzzy concepts. The accounts underline how group discussion can draw out social and team values; what it means to apply an SRI policy in a forward-looking manner; and how reputation risk can come into play.

Coca-Cola Amatil

In 2019, the SMF team was considering investing in Coca-Cola Amatil, whose core business at the time was the Coca-Cola bottling licenses for Australia and Indonesia. The proposal led to a lively discussion over the health issues that may arise from high sugar consumption, and how this related to both social injury and the longer-term drivers of the company's business. Regarding social injury, although the company had been awarded a high ESG rating, the point was raised that it might be considered as causing harm by contributing to obesity and related health complications. Other team members disagreed, expressing the view that the company's other socially beneficial initiatives offset their negative contributions, especially as their diversified product range includes water and kombuchas. While no clear consensus emerged that the company was causing social injury to an extent that precluded investment under the SRI policy, there was nevertheless some unease within the team.

In terms of the business effects, concerns were expressed over potential for a socially-driven shift away from high sugar products. Some team members expressed the opinion that Coca-Cola's brand equity is actually overstated due to movement towards health-conscious consumer decisions. Further, potential cannibalization of revenues was identified as a risk if consumers switched away from the company's high-sugar products to its healthier alternatives. On balance, it was decided that retention of the current customer base through a different mix of products was probably the best-case scenario, which in turn would be unlikely to generate sufficient growth in customers, revenue and cash flows to justify the share price. The team decided not to pursue the stock.

Westpac Banking Corporation and Rio Tinto

Westpac and Rio Tinto were two companies held by the Fund that were placed under SRI reviews following transgressions in 2019 and 2020, respectively. In both cases, the transgressions had adverse social impacts, and stemmed from failures of governance. The ultimate outcome was that Westpac was retained and Rio sold by the Fund. The distinction stemmed in a large part from evaluating the potential for social injury in forward-looking manner.

Westpac is a major Australian bank that was alleged by the regulator during November 2019 to have breached anti-money laundering and counter-terrorist financing laws on approximately 23 million occasions involving nearly $12 billion in transactions. Westpac had failed to adequately monitor transactions involving correspondent banks, which led to the facilitation of child exploitation in South-East Asia. Rio is a large resource company with the majority of earnings derived from iron ore. In May 2020, the company detonated explosives in expanding an existing iron ore mine that led to the destruction of an important indigenous cultural site in Western Australia (Juukan Gorge). The company was very heavily criticized for this action, which ultimately led to the CEO and two other executives stepping down and the subsequent replacement of some Board members.

The ANU SMF responded to these events by placing each company under SRI review. This involved the Risk and Compliance Team undertaking fact-finding and analysis, followed by SMF team discussion. These discussions commenced by addressing the severity and magnitude of the social injury. They then turned to how the transgressions came about, and what they signaled about the governance and values of the company, and hence the potential for further problems to occur. Investment implications were also considered, including stock valuations and the impact on the overall portfolio. The team discussions were quite nuanced, with a surprisingly broad range of diverse opinions being shared. For both companies, the notion that they had been involved in meaningful social injury was not called into question. Rather, the pivotal matter was what the incidents implied for the likelihood of the emergence of further SRI-related problems.

For Westpac, two considerations calmed concerns. First was that the breach of the anti-laundering regulations involved no intent, but rather seemed to arise as a failure of systems and their governance. Second, the company responded by announcing a range of measures spanning the three areas of immediate fixes, lifting of standards and taking actions to protect people. In any event, the team concluded that no clear line could be established between this incident and the likelihood of additional social injury in future. A number of ancillary issues were also considered. First was whether responding to bouts of negative SRI news would set a precedent of becoming an (re)activist investor in a way that could impact on returns over the long-run. Second was the reputation risk involved with retaining a position in a stock that had contributed to social harm, which was deemed as low risk in this case. Third was the investment and portfolio implications, given that the stock was trading at below the team’s valuation at the time. The stock was retained.

For Rio, a key difference was that the incident appeared to involve an element of intent, or at least indifference to the social implications. SMF members highlighted the company's initial dishonesty, delayed response and lack of remorse at that time. They noted early signs of potential SRI issues in other Rio projects. Further, they detected signs of an attitudinal change within Rio's management team with respect to their social obligations relative to that seen in the past, including the company breaching its own policy to act in accordance with the UN Declaration of Human Rights. The SMF team concluded that these matters indicated a significant probability that Rio might cause further social injury going forward. With the company trading modestly above the team's valuation, a decision was made to sell.

Finally, it is worth noting that the ESG ratings of both companies were significantly better than the benchmark, in particular for Westpac. These episodes thus helped drive home the need to reduce reliance on ESG ratings and undertake deeper analysis.

Woodside Energy

Woodside is set to become Australia's largest producer of oil and gas following a merger with BHP Petroleum, with a production profile that is concentrated prior to 2035 and strongly tilted towards LNG exports into Asia. The SMF team was considering purchase during 2021 on the basis that the stock was cheap relative to its valuation, which in turn was supported by the majority of output occurring within a window of potential supply deficit in oil and gas before climate transition might begin to really bite. The decision to consider the stock was undertaken with full realization that the Fund would be purchasing a hydrocarbon company, notwithstanding the acknowledged need to address climate change. There was also ample room within the Fund's carbon intensity 'budget', given that other active positions demonstrated relatively low carbon intensity.

The SRI implications of holding Woodside were initially addressed in two ways. First, scenario analysis was undertaken to gauge the impact on cash flows from differing rates of climate transition, with a view to establishing that the investment case was robust to faster than expected climate action leading to lower product prices. Second, SRI analysis and discussion was conducted around the issue of whether Woodside might be considered to be causing social injury due to its contribution to global warming. The latter spurred considerable debate. On the negative side, the team recognized the status of the company as a hydrocarbon producer with high scope 1, scope 2 and scope 3 carbon emissions, as well as fugitive methane emissions. Mitigating arguments that were raised included: the role of gas as a lower emission source of energy that was supplanting coal during energy transition; the company's stated intention to transition towards a low emissions energy company (e.g., hydrogen); and the social benefit from supporting economic growth in developing nations, noting that they were inevitably going to use some form of energy regardless of whether Woodside existed.

Reputation risk loomed large in the discussions. A core issue was whether the Fund wanted to be seen investing in a hydrocarbon stock, and how this might be viewed by stakeholders such as ANU management or alumni. The team was also aware of a vote and petition led by the ANU student newspaper that was calling for the University to divest of all investment in fossil fuels. This highlighted that purchasing Woodside would be out of step with the values held by some in the wider student base, which brought with it the specter of bad press or even campaigns against the Fund itself.

Ultimately the proposal to purchase Woodside was (narrowly) voted down by the SMF student team. Comments provided as part of the process suggested that the dissenting votes reflected a combination of personal beliefs that the Fund should not be purchasing a fossil fuel stock and concerns over the reputational risk. The upshot was that a prospective investment was rejected due a combination of personal values and a recognition that reputation mattered. This episode underlined the subjective and social elements of SRI, and how team-based discussion and decision making can assist with drawing out these aspects. It was out of this episode that the idea arose of pursuing engagement rather than straight out exclusion, as a potential path for better reconciling SRI considerations with the investment objectives of the Fund.

FINAL REFELCTIONS

The SMIF literature highlights a range of benefits from incorporating SRI into SMIF programs, including a deepening of learning and acquisition of skills that are being increasingly valued by employers. The experience of the ANU SMF fully accords with these contentions, and highlights elements that might be introduced to enrich learning. In particular, the learning experience can be deepened significantly by creating an environment where students directly address the subjective and nuanced nature of SRI. Such an environment may involve students formulating and maintaining their own SRI policy; integrating SRI into the investment analysis, rather than relying on ESG ratings; and addressing issues in a group context. Indeed, group discussion can be particularly helpful for drawing out differing viewpoints and new insights, and gaining an appreciation for the values of society or the students themselves.

Another message is that a SMIF needs to be cognizant of the environment in which it operates when designing and implementing an SRI policy. In addition to the implications for risk-adjusted returns, the polices of the sponsoring university and the values of society may also be relevant. These aspects can impact on a SMIF’s own brand and possibly ‘license to operate’, and potentially intersect with reputation risk under the expectation that a SMIF operating under the name of a university should invest in line with community expectations. Team discussion can help to guard against the risk of falling short of these expectations, and ensure that the Fund invests in a way that is purposeful as well as profitable.

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