UNEP Finance Initiative
Innovative financing for sustainability

CONSIDER US
Rock singer and children speak out on climate change
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0.618...

UNEP FI, Issue 9, October 2009

The golden ratio... building quantity without sacrificing quality

Financing change, Changing finance

Coming just six weeks ahead of the landmark United Nations Climate Summit in Copenhagen, UNEP Finance Initiative's 2009 Global Roundtable in South Africa, "Financing change, Changing finance", comes at a critical point.

The voices of African finance, as well as the continent's vibrant business community, need every opportunity to be heard in the global climate change debate. This event in Cape Town, convened with UNEP's over 180 financial institution partners from around the world, is the perfect platform for the views and opinions of the African and global financial community to be crystallized ahead of the UN meeting in Denmark.

Naturally, we are delighted that the Government of the Republic of South Africa, and co-hosts such as the Banking Association of South Africa, have given such committed support to this UNEP FI event.

I know that UNEP's Green Economy Initiative will form an important part of the Cape Town discussions as will the challenges and opportunities our financial service companies and capital markets face in coming decades as we transition to a global economy based on a low-carbon, clean energy and greentech foundation, to underpin all commercial, industrial and trading activities.

This transition creates an exciting period of innovation, renewal and productive growth for all involved in finance and business wherever they are in the world.

In closing, I would like to wish all participants a fruitful, productive and enjoyable meeting in Cape Town.

Achim Steiner
Executive Director UNEP

Fiduciary duty: A shining beacon in a financial storm

Paul Q. Watchman, QWC Consulting

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Paul Q. Watchman is recognized globally as a thought-leader in the field of fiduciary law as it relates to responsible investment. He was lead author for two landmark United Nations-backed reports (2005/2009) that made the legal case for the integration of environmental, social and governance considerations in investment policy and practice.

In 2005 the prevalent view of investors and asset managers was that the correct legal interpretation of the nature of the fiduciary duties owed by pension fund trustees to the fund's beneficiaries required an exclusive focus on financial returns.[1] It is now four years since the *Freshfields Report* challenged that view. In their 2005 report Freshfields concluded that the fiduciary duties of pension fund trustees did not preclude, but in certain circumstances required, environmental, social and governance (ESG) considerations to be integrated into mainstream investment decision-making.[2]

In July 2009 UNEP FI published a follow-up report, *Fiduciary Responsibility Legal and practical aspects of intergrating environmental, social and governance issues into institutional investment*, known as *Fiduciary II*, which charts how far financial markets have come in accepting the legality of the interpretation of fiduciary duties in the 2005 report and, by implication, the

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Global Roundtable

Building green bridges from Cape Town to the world

Robert Tacon, Standard Chartered & Chair, UNEP FI and
Cas Coovadia, Managing Director, Banking Association of South Africa (BASA)

For two days in October (22-23) bankers, insurers and investors from around the planet will gather in Cape Town, at the UNEP Finance Initiative Global Roundtable[1], alongside their African colleagues and the United Nations, to explore how the global financial community can help build a better world. The UNEP FI Global Roundtable, held every second year, is coming to Africa for the first time and will focus on the umbrella theme of "*Financing change, Changing finance.*"

We know that environmental, social and governance issues – known as "ESG" in the jargon of sustainable finance and responsible investment – are mainstreaming fast around the global financial and capital market community.

The 2007-2009 credit crunch, capital market crisis and economic downturn, as well as the looming threat of global warming – counterbalanced by the lure of multi-trillion dollar carbon markets – is simply accelerating the uptake of ESG by financial institutions serious about rebuilding balance sheets,

Experts agree: It's time to

On 10-11 September, 2009, The Sustainability Forum Zurich held its' 10th International Sustainability Leadership Symposium. The two-day event explored the theme of "Restoring Trust in the Financial Markets: Time to Think Sustainably". The following article is an extract from the Symposium's discussion paper which was based on a series of interviews undertaken with a group of eminent thinkers. The extract in this special Cape Town edition of UNEP FI's 0.618... is itself a summary distillation of the thoughts, views and opinions of the seven people interviewed as the paper was developed.

The Forum's interviewees included:

- Stine Bosse, CEO, TrygVesta
- Bill Emmott, Independent writer, speaker and consultant, former Chief Editor, The Economist
- Ernst Fehr, Professor, Chair of Microeconomics and Experimental Economic Research, University of Zurich
- Patrick M. Liedtke, Secretary General and Managing Director, The Geneva Association
- George Stansfield, Executive Vice President & Group General Counsel, AXA
- Peter Voser, Group CEO, Shell
- Klaus Wellershoff, Member of the Board of Directors, Schindler Holding, former Member of the Group Executive Board & Chief Economist, UBS

This extract explores the "main reasons for the current economic and financial crisis and, more importantly, ways of preventing or at least reducing the scale of similar dislocations going forward. Our approach is rooted in the notion of sustainability which is applied to financial markets, corporate business

re-establishing reputations and restoring trust. So what is the evidence that sustainable finance and responsible investment is real?

We know a few things:

- More than 180 financial institutions support UNEP FI, the oldest and largest partnership between the United Nations and the banking, insurance and investment worlds;
- The pace of global clean energy investment jumped from US$ 60 billion a year in 2006 to US$ 150 billion by 2007 and, despite the financial crisis, hit the same level in 2008;
- Banks controlling more than 80 per cent of global project finance volume back the Equator Principles[2];
- The world's largest institutional investors, managing assets of US$ 18 trillion, back the Principles for Responsible Investment[3], with the South African Government Employees Pension Fund as a founding signatory.

The United Nations and finance coming to Africa

The UNEP FI meeting is being co-hosted by UNEP FI and the Banking Association of South Africa (BASA) and, importantly, is generously supported by the event's sponsors, partners and supporters (see box).

Key questions for this meeting will include: how can finance and investment protect the planet, build better communities, invest responsibly, and roll back poverty? After two years of global financial and capital market turmoil are financial service organizations qualified to talk about sustainable development? We think the sector, which does indeed need to look hard at itself, must play a leading role as we work towards development that balances "people, planet, profit" in a manner that safeguards future generations.

We believe African and international financial and business leaders have every chance to build a bridge from Cape Town to Copenhagen. We believe the climate voice of South African, African and international finance and investment should be heard by the governments of the world.

Rebuilding balance sheets, reputation and trust

How, you may ask, can the financial and investment community build a better world? Despite the financial crisis of 2007-8 that turned into a global economic recession in 2008-9, there are many thousands of mainstream financial service professionals worldwide who are convinced that approaches based on sustainable finance and responsible investment are the wave of the future.

If you're serious about sustainable finance, responsible investment and how the clean, green, low carbon revolution will impact either your business or your own community, the UNEP FI 2009 Global Roundtable is a "must-attend" event.

1. On October 22-23, 2009, the 2009 UNEP Finance Initiative Global Roundtable comes to Africa for the first time. Hundreds of financiers, investors and business people will gather at the Cape Town International Conference Centre (CTICC). For more details visit: www.unepfi.org
2. The Equator principles are a financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. For details visit www.equator-principles.com/principles.
3. Principles for Responsible Investment are a framework for ensuring that environmental, social and corporate governance (ESG) are incorporated into investment portfolios. For details visit www.unpri.org

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- Johannesburg Stock Exchange
- Deutsche Bank
- Africa Geographic
- Africa Investor
- Catlin Arctic Survey
- Dot Eco
- Globe foundation
- Jetfin
- Green building council of South Africa
- Solar impulse
- National Business Initiative (NBI)
- Sustainable Finance Geneva
- TOP to TOP

To learn more about the work of UNEP FI and its Signatories please visit http://www.unepfi.org/

think sustainability

models, corporate governance structures and the realm of public policy. The paper reflects the outcome of a series of interviews with respected experts and executives."

During the expert interviews a wide variety of different perspectives emerged. Consensus views were the exception rather than the rule. Nevertheless, it is possible to distil a number of theses which reflect the "spirit" of the interviews.

What went wrong?

1. Risk has been grossly mis-priced by markets. In the absence of effective risk management tools, corporate decision-makers and regulators were lured into a false sense of security by the promise of securitization and globalization. Risks were supposed to be effectively dispersed and inflationary pressures tamed. This led to a monetary policy of cheap credit and excessive leverage of company and household balance-sheets.

2. Corporate business models were driven into an area of excess not just by ill-understood financial innovation but also by ill-designed compensation and incentive structures. On that basis, the macro-economic imbalances underlying the crisis – insufficient savings and excessive spending in the US – developed into a major dislocation of financial markets and real economies.

3. The way most boards of directors operate makes it difficult for dissenting voices to make themselves heard. Frequently, boards are too close to the CEO, not truly independent, reluctant to appoint dissenting newcomers and insufficiently familiar with enterprise risk management, including macro-economic exposures, and overly reliant on the role of the

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Sustainable investment

Why does it need to

Dr. Matthew Kiernan, Chief Executive of Innovest Strategic Value Advisors and author of the recently released *Investing in a Sustainable World.*

At the risk of some hyperbole, I think that it may be useful to conceptualize the global struggle towards "sustainable investment" in Hegelian terms. (Hegel was that German fellow who postulated around 1812 that the whole of human history could be explained in terms of a grand global dialectic: thesis; antithesis; synthesis. An initial idea or proposition – the thesis – provoked a countervailing reaction or force (the antithesis), and the tension and dynamic interaction of the two produced an outcome – the synthesis – which was a unique combination of the two. This dialectical model was later adopted and refined by Marx (Karl, not Groucho), and has influenced thinkers and philosophers from traditions as diverse as Buddhism and Talmudic scholarship.

And thus it is with sustainable investment. In this case, the thesis – only rarely articulated – is that environmental and social factors and phenomena really have no proper place in a sophisticated, professional investment analysis or strategy. The general historical indifference and even hostility towards sustainable investment from institutional asset owners and their professional advisors – consultants and money managers – can be explained in large part by at least six key elements of their deeply entrenched belief system. Together, they could be viewed as constituting the "thesis" in Hegelian terms, and they go a great distance towards explaining what has until now been the glacial pace of change in the investment community.

The Thesis:

A mythology in six parts

1) *Addressing sustainability factors is irrelevant or even injurious to risk-adjusted financial returns.* Conventional investment "wisdom" has long held that companies' performance on environmental and social (ES) issues is either immaterial or even harmful to the financial performance of both companies and their investors.

2) *It is, therefore very likely a breach of fiduciary duty to incorporate sustainability factors into investment strategy.* This myth follows directly from the first one. On a good day, analyst time spent assessing companies' ES performance is alleged to be simply an unconscionable waste of time; on a bad day, including them in the construction of clients' portfolios may actually harm both companies' and investors' financial performance, by arbitrarily narrowing the available investment opportunity set. Some traditional SRI managers, for example, will simply not invest in *any* mining, oil and gas, or forestry stocks on principle, notwithstanding any financial (or, for that matter, environmental, or social) virtues they might have.

3) *There is no academically credible evidence to support the sustainable investment thesis.* This is at once the most central and the most misguided of the six investment myths. The fact that it is blatantly untrue has done little to prevent some of the most respected and influential investment analysts and consultants in the world from parroting it from the highest mountain tops. The problem is not a lack of evidence; it is the fact that the sceptics are either blithely dismissive of it or, more frequently, unaware of its existence and disinclined to look for it.

4) *Sustainability and other "extra-financial" analyses are inevitably less rigorous and more arbitrary than traditional investment analysis.* Sadly, this particular myth is not simply intellectually inaccurate, it is actively preventing otherwise progressive institutional investors – particularly in the United States – from even considering sustainability strategies that could improve their risk-adjusted returns substantially. In many cases, they have thrown the sustainable investment "baby" out with the "neo-classical SRI bath water". The claim that sustainability analysis is woolly-minded and subjective becomes particularly ludicrous when one recalls what Wall Street regularly reports as the Number One determinant of companies' financial performance: management quality. Now there's an eminently precise, quantifiable metric for you!

5) *All SRI/sustainability research and investment approaches are essentially the same.* While it is true that some SRI analysis and investment products are of inferior quality and generate poor returns, precisely the same can be said for much of mainstream analysis and many of its products (viz: global market meltdown). In neither case should investors abandon the entire genre because of the failings of the worst.

be this difficult?

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6) *Unlike any other single set of investment factors, sustainability factors have to add value all of the time; otherwise they clearly must be intellectually bankrupt, worthless, or even harmful.* The "logical" corollary of this view is that the underperformance of any ES/sustainability fund or, God forbid, several of them, invalidates the entire investment approach. By contrast, every year, according to respected Princeton finance professor Burton Malkiel, roughly 80 per cent of all active, large-cap mainstream asset managers under-perform their benchmarks[1]. This, however, is apparently no reason whatsoever to call into question the entire discipline of active management. In the world of sustainable investment, however, this "shortcoming" is, apparently fatal.

The Antithesis:

Stark and counterveiling megatrends

This essentially negative thesis, however, runs headlong into the headwinds of some stark and countervailing megatrends, including:

- Accelerating natural resource degradation, scarcity and constraints, driven to a significant extent by the explosive pace of industrial development, population growth, and urbanization, especially in emerging market economies such as those in Brazil, Russia, India, and China (the so-called "BRIC" countries);

Major demographic and economic shifts, concentrating the most rapid population *and* economic growth in emerging markets, where the sustainability risks and impacts are arguably the greatest;

- The ongoing revolution in information and communications technologies (the Internet, YouTube, Facebook, webcasts, bloggers, et al.), which has enabled and accelerated the emergence of a stakeholder-driven competitive environment for companies with unprecedented transparency and, therefore, business and investment risk;
- Growing pressures from international non-governmental organizations (NGOs), armed with unprecedented financial and technical resources, credibility, access to company information, and global communications capabilities with which to disseminate their analysis and viewpoints;
- A substantial reinterpretation and broadening of the purview of legitimate fiduciary responsibility to include companies' performance on ES matters;
- A growing body of both academic and empirical evidence illuminating the tightening nexus between companies' performance on ES issues and their competitiveness, profitability and share price performance.

The Synthesis:

An inflection point beckons

While I do confess to occasional bouts of despair about the excruciating pace of progress, I also firmly believe that there can ultimately be but one outcome from this titanic, dialectical struggle for the hearts, minds, and wallets of investors: the ultimate triumph of sustainability-driven investment approaches. The secular global megatrends we reviewed earlier are simply too powerful and compelling to permit any other outcome.

What form will that triumph take? I would propose a zen-like paradox here: sustainable investment will in fact have truly triumphed when it disappears altogether. At some point in the future, sustainable investment will simply cease to exist as a discrete, stand-alone category or investment style. It will be impossible at that point to distinguish between "sustainable" investment and good old-fashioned *smart*, forward-looking investment, period.

And when, you ask, will this nirvana-like state be achieved? Well, I can't give you the precise week, but I do know this much: progress on this front, much like the impacts of climate change, is likely to be *discontinuous*. It will *not* be gradual and linear; it will involve a step-function change. And I believe that the tipping, or inflection point is nigh. The catalyst may well turn out to be the global market meltdown: by graphically demonstrating the limitations of traditional investment analysis, it could create a once-in-a-generation receptivity to new approaches. Now is our time!

"...the ultimate triumph of sustainability-driven investment approaches."

1 See Malkiel, Burton (2005) "Reflections on the Efficient Markets Hypothesis: 30 Years Later", Financial Review, vol. 40, no.1 (February): pp.1-9

Roadmap

The carbon caravan's journey

By **Paul Clements-Hunt** and **Remco Fischer** of UNEP FI

From Bali, to Poznan and on to Copenhagen… from CDM to NAMAs… from permanence to REDD… from "flexmecs" to "mrvable"… and then on to carbon assets…

At times, the climate change policy arena appears to be a magical mix of special places and undecipherable acronyms underpinned by proliferating jargon that few understand – unless they are deeply embedded in the "global warming" policy caravan that travels the world and speaks its own language.

Some financial institutions, with hefty analytical, lobbying and carbon marketing budgets are part of the caravan and revel in this world. These banking, insurance and investment companies, often giant, blue chip global corporations, have specialists to understand the fine detail of how climate change policy developments at the global, regional and national levels, will impact on their strategy decisions, asset allocations, portfolios, loan books and underwriting models.

Financial institutions starting the carbon journey

And then there are the many financial institutions worldwide – large and small – that are just starting their climate policy and carbon market journeys. In the coming months, UNEP Finance Initiative, building on its 14-year experience traveling globally within the "carbon caravan" will strive to bring some crystal-clear clarity to this policy complexity in language that is both jargon-free and almost acronym-free in order to highlight the "why and how" of international climate policy and what it means for all financial institutions.

At the end of this journey, whether you are a banker in Glasgow, an insurer in Lagos, an asset manager in Shanghai, or a pension trustee in Sao Paolo, we hope that you will at least have the ability to understand the route that the "carbon caravan" has covered to date, the road planned ahead and what it means for your institution. This article gives a short taster of how UNEP FI will unpack the manifold issues surrounding climate policy and current state of play. UNEP FI will now feature regular articles focused on finance and capital market issues at www.unepfi/carbon caravan/.org to shine a light on the route the carbon caravan is taking. We will also produce a special UNEP FI *CEO Briefing* ahead of Copenhagen to give financial institutions the ultimate inside track on this landmark negotiation.

London, Nairobi and the mystical Isle of Bali

Between October 2006 and December 2007, two things took place that fundamentally changed the climate game for financial institutions and capital market actors. In London in October, a few weeks ahead of a United Nations climate change summit in the Kenyan capital, Nairobi, the United Kingdom Treasury launched what would become known as the *Stern Review* (www.hm-treasury.gov.uk/sternreview_index.htm). Just over a year later, a group of 37 ministers and their most senior officials from finance ministries worldwide met for the first time in Bali to discuss the economic and financial implications of climate change. Neither of these events took place in isolation and were, in fact, built on foundations created by smart policy-makers over many years. However, both the London Stern launch and the Bali finance ministers meeting marked important milestones in the policy discussions.

These milestones ensured that the carbon caravan was able to take a new direction where the economic and financial risks and opportunities were far more to the fore in climate policy considerations. In fact, the UN climate meeting in Indonesia stressed the importance of finance as part of what has become known as the "Bali Roadmap", a plan agreed on by governments as the path towards a global deal that they hope will be achieved in Copenhagen by December 2009. One of the four key foundations

2009 Copenhagen's post 2012 agreement

2007 Bali Road Map set the course to the next agreement

2005 Kyoto Protocol entered into force

1997 Kyoto Protocol was signed

1992 Earth Summit: Climate Change Convention was signed

1972 First UN environmental conference

of the Bali Roadmap was "Enhanced action on financing, technology and capacity-building."

What this means, essentially, is that governments are currently negotiating how to pay for:

- the technologies to reduce the pollution that causes global warming;
- the changes we will have to make to cope with the physical impacts of climate change;
- the institutions, training and know-how to make a difference on the ground.

After Bali, the financial and investment focus of the carbon caravan intensified with many more intergovernmental policy meetings concentrating on this area, a good example being UNEP's gathering of environment ministers in Monaco in February 2008 that focused on "Globalization and the Environment-Mobilizing Finance to Meet the Climate Challenge" (www.unep.org/gc/gcss-x/).

The other 85 per cent

The *Stern Review* has been followed by other publications focusing on the financial magnitude of the challenge (such as the UNFCCC's report on the *Investment and Financial Flows to Address Climate Change*), and it has become clear that the largest share by far of financial means to address climate change – approximately 85 per cent – will have to come from the private sector.

And this 85 per cent figure is of critical importance for financial institutions interested in becoming players in the investment and financing around low-carbon technologies and the trading markets forming around carbon as a commodity. We know that the world's infrastructure investment needs for clean energy in coming decades – running to US$ 500 billion per year – are huge and will require all the positive forces available to capital markets to ensure that private capital flows. If, at the same time, global policy, starting with Copenhagen, provides incentives for the investment chain to finance low-carbon energy technologies, then the coming together of overwhelming energy demands for a growing world population and a transition to a low-carbon energy infrastructure can only mean one thing: tremendous new markets and opportunities for well-informed and well-positioned financial institutions to play the traditional role of intermediaries that smooth the working of the markets.

In coming months, UNEP FI's on-line "Carbon Caravan" series will assist your institution to understand what climate policy and carbon market developments mean for your business. Also, watch out for the special pre-Copenhagen CEO Briefing providing an insiders' guide for the historic Denmark summit for finance, investment and insurance players.

Pioneering global survey links ESG factors to insurance

Insurance is one of the largest industries in the global economy. In 2008, world premium volume exceeded US$ 4.2 trillion, while the insurance industry's global assets under management stood at around US$ 19.8 trillion. Given their unique combination of roles as risk managers, risk carriers and institutional investors – insurance companies have immense capacity to manage environmental, social and governance (ESG) risks and opportunities

From March to June 2009, the UNEP FI Insurance Working Group – comprising many of the world's leading insurers and supported by renowned academic institutions from Europe and North America – conducted a pioneering global survey on the understanding and integration of ESG factors in insurance underwriting and product development. The nature and scope of this survey made it the first of its kind.

Core survey objectives were to:

- Assess the understanding and integration of ESG factors in insurance underwriting and product development globally;
- Assess the influence and financial materiality of ESG factors in insurance underwriting and product development;
- Provide recommendations on the integration of ESG factors into core insurance processes;
- Provide research input for future projects; and
- Establish a solid business case for the development of "Principles for Sustainable Insurance".

The comprehensive survey covered a wide spectrum of ESG factors, spanning virtually all thematic work streams of UNEP FI, including:

- Environmental – climate change, biodiversity loss and ecosystem degradation, water management, pollution
- Social – financial inclusion (microinsurance), human rights, emerging manmade health risks, ageing populations
- Governance – regulations, disclosure, ethics & principles, alignment of interests

The survey was a real success, generating nearly 2,700 pages of data from respondents across the insurance value chain and stakeholders with over 3,800 years of cumulative insurance experience, coming from 60 territories worldwide-from Africa and the Asia-Pacific, to Europe, Latin America and the Caribbean, and North America.

The key findings and recommendations will be summarized in a ground-breaking UNEP FI Insurance Working Group report, titled: *The global state of sustainable insurance – Understanding and integrating environmental, social and governance factors in insurance*. The report will offer profound insights on the dynamics of ESG factors and core insurance processes, the state of play of sustainable insurance, sustainability challenges and potential solutions, and the many opportunities that remain largely untapped.

Green web

From institutional investor to institutional consumer

Jacob Malthouse and **Trevor Bowden,** Co-founders of Big Room Inc

Recessions are not all bad. They give space for green shoots to rise up and re-shape our economic system. Leadership and vision often comes from the most unexpected places. Sometimes it's a couple of guys in a garage in Menlo Park, California at the depth of the dot com bust who think of a better way to find things on the net. Other times it's a guy from Hawaii with roots in the mid-western US and Kenya who just seems to understand how to organize and motivate people.

Surprises don't always come from individuals. Large companies can also make bold changes. Wal-Mart's goal of implementing a new sustainability standard for its suppliers has generated massive momentum to green supply chains around the world.

Recessions urge us to be open to new ideas. It is these ideas that will lead us from stagnation to recovery. This is why this UNEP FI Global Roundtable is so important. Taking place in Africa and during Cape Town's Green Week, it urges us to think globally about where our planet is heading vis-à-vis both economics and ecology.

Indeed, it can be argued that the Principles for Responsible Investment, a UNEP FI innovation, has readied these "green shoots" of recovery by directing funds towards and raising awareness about the emerging green economy. UNEP FI's efforts to bring about effective climate legislation, to increase the sustainability rigour in lending practice, and recently, to green commercial banking, are all working the soil of the coming recovery.

As former team members of UNEP FI, we had the privilege of seeing this stage set first hand. We would argue that the truly green shoots of this recovery have already been seeded and the action needed now needed is to help them grow.

That is why we acted in 2007 to set up our own green shoot, a start-up called Big Room Inc. Big Room's vision is to harness the power of the Internet to extend the green economy into consumer choices, supply chains, and procurement. In 2007, we saw changing consumption patterns would become the next frontier in sustainability.

A new top-level domain

In 2009, we were pleased to see Wal-Mart agree with us, and are even more pleased to be collaborating with them and the World Resources Institute on the "eco-label" component of their work. This work will form an essential part of our Dot Eco top-level domain, a new Internet-based meta-trust-mark.

As a green shoot ourselves, Big Room's "from-the-trenches" view of recovery is that the two most critical things needed to take us, and many other green shoots, from shoot to tree are capital and wisdom.

As a green shoot, we see capital as our water and wisdom as our fertilizer. What will kill this recovery is a lack of these essential elements. At a time when capital is scarce and we are often too busy to impart wisdom, we must be careful where we invest our time and money. That is why vision is so important.

What is Dot Eco?

Dot Eco (as in www.example.eco instead of www.example.com) is a system that will display current, detailed sustainability information to anyone with a web browser, anytime they need it, anywhere on the planet.

It will do this by collecting information from people when they register Dot Eco domain names for their companies or products and then making that information freely available on a standardized platform.

Dot Eco is being developed by Big Room in collaboration with a multi-stakeholder group that includes WWF International, Green Cross International, Pax World Funds, Verite, Hewlett-Packard, Development Alternatives and others.

Once complete Dot Eco will greatly increase the accessibility and availability of environmental, social and governance data. A development session is being held in advance of UNEP FI's Cape Town Global Roundtable on Wednesday, 21 October from 2-4 p.m.

Vision gives us the confidence to apply our scarce resources in the ways needed to sustain a recovery.

UNEP FI members have proven before, and can prove again, that they have that vision. The opportunity exists to harness the power of commercial banking in tandem with the efforts of Wal-Mart and many others to define a new agenda for global consumption. One rooted in economic and ecological sustainability.

Sustainable supply chains

In the next few years huge government and corporate purchasers will press hundreds of thousands of suppliers, suppliers with accounts at many UNEP FI member banks and insurers, to improve the sustainability of their supply chains. In exchange, these powerful institutional consumers will agree to do business with these suppliers, funneling vast amounts of capital to the greenest.

Imagine if Wal-Mart had the coordinated backing of the world's largest financial institutions, present here at UNEP FI's Global Roundtable. Consider the opportunity of providing preferred banking services to suppliers who meet or are working to meet the criteria under development at the World Resources Institute, the Sustainability Consortium and elsewhere, to gain access to Wal-Mart's shelves, supply United Technologies with parts, and many others with eco-friendly resources.

Financial mechanisms where suppliers from all around the world could be obtain preferred loans, guarantees, or banking services in exchange for meeting new demand from the members of these green supply chain initiatives could be the next PRI. With the backing of most of the world's largest institutional investors in place, the next logical step is collaboration with the institutional consumer.

The green shoots of recovery could lie in investment of wisdom and capital into a vision of collaboration between the world's largest consumers and those who provide financial services to them and their suppliers.

Big Room Inc. is a Canadian start-up founded in 2007 by two former UNEP FI staff and PRI founders, Jacob Malthouse and Trevor Bowden and Anastasia O'Rourke, to help retail and institutional consumers make greener choices.

It's time to think sustainability continued from page 3

rating agencies as quasi regulators. In short, appropriate "rules of the game" are either not in place or not adhered to.

4. There was too little public intervention in certain aspects of corporate governance such as compensation schemes and risk taking. Frequently, regulators were not up to the challenge, lacking the necessary financial literacy and a truly global approach, matching the business realities of a globalized economy.

5. The financial crisis exposed serious flaws of corporate risk management. Stress testing was not properly implemented, particularly in banking. More often than not, quantitative models were allowed to supersede managerial judgment, experience and intuition.

6. In a large number of financial organizations traditional values such as sustainable and prudent behaviour were eroded by pecuniary incentives which encouraged short-termist and excessively risky behaviour.

The future of finance: Towards a sustainable paradigm

7. Transparency and disclosure must be enhanced markedly in order to render financial markets less susceptible to shocks and dislocations. Excessive risk taking, e.g. exacerbated by securitizations that permitted originators to lay off 100 per cent of their economic risk on the financial markets, must be constrained by appropriate regulations. These measures, however, are neither expected nor intended to lead to "fail-proof" financial markets as occasional set-backs and dislocations are a key feature of any markets-based economic system.

8. Governments should refrain from intervening with corporate business models and strategies as the downside of policy mistakes is significant. Customers and investors are expected to effectively push for more long-term oriented behaviour by management. Managers themselves (e.g. their personal wealth) have suffered during the crisis which is likely to promote more responsible and sustainable behaviour.

9. In corporate governance, however, there seems to be a strong case for increased public intervention, not least due to the public good character of corporate governance. Priority areas in this regard are incentive structures and ways of promoting dissenting voices in boards of directors in order to make boards of directors "less clubby and cosy". Such efforts could also be helped by a bigger role of third-party shareholder representatives advocating a longer-term perspective as well as new ways of selecting board members.

10. The crisis has revealed major public policy flaws. The domestic character and focus of regulation in times of globally operating companies and integrated economies has proven to be grossly inadequate. Global coordination and consistency need to be stepped up significantly. In addition, the notion of systemic risk, i.e. the risk posed by individual organizations to the financial system as a whole, needs to be introduced into global financial services regulation. And, last but not least, central banks should explicitly recognize asset inflation in order to pre-empt dangerous (credit) bubbles going forward.

To view the full discussion paper please contact Thomas Streiff, Chief Executive Officer, The Sustainability Forum Zurich (info@ sustainability-zurich.org) or visit The Forum's website: www. sustainability-zurich.org. 0.618....and UNEP FI offers sincere thanks to The Forum for their kind contribution of this extract from the Discussion Paper for this edition of 0.618.

Investment

A shinning beacon continued from page 1

integration of ESG assessment into mainstream investment decisions. [3] From the 2009 report it is clear that a paradigm shift has been achieved.[4] This is evidenced, for example, by the 560 signatories to the Principles of Responsible Investment[5] as well as by research findings. It is also clear from the follow-up report that there have been fundamental changes in market practice and increasing knowledge of the relevance of ESG considerations to investment.[6]

These changes, it is argued, are so elemental that pension fund trustees and asset managers who ignore ESG considerations or asset managers who, as professional expert consultants, fail to be proactive and raise with their clients the relevance of ESG considerations to investment decision-making may find themselves legally liable in the case of the trustees for breach of fiduciary duties, and in the case of the inactive or reactive asset manager professional negligence.[7]

THE CREDIT CRUNCH COMETH

The success of the UNEP FI initiatives in engaging the investment market in re-assessing the legal meaning of fiduciary duties and embracing responsible investment, however, did not occur in isolation from market forces. It occurred against the background of "the worst financial and economic crisis in generations".[8]

It is no exaggeration to state that in the last two years the financial world has been turned upside down. Credit has been crunched. Global financial institutions have become insolvent (Lehman Brothers collapsed) or (as with RBS and HBOS) the majority or substantial part of their shares is owned and debts guaranteed by government. If greed was ever good or bankers had a reputation for financial prudence, this is no longer the case. Financial market regulators have expressed doubt as to the social utility of some practices. For example, Adair Turner, Chairman of the UK FSA stated that "some financial activities which have proliferated over the last ten years were 'socially useless' ".[9]

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The predominant use of language in the financial world has changed. The need for global competiveness to attract business and to recruit and retain the best people required light touch regulation. Financial markets had to be freed substantially from red tape and regulatory scrutiny. Now this free market /light regulation view is held up to ridicule, sometimes by the very people who promoted it or by politicians who rewarded bankers for taking unacceptable risks.

This shift in the language of the financial world can be gleaned from examining the changing prevalent use of different financial expressions. This includes the replacement of the need for short-term financial returns with the need for sustainable finance; the demand for corporate governance discharged by an effective and financially expert Board of Directors; the requirement to overcome the shortcomings of inept directors found to have been asleep at the wheel of financial juggernauts or inappropriately awe-struck by maverick or charismatic chief executives; the ousting of incentive structures based on rewards and bonuses for short-term performance by incentive schemes based on just rewards for long-term economic success; the clawback of unjustified rewards; the recognition that financial instruments, such as derivatives and swaps, are not so much risk avoidance mechanisms but capable of facilitating gaming, and with it a casino culture and the creation of toxic debt; an acceptance that belief in an almost papal infallibility of private equity and hedge funds to produce high short-term returns was misplaced; and finally, an understanding that light touch regulation can be soft touch regulation.

Apparently without any sense of irony or shame, hence the charge of hypocrisy, we witness daily Damascene conversions amongst politicians and hard-nosed bankers to responsible investment, transparency, accountability and reporting of ESG performance and the need for global co-ordinated regulation of financial markets.

UNEP FI AND THE CREDIT CRUNCH

Having been said that there is no doubt that much of the financial crisis of recent years could have been worse without the intellectual infrastructure provided by the UNEP FI reports over the last five years on financial markets and investment which emphasized the need for a shift from the short-term economic values of financial markets to a more sustainable financial approach which placed great emphasis on ownership participation and openness in financial dealings. For example, those 560 asset owners and asset managers who had signed the Principles of Responsible Investment and others who had participated closely in the work of UNEP FI had realized that some aspects of financial markets were dysfunctional. Pension funds because

of their nature were always going to be vulnerable to crisis in the financial markets. OECD stated that private pension funds in OECD countries had lost nearly 20 per cent of their asset value, equivalent to US$5 trillion. By the time credit crunch bit deeply and the financial markets began to meltdown, however, some protection against them had been put in place. Changes had begun in the practices and policies of pension funds, other asset owners and asset managers to place greater emphasis on the sustainability of finance, the need for long-term planning and the benefits of responsible investment informed clearly by ESG considerations as well as other financial considerations.[11]

In addition, the UNEP FI Principles of Responsible Investment provided foundations on which a new financial order, a "Global Green New Deal" could be created [12] and governments, recognizing the opportunities as well as the risks of climate change and green investment, set aside substantial sums of money to stimulate the green economy[13] and are using their political and financial muscle to achieve changes in corporate and banking behaviour to bring about a more sustainable future.[14]

BANKING BUSINESS AS USUAL?

Against the argument that the credit crunch financial and economic crisis has led to acceptance by financial markets and investors of a less restrictive interpretation of fiduciary duties and the relevance to mainstream investment of ESG is a view that the banks and politicians are only paying lip service to these issues. Far from accepting that fiduciary duties are enabling, or that credit crunch has accelerated an acceptance of the relevance of ESG to mainstream financial decision-making by financial markets, it is argued that the financial crisis has merely increased the hypocrisy and resistance of the financial markets to ESG. Financial institutions may use the language of ESG, but in practice financial institutions are fighting a rearguard action to return to business as usual.[15]

Without doubt there is some truth in these observations. For example, banks recently bailed out by the public purse have sought to justify the pay out of substantial bonuses, and there have been personal attacks on regulators for criticizing banking activities. Add to these developments the re-emergence of arguments supporting light touch regulation and the need to recognize the demands for the best people driven by global financial markets competiveness by paying substantial bonuses and golden hellos and handcuffs.[16]

However, these trends should not be exaggerated. Avoiding insolvency or integrating new financial acquisitions may be regarded as a more primary objective in the short run than ESG integration. It may not be a disjunction between the acceptance of investors of the relevance of ESG considerations to financial decision-making and a re-focusing

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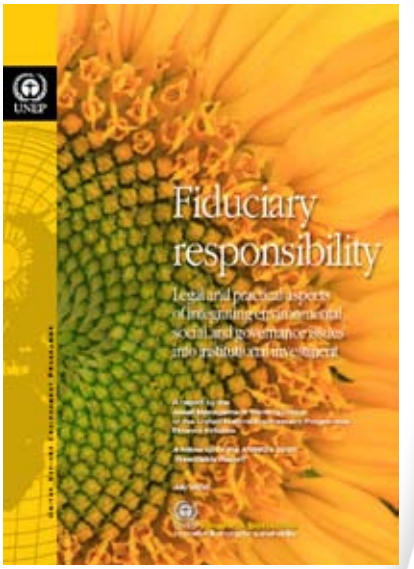
Fiduciary II puts ESG into legal perspective

In July, the UNEP FI Asset Management Working Group (AMWG) launched the much-awaited sequel to its landmark 2005 *Freshfields Report* which, until now, has arguably been the single most effective document for promoting the integration of environmental, social and governance (ESG) into institutional investment.



That *Freshfields Report* explored the complex relationship between ESG issues and fiduciary duty in nine major capital market jurisdictions, and concluded that "integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions."

The 2009 sequel, *Fiduciary responsibility – Legal and practical aspects of integrating environmental, social and governance issues into institutional investment* – known as *Fiduciary II* – takes off from where the *Freshfields Report* left by bringing ESG issues to the point of contract and providing a legal roadmap for fiduciaries looking for concrete steps to operationalize their commitment to responsible investment.

Fiduciary II has three main elements. The first is an exploration of the legal perspective on how best to operationalize the integration of ESG issues into the investment process, particularly with respect to investment mandates and investment management contracts. The second is an analysis of a pioneering survey sent by the AMWG to investment management consulting firms, covering ESG issues as they relate to various aspects of the investment management process, including legal language. The third is a literature review that focusing practical developments on the integration of ESG issues into the investment process, providing insights into the extent to which institutional investors have adopted, and can adopt, longer-term and more sustainable investment approaches. In addition, the literature review covers legal developments on fiduciary duty and ESG issues since, and including, the *Freshfields Report*.

The key conclusions of *Fiduciary II* are that in order to achieve the vision of the original *Freshfields Report*, where trustees integrate ESG issues into their decision-making, ESG issues should be embedded in the legal contract between asset owners and asset managers, with the implementation of this framework being governed by trustees via periodic ESG-inclusive reporting. The report also makes a case for consultants having a duty to proactively raise ESG issues within their advisory process, and highlights the culture among many consultants to neglect ESG issues and treat them with a "tick box" mentality, rather than issues of substance which need to be measured and appraised.

Standards

Good Morning, Mr. Chief Risk Officer

Olivier Jaeggi, Managing Partner and Chairman, ECOFACT AG

Isn't it funny how quickly the business environment can change? For years we don't see change happening and then – bang! – the rules of the game are different and once-accepted business practices are perceived as controversial.

Less then 15 years ago it was common practice for European companies to pay bribes when doing business abroad. As such payments were essential to certain types of business transaction, they were widely accepted and completely legal. New international standards and national legislation mean that such payments are now illegal.

Some change occurs virtually overnight. As a Swiss citizen, I was stunned by how quickly the rules for Swiss private banking were transformed. In March 2008 our Federal Councilor in charge of the Department of Finance reassured us that banking confidentiality was here to stay. Only a year later the same man revealed that the Swiss authorities would now support judicial cooperation in cases of simple tax evasion (they have always cooperated in cases of tax fraud). Once more, these changes were a result of reinforced international standards.

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The importance of international standards can suddenly gain unexpected momentum if the level of controversy reaches a tipping point. The pressure grows and grows until the financial sector's remuneration models are no longer accepted and the banks' capital requirements are toughened up.

Environmental standards are reaching the tipping point

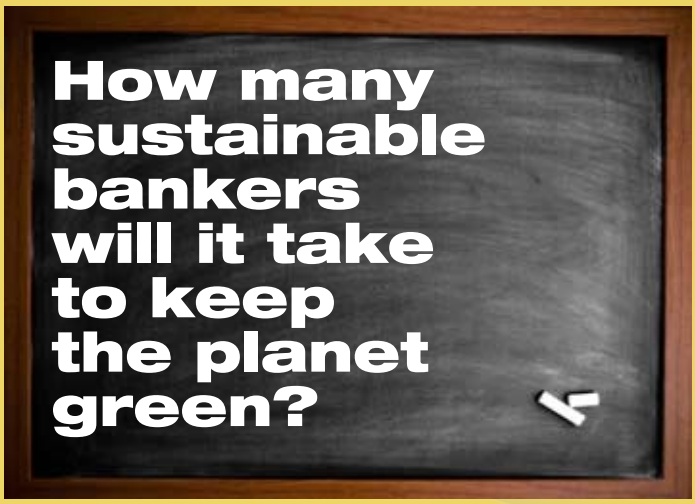
The concept of tipping points was used by the journalist Malcolm Gladwell to describe "mysterious" sociological changes. Once the tipping point – "the moment of critical mass, the threshold, the boiling point" – is reached, views change sweepingly. *Time* magazine writer Bryan Walsh described tipping points as "the levels at which the momentum for change becomes unstoppable".

Today, in the financial sector the Equator Principles and the Environmental and Social Standards of the World Bank Group provide a benchmark for the banks' financing and advisory activities.

However, most international standards define rules not for banks, but for their clients and prospects. For financial institutions, the mushrooming of international standards that clients should comply with is difficult to manage. More and more organizations feel entitled to define the rules that companies active in controversial sectors or difficult business environments should adhere to.

So far, complying with these standards has been voluntary, for clients as well as banks. But don't fool yourself – sooner or later these standards will become rules and they will shape good business practices. Even today, they provide benchmarks against which a company's management of environmental and social issues is measured.

The principles of the UN Global Compact may be considered easy to live with. As they are high-level principles, many companies believe that there is no need to ensure compliance. But standards can change, new requirements are added, existing requirements tightened, and general principles



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The answer surely is "the more the better". That is why UNEP FI considers training to be central to achieving its mission: the mainstreaming of sustainable finance best practice.

UNEP FI's training activities began in 2005 with a workshop in Buenos Aires, Argentina. Just four years later, UNEP FI, in collaboration with its partners InWEnt and the INCAE Business School, now offers a comprehensive Training Programme in Environmental and Social Risk Analysis (ESRA).

The training programme, which has served close to 1,000 risk managers and analysts across the world to date, includes three

are supplemented by technical guidelines. Some standards are strengthened by external reporting requirements, others by mechanisms that require independent reviews. We have seen this happening step by step with the Equator Principles as their scope was expanded.

Let's take the OECD's Guidelines for Multinational Enterprises as another example. You might believe that adhering to them is voluntary. Indeed, companies are under no legal obligation to comply. Yet OECD member states have also established National Contact Points that will initiate an investigation if people affected by a company file a complaint. The National Contact Points must also submit summary reports to OECD headquarters in Paris. Awareness of the relevant international environment and human rights standards is therefore more than just a nice-to-have.

Tomorrow Is Only a Day Away

Our risk radar tool RepRisk recorded 368 banks and 104 insurance companies criticized by the media or pressure groups in the context of environmental and social issues. Many of these institutions have been criticized for business relationships with controversial companies – companies that allegedly violate international standards.

By end of September 2009, RepRisk had captured criticism of 698 oil and gas companies, 931 mining companies, and more than 9,500 other companies from all industry sectors. We see that the number of controversies related to environmental and social issues, not to mention their intensity, is greater than ever.

Those who believe that nothing is changing will be haunted by the implications of these standards and their consequences. I'm not a futurist, but one thing you can bet on is that, more and more, we are reaching the tipping point at which environmental and social standards will not only present reputational risks, but also become a compliance issue for your risk management department.

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A shinning beacon continued from page 10

exclusively on "pure" financial considerations. Rather it may be a sign of confusion arising from a deep financial crisis. In a financial crisis confusion and inconsistency in approach are manifested by violent swings from hyperactivity to "rabbit in the headlights" paralysis in decision-making. This is typical of institutions faced with threats on many levels and, if so, will be a keynote to the behaviour of politicians and bankers and the other victims of the credit crunch crisis.

CONCLUSIONS

After credit crunch there should be no going back for banks and pension funds to business as usual. Transparency and accountability, sustainable finance and long-term planning, active ownership and ESG are here to stay. UNEP FI should be congratulated for promoting these values. It was UNEP FI which provided the intellectual and policy building blocks for a new more sustainable approach to investment and impetus to reform. It took a long time for governments and businesses to accept that climate change is anthropogenic. It took even longer for them to appreciate that intervention is required to mitigate and adapt to the challenges of climate change. It has also taken some time for the investment markets to understand the purpose of fiduciary duties is enabling investment, rather than restricting green investment, that fiduciary duties are organic rather than fossilized and that fiduciary process driven rather than presenting insurmountable obstacles to ethical investment and sensible investment decision-making. Equally, the relevance of ESG was resisted – perhaps correctly in the dark ages when there was little or no information available about ESG impacts on business and investment – initially by Friedman and later by others as half-baked misplaced philanthropy. However, the information and analytical tools are now in place to make ESG relevant to investment decision-making. EIRIS surveys point to ESG being an important investment consideration.[17]

For that too UNEP FI should take a bow.

1 UNEP Financial Initiative, Freshfields, Bruckhaus Deringer, A legal framework for the integration of environmental, social and governance issues into institutional investment (October 2005)
2 Ibid.
3 UNEP Financial Initiative, Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment (July 2009)
4 EIRIS, The value of environmental, social and governance factors for foundation investments (May,2009)
5 UNEP Financial Initiative, Principles of Financial Investment (2006) and PRI Reports on Progress (2007 – 2009)
6 Supra. Parts II and III. IFC, Sustainable Investing in Emerging Markets: Unscathed by Financial Crisis (2009), Mercer Consulting, Gaining Ground: Integrating Environmental, Social and Governance (ESG) Factors into Investment Processes in Emerging Markets (2009)
7 Ibid., Part I
8 Achim Steiner, Foreword from the United Nations Environment Programme, Fiduciary Responsibility (July,2009) p. 5
9 Adair Turner, Baron Turner of Ecchinswell, Mansion House Speech, 22 September, 2009.
10 OECD stated that private pension funds in OECD countries had lost nearly 20 per cent of their asset value, equivalent to US$5 trillion.
11 PRI Reports on Progress (2007 -2009)
12 Achim Steiner, supra.
13 Figures for UK and USA?
14 US Government makes loans to car manufacturers subject to conditions requiring the production of low carbon emitting vehicles.
15 Jess McCabe, 'Back to business as usual', Environmental Finance (June,2009);
16 'Penny Shepherd, 'Responsible investment: No more business as usual', Ethical Corporation (2009)
17 EIRIS,supra,

components: a one-day Introductory Training Workshop (ITW), a one-and-a-half day Advanced Training Workshop (ATW) and a three-week Interactive Online Course. Both the workshops and the online course include a clever mix of theory, peer-to-peer illustrations and practical exercises.

However training at UNEP FI doesn't stop at Environmental and Social Risk Management. An online course on the Risks and Opportunities of Climate Change for the Financial Sector has been available since 2007, providing a thorough introduction to impacts of climate change on the financial system.

Finally, because "walking the talk" has always been the best policy, UNEP FI launched a new online course – on Corporate Ecoefficiency for Financial Institutions – in collaboration with the Ecobanking Project in 2009. This course offers sustainability managers and administrators a four-week "learning by doing" experience, taking them all the way from green buildings to supply chain management.

So, what's better than a bank with practitioners who know how to implement sustainability?

Simple.

Many banks with many practitioners who know how to implement sustainability.

For further information, please visit: www.unepfi.org/training

Climate change

Building business resilience to climate change

Dr Richenda Connell, CTO & Co-founder, Acclimatise

Climate change is clearly underway, and we face many more decades of unavoidable changes. These will increasingly affect business performance, unless the risks are successfully managed.

In the absence of proactive risk management strategies to address the effects of higher temperatures, changing patterns of precipitation, higher sea levels and increased frequency and severity of extreme events, businesses will find themselves coping reactively with a host of damaging impacts, including:

- Changes in market demand – for instance in Russia a 2°C temperature increase could decrease heating demand by 5 to 10 per cent;
- Reduced output, productivity and efficiency – a factory shutdown for major semi-conductor producers because of water unavailability could result in US$100 to US$200 million in missed revenue a quarter;
- Increased CAPEX & OPEX – wear and tear costs for some assets will increase 10-15 per cent in the next two decades;
- Faster asset deterioration and reduced asset life;
- Higher insurance costs and/or difficulty obtaining cover;
- Increased risks of environmental damage and litigation – a power company in Australia faced a class action earlier this year over its alleged failure to manage transmission lines, which fell during extreme high winds, heat and drought, causing a wildfire;
- Increased risks of community conflict;
- Greater decommissioning liabilities.

If left unaddressed, these will lead to lower profit margins, lower asset values, reputational damage, reduced competitiveness, inability to repay debts and failure to realise equity growth. For some sectors and geographies, our research has shown the business risks will be material in the short- to medium-term.

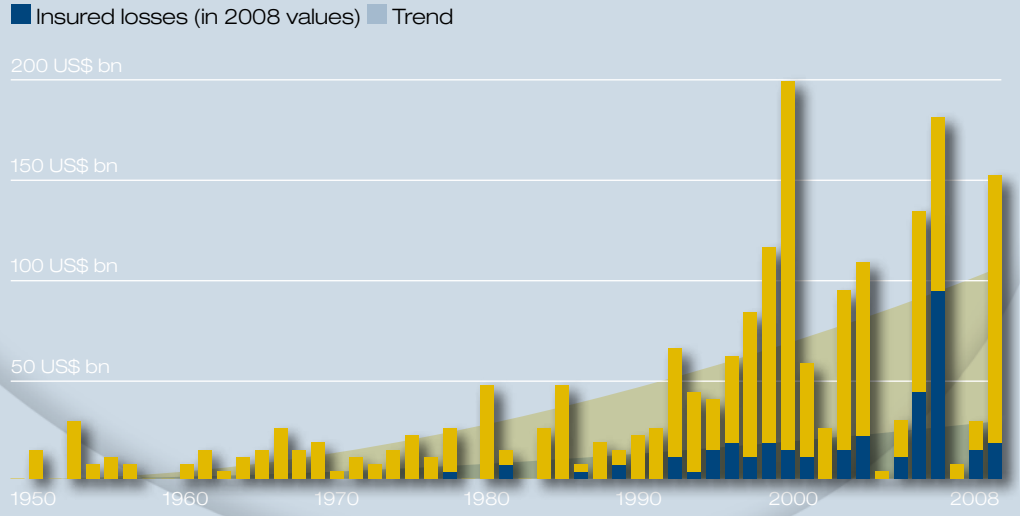
The proactive businesses will be the ones who flourish, leaving the late "reactive" ones behind.

The hot European summer of 2003 showed how significant the business impacts can be. Agricultural production fell by 10 per cent, with a financial impact of about €13 billion (approx US$19 billion). Electricity producer EDF was forced to shut down 14 nuclear power plants and lost €300 million (approx US$440 million). The sustained period of high temperatures, which are a 1-in-500 year event in the current climate, will by 2040 be a 1-in-2 year occurrence – a "normal" event. This underlines the importance of planning for the future with a changing climate in mind. Decisions based on the historical climate are no longer robust.

Because many climate risks are reasonably foreseeable, governments, investors, banks, insurers and other business stakeholders are developing climate change adaptation policies and processes. Our work with the financial services sector reveals that banks face the following risks:

- Credit risks – reduction in the credit profile of clients, countries, or financial counterparties, as a result of climate-related decrease in income. GDP in Brazil fell by two per cent (US$20

Great natural catastrophies 1950 to 2008



billion) in 2001, after electricity rationing due to a severe drought.

- Financial risks – loss in value of investments or other assets leading to reduced liquidity.
- Environmental / social risks – failure of investments to meet environmental and social standards, leading to reputational damage.
- Operational risks – losses resulting from events involving staff, systems and processes, such as deficiencies in contingency planning, and breakdowns in information systems or business continuity.

Some in the banking sector have been pro-active in addressing the issues. As part of the London Accord Project, Barclays has explored the credit risk implications of a changing climate across a diverse range of industry sectors. The European Bank for Reconstruction and Development (EBRD) has begun to develop guidance and tools for integrating climate risk assessment and adaptation into its project cycle management, so that investments can be made climate-resilient where appropriate. Finally, the International Finance Corporation (IFC) is undertaking climate risk case studies as part of its Adaptation Programme, with the overall goal of developing general tools and methods to assess climate risks and opportunities for the private sector. The programme will also address private sector adaptation opportunities.

Adaptation to climate change benefits business and its stakeholders. Allowances for a changing climate can be incorporated into performance standards and design criteria, so that facilities are able to cope with the climate that they will experience over their design life. In order to safeguard investments, developers should require that climate resilience is built in, as part of tender documents. Climate-resilient development can help ensure profitable businesses and returns to lenders and investors. It helps avoid environmental, social and reputational risks and improve the adaptive capacity of local communities.

To build resilience, we advise that climate risk management should be integrated into core business risk management processes – both by companies with large fixed assets or complex supply chains and their financial services partners.

The proactive businesses will be the ones who flourish, leaving the late "reactive" ones behind.

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Investing

Environmental Investing: It's about Alpha, not Absolution

Angelo A. Calvello, Ph. D. Environmental Alpha LLC

"When I asked John Doerr – a partner at Kleiner Perkins Caufield & Byers – whether he was investing to save the environment, he said, 'We are ruthlessly single-minded about our job which is to make a lot of money for our investors.' In his view, the process of making money could change the world. But the firm was not directly pursuing a 'cause.' If some of Kleiner's investors…wanted to do that with their profits, he added, then that was up to them." [1]

The financial crisis and economic downturn have converged to exert considerable pressure on all types of environmental investments. However, this pressure is temporary and will likely abate as economies improve, stimulus packages take effect, and credit flows through the system.

But the crisis and downturn are giving rise to a potentially systemic force that could profoundly impact the development and funding of market-based solutions to climate change. This change is occurring among institutional investors – fiduciaries – who are a critical funding source of strategies and technologies that will mitigate future greenhouse gases and adapt to consequences already in the pipeline.

These asset owners have come through the past 18 months with a renewed commitment to their primary fiduciary duties: earning a (real) return that will allow them to achieve their investment objectives (paying liabilities, supporting spending policy, etc.). This commitment has directed them to carefully understand and manage the material risks in their portfolios and to carefully consider how and where they make their active bets in the portfolio. Some investors – I would argue many – now realize they can best achieve their specific investment objectives with the help of alpha-centric strategies that provide the real returns and genuine portfolio diversification.

It's All about Alpha

In general, environmental investments tend to have the risk/return profile investors are seeking. Environmental investing is, at heart, a type of thematic investing, with the underlying theme being broadly defined as climate change. Its drivers are science, economics, policy, and technology, with these drivers resulting in a variety of environmental-investment risks and opportunities.

These drivers are complex, diverse, and dynamic and as such give rise to rather wide "gaps" (to paraphrase the theologian Dietrich Bonhoeffer) where an investor could employ their skills to gain a genuine edge in an effort to earn a return above what the market can provide – or what I call environmental alpha. By extension, if these returns reflect genuine alpha, then they should provide genuine portfolio diversification.

An example of an environmental alpha opportunity arises from having access to a scarce natural resource. Much of greenhouse gas (GHG) abatement will depend on lowering emissions or offsetting carbon emissions through location-dependent technologies: wind, solar, geothermal, tidal, and other renewable energy sources are likely much more economical in certain locations than in others; forests more productive, carbon sinks more effective in some parts of the world than others, and so on. Managers who can identify those "best locations" should be able to create a sustainable resource-based competitive advantage or, put differently, achieve superior alpha performance – and this performance will probably not be highly correlated with other more traditional investments.[2]

It is hard to concentrate on brighter things when your hair is on fire[3]

In spite of their compelling attributes, environmental investments are not often seriously considered by institutional investors. Why? Because too often environmental investments are unnecessarily classified as a subset of socially responsible investing (SRI). This misguided investment taxonomy subjugates environmental investing to the yoke of SRI and produces an unfortunate response among institutional investors, here described by Matthew Kiernan: "I can confirm from direct personal experience that at the mere mention of the words 'environment' or 'social,' 99 per cent of chief investment officers default to the presumption that traditional – and therefore presumably under-performing – SRI funds are about to be discussed. Their eyes then promptly

either glaze over or actually roll back in their heads..."[4]

I have no axe to grind with SRI and its affiliates. However, subsuming environmental investing under SRI forces investors, already reeling from the events of the past two years, to deal with four specious issues, all of which trivialize and delegitimize environmental investments (to borrow a phrase from Matthew Kiernan) and present the investor with a fair amount of career risk:

- Definitional confusion;
- Investment returns suffers because of the use of arbitrary extra-financial "constraints";
- Fiduciary responsibility is compromised by considering environmental issues;
- Investment policy statements must be revised and portfolios must be restructured to accommodate environmental investments.

Certainly these issues can be satisfactorily addressed, but engaging in such a second-order discussion at this point in time – in a post-crisis world that is facing a temporal imperative to create and deploy scalable responses to climate change – is an activity that institutional investors would prefer to avoid.

This discussion could be avoided entirely by simply acknowledging that there is no necessary or natural nexus between environmental investing and SRI. Environmental investing is not, as one author claims, "similar to SRI in that both are strategies driven by investors' desire to achieve financial return while maximizing social good."[5] Maximizing social good is neither a sufficient nor necessary condition of environmental investing. Environmental investing is about alpha, not absolution; the value of an environmental investment can be measured first and foremost by a manager's ability to consistently generate alpha.

Unintended Consequences

This argument might seem like an exercise in Aristotelian classification until you consider the following: We will need enormous sums of money to develop and deploy the technologies that will help us mitigate GHG emissions and adapt to GHG emissions already in the pipeline. For example, a report by the International Energy Agency estimates that it will take an additional US$17 to US$45 trillion over the next 40 years to develop and deploy mitigation technologies that will allow the power sector achieve its share of the emission targets.

Institutional investors will be a key source of the necessary investment capital, given the size of their asset base and their long-term investment horizon. However, misclassifying environmental investing as a subset of SRI results in the adverse unintended consequences of:

- distracting and discouraging investors from recognizing the potential robustness of environmental investments and how these investments can contribute to the achievement of their investment goals; and
- categorizing environmental investments as fringe investments that are will likely be placed in the five per cent SRI allocation (if one even exists).

In the end, this classification acts as a disincentive for investment and in doing so exacerbates rather than ameliorates the climate change problem. This situation is currently magnified as institutional investors employ a post-crisis decision-making framework that focuses now more than ever on return and risk and not on social or "extra-financial" issues. We cannot wait for SRI to reach a tipping point. We need to move beyond the stultifying misclassification and misunderstanding of environmental investing as a form of SRI and consider these investments on their own merits. Doing so will, in a perverse sort of way, actually allow the full social benefits of environmental investing to be realized.

rebusparis.com © R. Hunter

The financial crisis and economic downturn have converged to exert considerable pressure on all types of environmental investments.

1 Jon Gernter, "Capitalism to the Rescue," The *New York Times Magazine*, October 5, 2008: 82. http://www.nytimes.com/2008/10/05/magazine/05Green-t.html?_r=1&scp=1&sq=%22capitalism%20to%20the%20rescue%22&st=cse

2 Adapted from Jurgen Weiss and Veronique Bugnoin, "Carbon as an investment opportunity," in *Environmental Alpha, New York: John Wiley &Sons, forthcoming*

3 Miles Kennedy, a partner in PwC's risk advisory practice, quoted in Andrea Felsted, 2009, "Difficult decisions on how to stay safe," *Financial Times. Special report on risk management*, April 20.

4 Matthew Kiernan, 2009, Investing in a Sustainable World, AMACOM, New York: 22.

5 Rita Chhabra, "Environmental Investing: Is the Grass Always Greener?" JP Morgan *Investment Analytics and Consulting* newsletter, April 2008.

Opinion

Reasons to be cheerful

Leo Johnson

Blow away the Copenhagen blues! Will yourself back from the ledge. Here are three reasons for unbridled optimism:

Poverty:

We are going to be so heavily indebted that we may just realize we can't afford to spend what the International Energy Agency estimates to be a collective US$ 310 billion annual subsidy to fossil fuels. Plus the 12 per cent emissions reduction the IEA estimates would be delivered as a result of not paying the subsidy wouldn't hurt.

Fear:

China is now upgrading to Euro III and then state-of-the-art Euro IV equivalent emissions regulations for the auto sector. Strategic implications? Good news if you happen to meet those standards (Chery QQ, Sonata, Elantra, Kia-Qianlima etc.) Bad news if your gas-guzzling technology locks you out of a country with sales of 10.2 million units in 2009, and at a target rate of a million units a month, set to be the world's biggest auto market largest by the end of 2010. For those remembering the glory days of the domestic market, China's Build Your Dreams (BYD), producers of a third of the world's mobile phone batteries, is now bringing its five-seater electric car to the US.

Taxes:

Put yourself in a government's shoes. If carbon-intensive goods face a risk of import duty taxation, you have got no choice. Step 1: tax them on export instead. Step 2: fill the coffers back home, and claim the WTO prohibition on double taxation. The question is not whether environmental taxes are going to be levied, it's by whom, and how fast.

What is emerging as a possibility? A tipping point in the transition to a low carbon economy. Its driver? Not moral suasion at the negotiating table, but the direction of intelligent policy towards vital economic interests.

Leo Johnson is the co-Founder of Sustainable Finance, and a Partner in the Sustainability & Climate Change Practice of PricewaterhouseCoopers. He contributes to 0.618 in a personal capacity.

CONSIDER US

倾听全世界儿童的声音 – “请为我们着想”

在全球的政策制定者、资深学者以及行业领袖都将目光聚集在将于12月在哥本哈根举行的联合国气候大会，致力于制定未来气候变化及碳排放全球政策时，将最终受这些政策影响的群体 – 全世界的儿童 – 向全球领袖们发出呼吁：“请为我们着想”。联合国环境规划署金融行动机构（UNEP FI）与WPP集团旗下的ZOOM广告公司合作，启动了一场全球的大型宣传活动。我们在世界各地的学校，号召孩子们用20个字写下他们对气候变化的看法，和对全球领袖们的希望。

South African rock singer Arno Carstens is linking Africa's school children with his mates worldwide to give the next generation a voice on climate change.

The singer/songwriter is backing the Consider Us Campaign that will link school children globally to deliver “the real message” on climate change to world leaders.

Arno penned the song, *Emergency,* earlier this year, while working in London and Spain, with legendary British producer Youth. It will be released as a single off his third solo album, *Wonderful Wild,* which is scheduled for release in the first quarter of 2010.

After hearing about the Consider Us Campaign, Arno felt instinctively that the track suited the concept as if it had been written for it. Prior to its release as a single, *Emergency* will be used by the United Nations as their global warming anthem to heat up the Consider Us Campaign. The rock singer wants South African finance and investment institutions to seal the deal.

Arno will be working behind the scenes with another celebrates South African musician Theo Crous on this campaign, and adding the voices of Africa's school children to the chorus, which did not form part of the original track. South Africa's coolest musicians, who headed up the band The Nudies in the 1990s, will perform Arno's hottest song yet; live at a United Nations conference that meets in Cape Town on 22-23 October 2009.

Then the song will be delivered direct to the world leaders at the biggest-ever United Nations meeting on global warming that meets in Copenhagen, Denmark, in December 2009. Consider Us, a global advertising and multi-media campaign created by Zoom Advertising of South Africa, the country's first carbon-neutral advertising agency, will collect 20-word messages about climate change from children in Cape Town, Copenhagen, Chendu, Caracas, Chennai, Chicago, Canberra and beyond.

The children's messages for Consider Us will be delivered direct to the world leaders when they meet in Denmark before Christmas to decide the future of their planet – “ hot, cool, cold or perfect”.

Arno Carstens explained: “What children think and say on climate change needs to be heard by the world's leaders. That's why I am backing Consider Us with a song that I hope rocks a generation.

“We think Consider Us and Cape Town Green Week is a brilliant concept to encourage the younger generation to work with the United Nations for their future,” he added.

Steve Massey, Managing Director of Zoom Advertising, explained: “Important people will debate big issues and make crucial commitments regarding climate change and carbon emissions. But the most important people will not be there: the ones who will inherit the outcome of these decisions – the children.

Rob Tacon, Chair of UNEP Finance Initiative, a partnership between the United Nations Environment Programme and some 180 financial institutions, added: “Arno and Theo's support for UNEP FI and Consider Us is essential as their music moves young people in South Africa, across Africa and around the world. Those same young people deserve, need and want a voice on global warming and the future of the planet.”

MUSIC MOODS SOUTH AFRICA

Arno and Theo will perform Emergency with Arno's full band live at the start of the 2009 UNEP Finance Initiative Global Roundtable “Financing change, Changing finance,” 22-23 October, 2009, Cape Town International Conference Centre (CTICC), Cape Town, South Africa. (www.unepfi.org/events/2009/roundtable/index.html)

Arno Carsten's third solo album will be released in the first quarter of 2010 and. It was written, recorded and mixed in London and Spain with co-songwriting contributions from Giles Martin, James Walsh, Jim Duguid and Youth. The album was produced by legendary British producer Youth (The Verve's *Urban Hymns*) and Jim Duguid (Paulo Nutini's *These Streets*). Final mix on the album is by Tim Bran (The Verve's recent UK Number 1 album).

Emergency will be released as a single off this album during the course of 2010.

www.arnocarstens.com

Why 0.618...

The UNEP FI newsletter is named: 0.618.... Many readers will ask "Why?" The reason behind our choice of name for the newsletter is given in Peter L. Bernstein's book: Against The Gods. The Remarkable Story of Risk.
In a fascinating section in chapter two – covering the very beginnings of our modern day understanding of risk – Bernstein explains: "The Greeks knew this proportion and called it "the golden mean." The golden mean defines the proportions of the Parthenon, the shape of playing cards and credit cards, and the proportions of the General Assembly Building at the United Nations in New York... The golden mean also appears throughout nature – in flower patterns, the leaves of an artichoke, and the leaf stubs on a palm tree". Also known as the Fibonacci ratio, after the 13th century Italian mathematician of that name, the ratio defines the shape of a spiral which appears in some galaxies, seashells and the coil of ocean waves. The journalist William Hoffer remarked: "the great golden spiral seems to be nature's way of building quantity without sacrificing quality."
0.618... believes that for financial institutions the challenges and opportunities posed by sustainable development centre around an ability to build wealth for shareholders and communities while contributing to the protection of the natural environment – in essence, building quantity without sacrificing quality.

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About UNEP FI

Innovative financing for sustainability

The United Nations Environment Programme Finance Initiative (UNEP FI) is a unique public-private partnership between the United Nations and the financial sector.

Mission

"To identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations."

Background

The concept of UNEP FI was launched in 1991, when a small group of commercial banks joined forces with UNEP to catalyse the banking industry's awareness of the environmental agenda. In May 1992, the UNEP Financial Institutions Initiative was established, followed by the UNEP Insurance Industry Initiative in 1995. Both Initiatives were merged into the current, joint, Finance Initiative in 2003, following the first joint Annual General Meeting held in October 2003.

Today, UNEP FI is the largest global voluntary partnership of its kind, with over 180 signatories to the UNEP FI Statements. UNEP FI members include bankers, insurers and fund managers, all working together to understand the impacts of environmental and social considerations on financial performance.

Why Join UNEP FI?

Financial institutions are under closer scrutiny than ever before. Investors and regulators are increasingly asking challenging questions about corporate governance, the social and environmental impacts of operations and investments and how institutions support their local communities.

Answering these questions is not easy and requires organizations to change policies and practices. This may seem a daunting task. But membership of the United Nations Environment Programme Finance Initiative (UNEP FI) has proved invaluable, helping hundreds of signatories since 1992 to understand stakeholder concerns, exchange best practice and stay on top of the issues.

Membership in UNEP FI is about learning how to turn sustainable development into an opportunity for growth.

New UNEP FI Signatories

Access Bank Plc.
Banco Espírito Santo
Bank of Industry Ltd
Caixa Geral de Depositos SA
Caledonia Wealth Management
CalPERS
Commonwealth Bank of Australia
Fidelity Bank plc
FIRA-Banco de Mexico
Industrial Development Corporation (IDC)
Investa Property Group
Kennedy Associates RE Counsel, LP
Members Equity Group
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Royal & SunAlliance
Shinhan Bank
Turkiye Sinai Kalkinma Bankasi (TSKB)
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