

SOCIALLY RESPONSIBLE INVESTMENT: TOWARDS SUSTAINABLE GROWTH

The recent conference on Socially Responsible Investment (SRI) in Luxembourg provided an opportunity to shed light on a sector still in its infancy but with promising potential. Indeed, the assets managed under SRI criteria have doubled between 2005 and 2007, a rise that could still accelerate in the current conditions, boosted by a disoriented market seeking strong ethics, good governance and transparency. As the leading domicile for investment funds in Europe, Luxembourg intends to contribute fully to this growth.

Organised by the Association of the Luxembourg Fund Industry (ALFI), the SRI conference held on 15 January 2009 attracted around 120 attendees and gathered together a diversified panel of speakers including asset managers, bankers, academics and politicians.

But what does SRI really mean? In its broader sense, SRI is a generic term covering ethical investments, responsible investments, sustainable investments, and any other investment process that combines financial objectives with concerns about environmental, social and governance (ESG) issues.

SRI origins can namely be traced back to the 18th century when a community of Quakers decided to prohibit their members from financially participating in slavery and human trafficking activities. For a long time, SRI remained almost exclusively concentrated in the United States and it is only since the turn of this century that a significant geographical shift can be seen since, in less than five years, Europe increased its market share in SRI funds from 16% in 2003 to 53% in 2007,

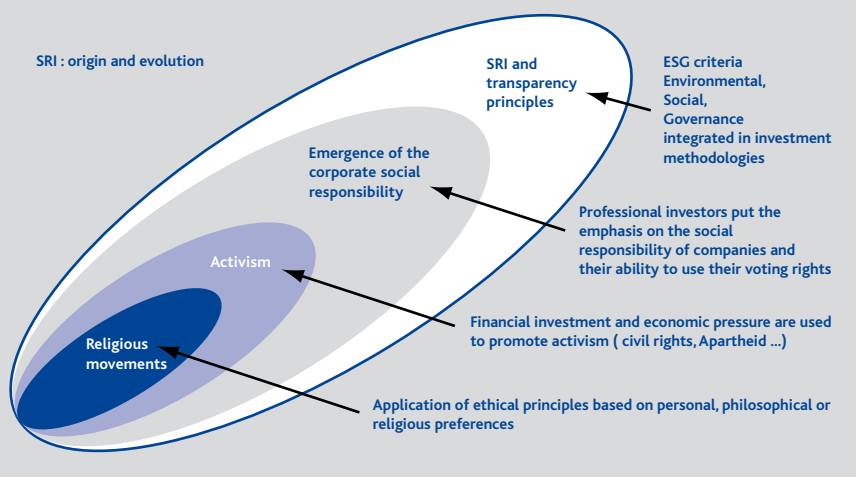


in a market worth around USD 5,000 billion euros under management. Furthermore, the share of SRI funds (broadly defined) within Europe is steadily rising and, according to European Sustainable Investment Forum (Eurosif) data, probably reached 17.6% of the asset management industry by the end of 2007.

In Europe, currently around 75 % of investment funds distributed in at least three countries are Luxembourg-domiciled. Hence we believe that Luxembourg is well placed to become a key player in the development and promotion of SRI funds. The financial centre has built its leadership on a solid banking presence, strengthened by a long tradition of regulatory innovation. In the SRI universe, this can be illustrated by the establishment in 2006 of the LuxFLAG agency, which grants a label to microfinance investment funds that meet pre-defined criteria. This government-backed initiative has proven very successful and today, Luxembourg is considered as one of the main European actors in this field, with over 800 million euros managed in Luxembourg-domiciled vehicles.

Apart from microfinance, ethical investment in Luxembourg is still in its infancy, as shown by the etika

SRI : origin and evolution



guide on responsible investment. This guide lists 109 Luxembourg-domiciled funds which take social and environmental criteria into account; a relatively low figure compared to the size of Luxembourg fund market. However, let us not forget that thematic funds are enjoying positive growth. These funds may focus on sectors such as water or energy, or issues such as the transition to sustainable development and a low carbon economy.

Nevertheless, if SRI remains a niche product that has not yet attracted all investment firms, the increasing interest by both institutional and private investors should help stimulate the sector. The current negative image of the financial world could also act as a catalyst - by stimulating the restoration of a climate of trust and transparency. What better way to achieve this than

by fostering the values of sustainable investment? Given that we believe the SRI sector's main constraint is its lack of visibility, increased willingness to promote it should help better exploit its potential.

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LOOKING FOR A SAFE INVESTMENT? THINK ABOUT *LETTRES DE GAGE*!

Luxembourg has innovated by introducing moveable *lettres de gage* that are guaranteed by rights in or security interests over aircraft, boats or railway equipment recorded in a public register.

Traditionally guaranteed by rights in or security interests over real estate or claims against public entities, *lettres de gage* (in German: *Pfandbriefe*) have been considered for decades as a secure investment. Created in Prussia in 1769, *lettres de gage* seem to be perfectly safe financial instruments. Indeed, since their creation, no German *lettre de gage* has defaulted. This extraordinary track record is due to the particularly regulated legal framework for *lettres de gage* that, among other characteristics, distinguishes *lettres de gage* from ordinary asset backed securities (ABS), and in particular mortgage backed securities (MBS).

In Luxembourg, the regime for banks issuing *lettres de gage* was introduced in 1997 with a law amending the 1993 banking law and has since been improved. To our knowledge, no Luxembourg *lettre de gage* has ever defaulted.



Different categories of *lettre de gage*

A *lettre de gage* is a debt security issued by a bank issuing *lettres de gage* and guaranteed by a cover pool specifically allocated to these securities. Unlike ABS, *lettres de gage* are on-balance-sheet for the issuing bank,