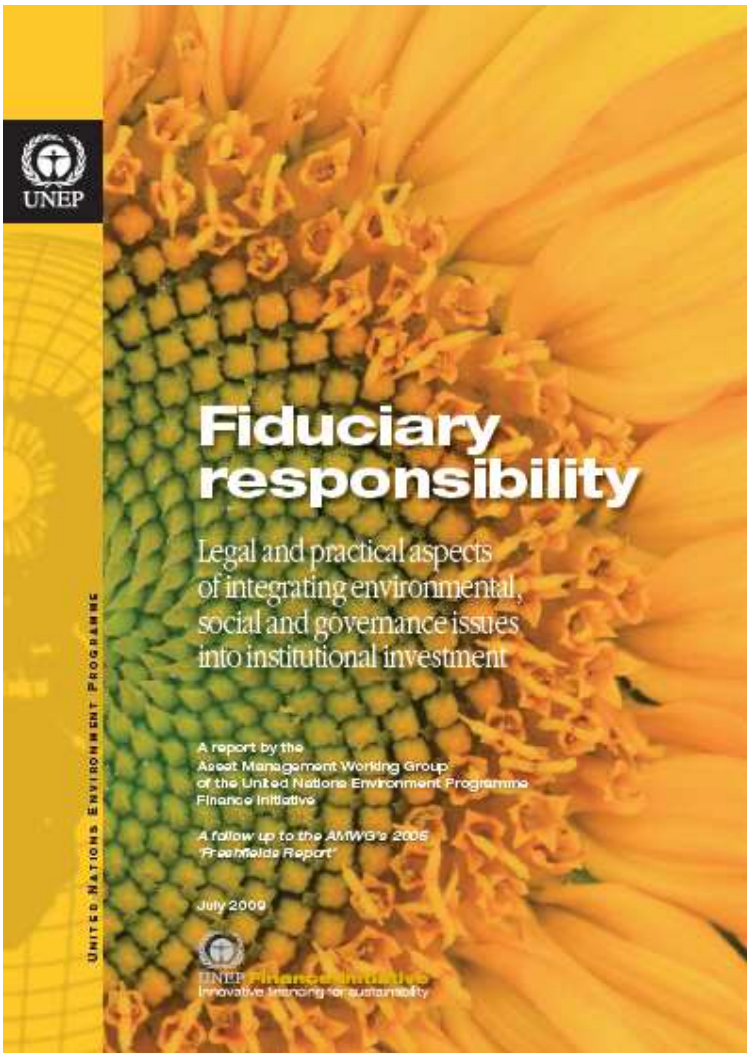
UNEP Finance Initiative
Innovative financing for sustainability

UNEP FI Asset Management Working Group



The 'Fiduciary II' report

Sample media coverage
as of January 2010

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- To download the Fiduciary II report and press release:

  http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf

  http://www.unepfi.org/fileadmin/documents/fiduciaryIIpress.pdf

Part I → News articles

Green investments a legal responsibility, say UN and top asset managers

14 July 2009 –'Green' investments are no longer just a luxury, but are now a legal responsibility, according to a new report by the United Nations Environment Programme (UNEP) and a powerful group of asset managers controlling some $2 trillion in assets.

The 120-page publication released today argues that if investment consultants and others do not incorporate environmental, social and governance (ESG) considerations into their services, they face "a very real risk that they will be sued for negligence."

It also stressed the central role that the world's largest institutional investors – including pensions funds, insurance companies, sovereign wealth funds and mutual funds – have in easing the transition to a low-carbon and resource-efficient green economy.

"ESG issues are not peripheral but should be part of mainstream investment decisions-making processes across the industry," said UNEP Executive Director Achim Steiner.

Further, he noted that creative market mechanisms and other incentives can help to ensure that as investors return to markets after the current financial turmoil ends, they will put their funds into a greener economy and not the "brown economy of yesterday."

The new report, entitled "Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment," was produced by Asset Management Working Group of the UNEP Finance Initiative (UNEP FI), a partnership between the agency and more nearly 200 financial institutions around the world.

It was launched on the eve of the annual Principles for Responsible Investment (PRI) event in Sydney, Australia, which will draw many of the largest institutional investors.

Almost 600 institutions, representing over $18 trillion in assets, have signed up to the PRI, a joint effort between the UNEP FI and the UN Global Compact, a voluntary initiative to promote corporate citizenship which currently involves over 5,000 companies across 130 countries.

Non-green asset managers could be sued: U.N. report

Tue Jul 14, 2009 11:08am EDT

LONDON (Reuters) - Investment advisors and asset managers could be sued for negligence if they do not consider the environment and other social issues when making investment decisions, a United Nations report said on Tuesday.

Money managers have a legal responsibility to raise environmental, social and governance (ESG) issues when tendering investment and advising clients, a law expert and one of the report's authors said.

"(There is a) very real risk that (the advisor) will be sued for negligence on the grounds that they failed to discharge their professional duty of care to the client by failing to raise and take into account ESG considerations," said Paul Watchman.

The report was produced by the Asset Management Working Group of the U.N. Environment Programme's Finance Initiative (UNEP FI), a partnership between the United Nations and more than 180 financial institutions with over $2 trillion under management.

"Responsible investment, active ownership and the promotion of sustainable business practices should be a routine part of all investment arrangements, not an optional add on," said Steve Waygood, head of sustainability research and engagement at Aviva Investors, who also worked on the report.

The report said that in the wake of the economic downturn, investment professionals now had a central role in using global economic stimulus money, estimated by HSBC to be around $2.8 trillion, to fund the transition to a low-carbon and resource efficient 'green' economy.

"As investors return to the markets, the question remains whether the funds will go to the brown economy of yesterday -- or to a new green economy," said Achim Steiner, head of UNEP.

But only around $430 billion, or 15 percent of these funds have so far been earmarked for funding the green infrastructure, according to research published by HSBC Global Research in February.

One author said the worst financial and economic crisis in generations paled in comparison to what he called a looming "natural resources crisis" that would require investment professionals to rethink where they put clients' money.

Last year, environmental group WWF said investors faced increased risk from companies that invested in unconventional fossil fuels without considering pending climate regulations or greenhouse gas emission permit costs in a carbon-constrained economy.

(Reporting by Michael Szabo; Editing by Michael Kahn and Jon Boyle)

Pensions&Investments

U.N. to managers: Ignore ESG issues at own legal peril

By Barry B. Burr
Source: Pensions & Investments
Date: July 14, 2009

Investment managers and consultants could face negligence lawsuits if they don't consider environment, social and corporate governance issues when making investment decisions for pension funds and other clients, according to a new United Nations report.

"In tendering for investment mandates, it would be expected that the investment consultant or asset manager would raise ESG considerations as an issue to be taken into account and discussed with the client, even if the pension fund had not specified ESG considerations as material to the tender," Paul Watchman, CEO of Quayle Watchman Consulting, said in the report. Mr. Watchman was a legal consultant on the report.

"If the investment consultant or asset manager fails to do so, there is a very real risk that they will be sued for negligence on the ground that they failed to discharge their professional duty of care to the client by failing to raise and take into account ESG considerations," he said.

Among the recommendations in the report, "Advisers to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position. Therefore, responsible investment, active ownership and the promotion of sustainable business practices should be a routine part of all investment arrangements, rather than the optional add-on which many consultants appear to treat it as."

The report, "Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment," was prepared by the asset management working group of the United Nations Environment Programme's Finance Initiative, which is a partnership of the U.N. and some 180 investment firms, banks, and insurance companies. The group includes AIG Investments, BNP Paribas Asset Management, Calvert Investments, ClearBridge Advisors, HSBC Global Asset Management, Mitsubishi UFJ Trust & Banking, Nikko Asset Management Japan and Pax World Management.

Climate-L.org

UNEP Report on Green Investments Wins Asset Managers Support

14 July 2009: The UN Environment Programme Finance Initiative (UNEP FI) Asset Management Working Group, a partnership between UNEP and over 180 financial institutions worldwide, has released a report titled "Fiduciary Responsibility - Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment." The Group of 180 asset managers represents approximately US$2 trillion in assets under management and argue that integrating environmental, social and governance (ESG) considerations into investment decisions is no longer a luxury, but a legal responsibility.

The report underlines how the world's largest institutional investors, including pension funds, insurance companies, sovereign wealth funds, mutual funds and foundations, have a central role in assisting the transition to a low-carbon and resource-efficient green economy. It also states that professional investment advisors and service providers, such as investment consultants, asset managers and institutional investors may have a far greater legal obligation to incorporate ESG issues into their investment services or face "a very real risk that they will be sued for negligence." [UNEP press release] [The report]

UN: GREEN INVESTMENTS A LEGAL RESPONSIBILITY

UNITED NATIONS, July 15 (NNN-UNNS) -- 'Green' investments are no longer just a luxury, but are now a legal responsibility, according to a new report by the United Nations Environment Programme (UNEP) and a powerful group of asset managers controlling some $2 trillion in assets.

The 120-page publication released Tuesday argues that if investment consultants and others do not incorporate environmental, social and governance (ESG) considerations into their services, they face "a very real risk that they will be sued for negligence."

It also stressed the central role that the world's largest institutional investors – including pensions funds, insurance companies, sovereign wealth funds and mutual funds – have in easing the transition to a low-carbon and resource-efficient green economy.

"ESG issues are not peripheral but should be part of mainstream investment decisions-making processes across the industry," said UNEP Executive Director Achim Steiner.

Further, he noted that creative market mechanisms and other incentives can help to ensure that as investors return to markets after the current financial turmoil ends, they will put their funds into a greener economy and not the "brown economy of yesterday."

The new report, entitled "Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment," was produced by Asset Management Working Group of the UNEP Finance Initiative (UNEP FI), a partnership between the agency and more nearly 200 financial institutions around the world.

It was launched on the eve of the annual Principles for Responsible Investment (PRI) event in Sydney, Australia, which will draw many of the largest institutional investors.

Almost 600 institutions, representing over $18 trillion in assets, have signed up to the PRI, a joint effort between the UNEP FI and the UN Global Compact, a voluntary initiative to promote corporate citizenship which currently involves over 5,000 companies across 130 countries. -- NNN-UNNS

responsible investor

UN-backed report says advisors and fund managers risk being sued if they don't put ESG in contracts

Follow-up to Freshfields report on fiduciary duty extends legal argument on environmental, social and governance responsibility.

by **Hugh Wheelan** | July 15th, 2009

Institutional investment consultants and fund managers face a "very real risk" of being sued for negligence if they are not proactive in incorporating environmental, social and governance (ESG) factors into legal contracts with pension funds, according to a United Nations-backed report. The opinion, published by the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (UNEP FI), a partnership between the UN and over 180 financial institutions worldwide, is titled Fiduciary 2, and is a follow-up to 2005's Freshfields report that looked at whether pension trustees, notably in the UK but also in different countries, would be breaking fiduciary law if they considered ESG aspects in investment. It goes further than its predecessor by suggesting that the contract law under which consultants and asset managers operate in some jurisdictions could see them taken to court if they are found not to be providing a "duty of care" on issues such as environmental protection.

The report is based on the legal opinion of Paul Watchman of Quayle Watchman Consulting in the UK, principal author of the Freshfields Report, and Michael Gerrard, Robert Holton and Aron Estaver of Arnold & Porter LLP in the US. The report says consultants and asset managers' mandate contracts and operation under tort law as professional advisers mean they could

be obliged to raise ESG considerations that could be "material" to the contract, or face action if they don't: "As professional investment advisers, investment consultants and asset managers are under a contract for services rather than a contract of service. They are professional advisers to the client, not employees of the client; hence in exercising significant professional discretion (unless the professional investment adviser contracts out of that duty and even then it may be doubted if this can be done successfully), investment consultants and asset managers must be proactive rather than reactive." The report said: "If the investment consultant or asset manager fails to do so, there is a very real risk that they will be sued for negligence on the ground that they failed to discharge their professional duty

of care to the client by failing to raise and take into account ESG considerations. The duty of care as a professional is much more onerous than that of a non-professional as the person to whom the duty is owed is placing trust in the skills of the professional, and the professional is exercising discretionary powers far beyond those to be expected of a non-professional or layman." The report looks specifically at fiduciary and corporate law in the UK and US. Quayle Watchman Consulting said three main factors in the UK supported the case for a legal backing for ESG consideration. The first, it said, was commentary from Lord McKenzie during the passage of the UK Pensions Bill in 2008 that there was no reason in law why trustees could not consider social and moral criteria in addition to their usual criteria of financial returns, security and diversification. The second it said was the 'obligation' on pension fund trustees to say in their Statement of Investment Principles what the fund's guidelines are on responsible investment and to what extent social, environmental or ethical considerations are taken into account. The third it said was the potential related precedent of the 2006 Act on corporate directors' duties that it said could also cover pension trustees. The Act includes a duty for directors to run their business with regard to the impact on the community and the environment. The report said: "It is arguable that the duties of pension fund trustees are similar to company directors' common law statutory fiduciary duties but, if anything, because of the special relationship between trustees and beneficiaries, are more extensive and more long-term than the duties of company directors."

US law firm, Arnold & Porter in its commentary, said: "It does not appear that current US law forbids integrating ESG considerations into an asset manager's decision making process, so long as the focus is always on the value inuring to the beneficiaries and not on achieving unrelated objectives—even if positive collateral benefits result." It added: "So long as ESG considerations are assessed within the context of a prudent investment plan, ESG factors can (and, where they implicate value, risk and return, arguably should) constitute part of the asset management process." The report said that pension funds could look to base ESG policies on specific international law treaties, conventions or voluntary guidelines or principles, such as the Universal Declaration of Human Rights, ILO conventions, World Bank or IMF guidance and policies, the Equator Principles, the Carbon Principles, the Private Equity Council Guidelines for Responsible Investment, the UN Global Compact Principles, and industry or agricultural standards, for example, in relation to coffee, cocoa, palm oil or sustainable forestry. The UNEP FI report is due to be discussed at the Principles for Responsible Investment (PRI) Annual Event in Sydney, Australia, which starts today and convenes many of the world's largest institutional investors representing more than $18 trillion in assets.

Link to download report

MINISTRY OF FINANCE

Speech/article, 15.07.2009
By: Minister of Finance Kristin Halvorsen

Foreword – UN-report for promoting the integration of environmental, social and governance issues into institutional investment

The Norwegian Ministry of Finance is the formal owner and has overall responsibility for the management of the Government Pension Fund – Global, one of the largest funds in the world. The Fund is managed by the Ministry on behalf of the people of Norway—both present and future generations—who are the ultimate beneficiaries.

By virtue of our long-term investments in a large number of the world's companies, we have a responsibility for and an interest in promoting good corporate governance and safeguarding environmental and social concerns. In this vein, the Ministry aims towards integrating material environmental, social and governance issues, such as the risks and opportunities associated with climate change, into different parts of the management of the Fund.

Given the strength of the scientific evidence linking human activity with climate change, and the associated economic, social and political risks, I believe it is prudent for fiduciaries of financial institutions to consider the implications of climate change for strategic asset allocation decisions. The Ministry of Finance has recently detailed plans to establish a new environmental investment programme—aimed at investments that can be expected to yield indisputable environmental benefits, such as climate-friendly energy, improving energy efficiency, carbon capture and storage, water technology and management of waste and pollution. In addition, the Ministry is going to participate in a comprehensive research project managed by the consulting firm Mercer, which aims at assessing the impact of climate change on financial markets, as well as implications for strategic asset allocation. This is set up as a collaborative project where other investors are encouraged to join in.

The Ministry and Norges Bank, which undertakes the operational management of the Fund, are joint signatories to the Principles for Responsible Investment. Furthermore, the Fund is managed according to a set of Ethical Guidelines. Through the guidelines and the mechanisms under the guidelines, we signal expectations towards companies in the portfolio to respect and uphold widely shared fundamental ethical norms, such as human rights, in the conduct of their operations.

It is in this light that the Ministry welcomes this landmark publication by the United Nations Environment Programme Finance Initiative on the fiduciary responsibility of institutional investors. The report continues the debate initiated by the 2005 'Freshfields Report' of UNEP FI that explored the complex relationship between fiduciary law and environmental, social and governance issues in investment policymaking and practice.

UNEP FI's work to align investors, companies, markets and economies more closely with the goals of sustainable development is an important contribution to the advancement and dynamism of responsible investment.

green business.asia

Asset managers back green investments

15 July, 2009 09:23:00 UNEP
Font size: − +

A powerful group of asset managers, representing around USD 2 trillion in assets under management, are arguing that integrating environmental, social and governance (ESG) considerations into investment decisions is no longer just a luxury, but a legal responsibility.

The case, outlined in a new report with the United Nations Environment Programme (UNEP), underlines how the world's largest institutional investors -such as pension funds, insurance companies, sovereign wealth funds, mutual funds and foundations -have a central role in assisting the transition to a low carbon and resource efficient Green Economy.

Indeed, the report says that professional investment advisors and service providers -such as investment consultants and asset managers -to institutional investors may have a far greater legal obligation to incorporate ESG issues into their investment services or face *"a very real risk that they will be sued for negligence"* if they do not.

The 120-page report has been produced by the Asset Management Working Group of UNEP Finance Initiative (UNEP FI), a unique partnership between the UN's environmental arm and over 180 financial institutions worldwide.

The report also provides indicative legal language that can be used to embed ESG considerations in the investment management agreements and related legal contracts between institutional investors and their asset managers.

Achim Steiner, UN Under-Secretary-General and UNEP Executive Director, said: *"The significant environmental investments underpinning the current multi-trillion dollar stimulus packages are signalling the determination of some governments to make a transition to a more sustainable, 21st century economy."* he said.

"As investors return to the markets, the question remains whether the funds will only go to the brown economy of yesterday -or to a new Green Economy. Market signals, creative market mechanisms and other signals and incentives can play a transformational role,"

"This report also makes a powerful legal case for leadership in this area, underscoring the considered opinion of an influential group of asset managers that ESG issues are not peripheral but should be part of mainstream investment decision-making processes across the industry," said Mr. Steiner.

This entry was posted on Thursday, July 16th, 2009.

Leadership Blog Post

Report Links ESG and Fiduciary Duty

By Christie Renner

The world's largest institutional investors must play a central role in the transition to a low carbon economy, according to a report released yesterday by the Asset Management Working Group of the UN Environment Programme Finance Initiative (UNEP FI).

Fiduciary Responsibility – Legal and Practical Aspects of Integrating Environmental, Social and Governance (ESG) Issues into Institutional Investment states that investment options which take into account ESG issues should be the default, not the exception, and outlines the need for global capital market policymakers to support this investor duty.

Produced in partnership with over 180 financial institutions worldwide with over $2 trillion in assets, the report provides legal language for including ESG issues in the legal contracts between institutional investors and their asset managers.

It also makes the case for market incentives that reward long-term investment, and states that failing to incorporate ESG factors into investment decision making puts firms at "a very real risk that they will be sued for negligence."

Achim Steiner, UN Under-Secretary-General and UNEP Executive Director, said, "As investors return to the markets, the question remains whether the funds will only go to the brown economy of yesterday-or to a new Green Economy. Market signals, creative market mechanisms and other signals and incentives can play a transformational role."

Butch Bacani, Programme Officer, Insurance & Investment, UNEP Finance Initiative, pointed out, "The worst financial and economic crisis in generations pales in comparison to a looming 'Natural Resources Crisis.' Investors and financial markets should put an end to 'short-termism' and embed inherently longer-term ESG issues in their organizational DNA. [This report] offers a legal roadmap for responsible investing and marks an enlightened step towards a green, inclusive and sustainable global economy."

The UNEP FI is a collaborator in the Principles for Responsible Investment (PRI) initiative, to which First Affirmative was an early signatory. Over 560 institutions from around the world have signed onto the PRI, which provides a framework for investors to incorporate ESG issues in the investment process.

This new report was released just one day before the launch of the PRI in Person conference in Sydney, Australia, where PRI signatories (including many of the world's largest investors) from over 32 countries will come together to discuss the report's findings in the context of larger discussions on incorporating ESG criteria into investment decision making.

The 20th annual SRI in the Rockies Conference, October 25-28, 2009, produced by First Affirmative, will have a session focused on the evolving definition of fiduciary duty.

Christie Renner
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Legally Binding Disclosure of Environmental Risks Moves Closer to Reality

Fri Jul 17, 2009 1:00pm EDT

A new United Nations report suggests advisors to institutional investors may end up in court if they ignore environmental and social concerns.

Meanwhile, the Securities and Exchange Commission may reportedly consider whether to force public companies to tell their investors about the financial and physical risks they face from climate change.

The developments this week come as climate change legislation works its way through Congress. The centerpiece of the bill is a greenhouse gas cap-and-trade program that will put a price on carbon and impact energy-intensive industries the greatest. It is also a tumultuous time economically, with the world still reeling from a deep global recession in which assets have shrunk in value and investors have left the market.

Many in the responsible investing realm see the economic crisis as an opportunity to recast some of the basic tenets of fiduciary responsibility, according to the Asset Management Working Group of the United Nations Finance Initiative. Making decisions that account for environmental, social and governance (ESG) issues should be the default practice for all asset managers advising behemoth institutional investors, such as pension funds, foundations and insurance companies, according to their report, “Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment.”

Raising ESG issues with clients, even if not specified as material to the tender, would be expected, according to co-author Paul Watchman, who was also the principal author of the “Freshfields Report,” (PDF) the original legal interpretation from UNEP FI that examined the link between fiduciary law and ESG issues. “If the consultant or asset manager fails to do so, there is a very real risk that they will be sued for negligence on the ground that they failed to discharge their professional duty of care to the client by failing to raise and take into account ESG considerations,” Watchman said.

Responsible investors in the U.S. may soon learn more environmental information from the pubic companies into which they sink their money. Climate Wire reported this week the SEC, which has long resisted calls to require for companies to divulge climate change risk, is holding private meetings with investor advocacy groups to explore how much climate change disclosure companies should provide. "The staff is going to be working on it this year," SEC Commissioner Elisse Walter told Climate Wire, adding that it would be too speculative to predict when, or if, the commission would formally adopt new disclosure standards. "We have a lot of internal education to do," she said. "This obviously is not an agency populated with climate experts, and we're going to talk to everyone who is knowledgeable in the area, who's willing to talk to us. We'll educate ourselves, and then we'll decide -- the staff will decide -- what to put before the commission or not."

Ceres, a Boston-based network of NGOs and investors that advocates sustainable business practices, has long pressured the SEC on climate change disclosure. The chorus continues growing louder, with new calls ranging from pension funds to the National Association of Insurance Commissioners and the State of New York. A new disclosure requirement from the SEC would force companies across the country to measure their impacts, evaluate whether they are material to them, and report their findings, which could lead to a mass corporate scramble to create and analyze greenhouse gas inventories.

Benefits CANADA

This article is courtesy of www.benefitscanada.com

UN to investors: the world is in your hands

July 17, 2009 | Jody White

The world is now at a point where environmental, social and corporate governance (ESG) issues should be of paramount importance to institutional investors, and advisors should have a fiduciary duty to make such issues the default investment option, according to a report by the United Nations.

Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment, by the Asset Management Working Group of the United Nations Environment Programme Finance Initiative, draws a line in the sand for institutional investors and their advisors, challenging them to use their considerable power to effect change through their investments.

At the top of the group's action list is what it refers to as the "natural resources crisis," and the report suggests that responsible investing would have a threefold effect:
- It would make a major contribution to reviving the world economy, saving and creating jobs, and protecting vulnerable groups;
- It would reduce carbon dependency and ecosystem degradation, putting economies on a path to clean and stable development; and
- It would encourage sustainable and inclusive growth and end extreme poverty by 2015.

The report calls for the general adoption of the *Principles of Responsible Investment*, (PRI)—which were developed in 2006 in conjunction with the UN— along with several legal actions to be implemented in order to bring about change:

1. Advisors to institutional investors should have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the *default* position.

"Responsible investment, active ownership and the promotion of sustainable business practices should be a routine part of all investment arrangements, rather than the optional add on, which many consultants appear to treat it as," states the report's authors.

2. All asset manager and asset owner signatories to the PRI should be required to embed ESG issues in their legal contracts and should commit to integrating such issues into investment analysis.

3. All consultant, asset manager and other service provider signatories to the PRI should make a commitment to proactively raise ESG issues within their advisory and client take-on process.

The report argues that the most important aspect of the PRI is that institutional investors—who collectively represent approximately US$18 trillion in assets under management to date—have endorsed *Principle 4*, which states: "We will promote acceptance and implementation of the principles within the investment industry, including possible concrete actions such as incorporating principles-related requirements in requests for proposals and aligning investment mandates, monitoring procedures, performance indicators and incentive structures accordingly."

“The key question is whether these current trends among fiduciaries, along with commensurate actions from policymakers and civil society institutions, will reach a tipping point where the asset management industry is sufficiently engaged to help avert the natural resources crisis,” says the report.

“Some have argued that the ongoing financial crisis may not have been so deep or so protracted if institutional investors had been collectively willing to challenge the financial institutions that were at the heart of creating the systemic risks within the financial system. We also believe that one of the most important lessons from the crisis is that institutional investors’ responsible ownership needs to be strengthened in order to be fit for purpose.”

Read the report here.

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Managers, U.N. Push For 'Responsible' Investing

- 07/17/2009 **To comment on this article click here (0)**

A group of asset managers has teamed up with the **United Nations Environment Programme** (UNEP) to push for the integration of environmental, social and governance considerations in the investment process. The initiative--focused around a report published this past week and aimed at investment advisors and service providers--is an exercise in rebranding, a move away from the old image of "socially responsible" investing toward, simply, "responsible investing" that takes into account the myriad issues affecting the long-term viability of today's publicly traded companies.

The mutual fund and exchange-traded fund markets already have seen an uptick in the number of so-called green funds in recent years, launched both by firms known for socially responsible investment practices and by more mainstream, traditional asset managers. Going forward, those who worked on the UNEP report expect to see even more money flow into mutual funds, ETFs and other investments that proactively look at environmental, social and governance issues. In fact, they anticipate the examination of these practices will become a routine part of the investment process and therefore no longer be associated with what has been deemed a purely ethical or moral approach to evaluating investments.

"A lot of people argue ethics are important--I'm not trying to convince people there's an ethical issue here," **Paul Watchman**, ceo of U.K.-based **Quayle Watchman Consulting** and a contributor to the UNEP report, told *FA*. "What I'm trying to convince them of is that there's an investment issue here. There's a real question of investment prudence."

The 120-page report, *Fiduciary Responsibility--Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment*, was produced by the Asset Management Working Group of UNEP Finance Initiative, a partnership between UNEP and more than 180 financial institutions representing some $2 trillion in assets under management. It will be detailed during a telephone briefing this week led by its major contributors.

Paul Hilton, director of advanced equities research at **Calvert Investments** in Bethesda, Md., says his firm, which specializes in socially and environmentally responsible investing, has seen more money flowing in from investors and more attention being paid to ESG issues by mainstream mutual fund players such as **Wells Fargo** and **Dreyfus**, and data provider **Bloomberg**. "What we're trying to get to is the fact that whereas before people thought it was nice to tick a box, now it's a core part of the business," he said. "We're not just taking out bad companies--we're looking at big issues like climate change, water scarcity and product safety. We've gone from being an afterthought to being a core part of the debate."

Going forward, Hilton expects new funds and other investment vehicles to be focused more on environmental than social or governance issues, particularly with regard to energy.

Mary Jane McQuillen, a portfolio manager and director of the socially aware investment program at **ClearBridge Advisors** in New York, agreed one of the goals of the initiative with UNEP is to change the image of socially responsible investing. But she was reticent to push aside the ethical aspect of this type of evaluation. "I wouldn't entirely relinquish the concepts of ethics and morals as they are still implicitly part of the ESG process," she said. "I would expect the legal commentary and investment consultant feedback on ESG, as discussed in [the UNEP report], will provide strong support for a closer review of ESG factors into the investment-selection process." ***--Hillary Jackson***

FT.com
FINANCIAL TIMES

Time to prove responsible investment credentials

By Sophia Grene
Published: July 19 2009 09:21 | Last updated: July 19 2009 09:21

The investment management industry is coming under pressure to show its newfound interest in responsible investment is more than lip service.

Until now, the UN Principles for Responsible Investment have offered a free-rider opportunity to asset managers and owners anxious to jump on the sustainable bandwagon.

With no mandatory contribution and no requirement to do anything other than sign up, being a signatory has been far from onerous.

“There are people who are not contributing, but are benefiting financially from their signatory status,” says Steve Waygood, head of research and engagement at **Aviva** Investors.

This year, however, should see the first signatories ejected from the group, as those who did not fill out the self-assessment questionnaire are delisted.

Those who are ejected may then find themselves with more than a minor public relations problem as investment consultants are advised they have a duty to give environmental, social and governance issues a higher priority.

A report released by a UN asset management working group this week included a legal opinion that investment consultants could be sued if they fail to raise the question of ESG issues with their clients.

The report, from the UN Environment Programme Finance Initiative, calls for policymakers to make it clear that “advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position”.

It also recommends investment managers should routinely embed the PRI in their legal contracts, such as investment management agreements and statements of investment principles.

While Aviva does this already, Mr Waygood says “it’s only a very, very small minority that enshrine the Principles in their default agreements”.

He is also disappointed in signatories’ failure to examine their own progress with respect to ESG issues. “I don’t know of any who ask to see the annual assessment,” he says.

This would allow managers to compare their own performance with that of their peers and the industry in general.

The PRI released the 2009 annual report on the self-assessments of its signatories at its annual general meeting in Sydney last week.

Although the report is focused on the positive, citing a huge increase in numbers of signatories and the assets they represent, as well as the improvement in integration of SRI principles into mainstream investment, it is just the precursor to the group’s getting serious.

The PRI says members who failed to participate in the self-assessment will be delisted by the end of August. Mr Waygood wants even tougher action, calling for the process to be subject to more stringent verification, and for asset managers to be required to share the results of their assessment with investors.

“The PRI’s process needs to be enhanced over the next three to five years,” he says. Mr Waygood is a member of the asset management working group, while Aviva was a founder signatory of the PRI.

July 21, 2009

Advisors Should Be Required To Look At ESG Factors

Fiduciaries should be legally required to integrate environmental, social and governance factors into investment decision-making, says a new United Nations report supported by investment managers representing approximately $2 trillion in assets under management.

The report, Fiduciary Responsibility—Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment, was produced by the Asset Management Working Group of United Nations Environment Programme Finance Initiative (UNEP FI), a partnership between the UN's environmental arm and more than 180 financial institutions worldwide.

During today's news briefing, Calvert Investments, ClearBridge Advisors, Pax World Investments and UNEP FI experts revealed key findings of the report and discussed the responsibility fiduciaries have to incorporate ESG factors into investment decisions.

"We finally made the case that prudent fiduciaries should consider material ESG issues as an integral part of their investment decisions. This report takes the next step by making the case that advisors must be proactive in raising ESG issues with their clients, and by collectively calling on the investment industry, policymakers and civil society to move toward responsible and sustainable capital markets to help avert a 'Natural Resources Crisis'," said Paul Hilton, Calvert's director of advanced equities research and the Fiduciary II co-project lead.

"In order for our economy to advance in a responsible, sustainable way, ESG criteria should be incorporated into every investment decision," says Dr. Julie Fox Gorte, senior vice president for PAX Word Management Corp. and co-chair of UNEP FI Asset Management Working Group. "This report makes a powerful case that investment managers may be putting clients at risk if ESG issues aren't considered, and should be held responsible for those decisions. There must be a shift in investment philosophy to focus more on long-term, sustainable options, rather than short-term gains."

Professional investment advisors and service providers—such as investment consultants and asset managers—may have a legal obligation to incorporate ESG issues into their investment services or face a very real risk that they may open themselves up to legal liabilities if they do not, cites the report.

Key findings in the report include:

- The global economy has now reached the point where ESG issues are a critical consideration for all institutional investors and their agents.

- Investment consultants and asset managers have a duty to proactively raise ESG issues within their advice and services to institutional investors.

- ESG issues must be embedded in the legal contracts between institutional investors and their asset managers to hold asset managers to account, and that ESG issues should be included in periodic reporting by asset managers. Equally, the performance of asset managers should be assessed on a longer-term basis and linked to long-term incentives.

- Institutional investors will increasingly come to understand the financial materiality of ESG issues and the systemic risk they pose, and the profound long-term costs of unsustainable development and the consequent impacts on the long-term value of their investment portfolios.

- Institutional investors will increasingly apply pressure to their asset managers to develop robust investment strategies that integrate SG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.

- Policymakers should ensure regulatory frameworks that enable greater transparency and disclosure from institutional investors and their agents on the integration of ESG issues into their investment process—as well as from companies on their performance on ESG issues.

- Civil society institutions should collectively bolster their understanding of capital markets such that they can play a full role in ensuring that capital markets are sustainable and delivering responsible ownership practices.

- Market incentives that reward long-term investment must be made to help create responsible and sustainable capital markets that would help identify future challenges in the financial system, reduce the chances of further crises and help avert a "Natural Resources Crisis"—and accelerate the transformational process to a green, inclusive and sustainable global economy.

Click here for a copy of the 120-page report.

Pensions&Investments

ERISA requires ESG considerations, U.N. report says

By Barry B. Burr
Source: Pensions & Investments
Date: July 21, 2009

Pension fund fiduciaries under ERISA are “arguably required” to integrate environmental, social and corporate governance factors into their regular investment decision-making process, Paul A. Hilton, director of advanced equities research, Calvert Investments, said today at a teleconference on a new United Nations report on such fiduciary responsibility.

“These ESG issue are increasingly becoming very real and material issues that have bottom-line impacts on companies,” Mr. Hilton said at the teleconference. “And so with that understanding, it's clear, unlike (using only) a simple value approach, an approach that integrates these (factors) as part of the regular investment process is arguably required by any major fiduciary and that certainly holds true” under the Employee Retirement Income Security Act of 1974, Mr. Hilton said at the teleconference.

“ERISA language says if it is a material issue, it needs to be considered (in the investment process), and a lot of these ESG factors are material issues,” Mr. Hilton said in an interview after the teleconference. “Within the report is a call to policymakers to be more clear on the responsibility of (fiduciary) investors.”

Mr. Hilton was co-leader of the project by the U.N. asset management working group that produced the report “Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment.”

Butch Bucani, program officer-insurance and investment, United Nations Environmental Program, said at the teleconference that the report makes the case of “consultants and asset managers having a duty to proactively raise ESG issues within their advisory services to asset owners.” Mr. Bucani was the project manager and chief editor of the report.

GLOBAL: UNEP report claims green investments 'are a legal responsibility' (21/07/09)

Green investments are no longer just a luxury, but are now a legal responsibility, according to a new report by the United Nations Environment Programme (UNEP) and a powerful group of asset managers who control some $2 trillion in assets.

The 120-page publication argues that if investment consultants and others do not incorporate environmental, social and governance (ESG) considerations into their services, they face 'a very real risk that they will be sued for negligence'.

It also stressed the central role that the world's largest institutional investors – including pensions funds, insurance companies, sovereign wealth funds and mutual funds – have in easing the transition to a low-carbon and resource-efficient green economy.

UNEP Executive Director Achim Steiner said: 'ESG issues are not peripheral but should be part of mainstream investment decisions-making processes across the industry.'

He also noted that creative market mechanisms and other incentives can help to ensure that as investors return to markets after the current financial turmoil ends, they will put their funds into a greener economy and not the 'brown economy of yesterday'.

The new report, titled 'Fiduciary responsibility: legal and practical aspects of integrating environmental, social and governance issues into institutional investment', was produced by the Asset Management Working Group of the UNEP Finance Initiative (UNEP FI), a partnership between the agency and nearly 200 financial institutions around the world.
Lis Stedman

alternativeassetadviser

Advisers must proactively raise ESG issues with clients, says UN group

Wed, 22 Jul 2009

A group of asset managers, representing approximately USD2trn in assets under management, say that integrating environmental, social, and governance considerations into investment decisions should be a legal responsibility.

The statement is outlined in a new report, 'Fiduciary Responsibility - Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment', produced by the Asset Management Working Group of United Nations Environment Programme Finance Initiative, a partnership between the UN's environmental arm and over 180 financial institutions worldwide.

"We finally made the case that prudent fiduciaries should consider material ESG issues as an integral part of their investment decisions. This report takes the next step by making the case that advisors must be proactive in raising ESG issues with their clients, and by collectively calling on the investment industry, policymakers and civil society to move toward responsible and sustainable capital markets to help avert a natural resources crisis," says Paul Hilton, director of advanced equities research at Calvert and the Fiduciary II co-project lead.

"This new report on fiduciary duty provides a significant, multi-faceted analysis of the legal and practical ESG developments in the global investment arena, including updated legal views from North America. With forward-looking commentary and recommendations from leading legal experts, investment consultants, and asset managers, it appears that institutional investors will have an easier time allocating to well-managed sustainable investments," says Mary Jane McQuillen, director and portfolio manager, socially aware investment at ClearBridge Advisors, and the Fiduciary II co-project lead.

Professional investment advisers and service providers - such as investment consultants and asset managers - may have a legal obligation to incorporate ESG issues into their investment services or face the risk of opening themselves up to legal liabilities if they do not, the report says.

The report also provides indicative legal language that can be used to embed ESG considerations in the investment management agreements and related legal contracts between institutional investors and their asset managers.

The report found that the global economy has now reached the point where ESG issues are a critical consideration for all institutional investors and their agents.

It says ESG issues must be embedded in the legal contracts between institutional investors and their asset managers to hold asset managers to account, and that ESG issues should be included in periodic reporting by asset managers. Equally, the performance of asset managers should be assessed on a longer-term basis and linked to long-term incentives.

The group believes institutional investors will increasingly come to understand the financial materiality of ESG issues and the systemic risk they pose, and the profound long-term costs of unsustainable development and the consequent impacts on the long-term value of their investment portfolios.

Institutional investors will also increasingly apply pressure to their asset managers to develop robust investment strategies that integrate ESG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.

The report states that market incentives that reward long-term investment must be made to help create responsible and sustainable capital markets that would help identify future challenges in the financial system, reduce the chances of further crises and help avert a natural resources crisis.

July 22, 2009

UNEP Hones Legal Argument for ESG Incorporation in Investments in New Study

by Robert Kropp

Report by the United Nations Environment Program Finance Initiative's Asset Management Working Group serves as a sequel to landmark Freshfields study, which established legal case for ESG criteria in investing. First in a two-part series.

Whether asset managers have a fiduciary, and even legal, responsibility to incorporate environmental, social, and governance (ESG) issues into the investment decisions they make on behalf of their clients has long been a matter of debate. If the purpose of investing is to secure a financial return, can ESG criteria be said to be material? When seeking financial returns on behalf of their clients, what investment horizon should asset managers consider? Do asset managers place themselves at risk of being sued if failure to incorporate ESG criteria in investment decisions leads to losses due to such factors as climate change?

A report recently issued by the United Nations Environment Program Finance Initiative (UNEP FI) seeks to provide updated information on the legal ramifications of ESG criteria in investment management, as well as describe the growing support for such ESG initiatives as the Principles for Responsible Investment (PRI) among both asset owners and managers.

Entitled Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment (Fiduciary II), the report argues that consultants may well have a legal duty to proactively raise ESG issues with their clients. The report also recommends that ESG issues be embedded into legal contracts between asset owners and asset managers.

Fiduciary II is but the latest stage of an ongoing effort by UNEP FI to make the case for incorporating ESG criteria into investment decision-making. In 2002, it formed the Asset Management Working Group (AMWG), which now includes 15 members and represents approximately $3 trillion of assets under management.

Dr. Julie Fox Gorte, who in addition to serving as Senior Vice President of PAX World Funds, is Co-Chair of the AMWG, said, "UNEP FI exists because over 170 banks, insurance companies, and asset managers believe that integrating ESG analysis in financial decision-making is crucial, for the proper functioning of financial markets and for the continued health of the planet and its societies."

Dr. Gorte continued, "Since 2002, the AMWG has issued a stream of reports that helped catalyze the incorporation of ESG issues into both buy-side and sell-side financial analysis, introduced the idea of integration into private equity management, and helped to launch the PRI."

One of the most important early reports, issues in June, 2004, sought to determine the business case for incorporating ESG issues into investment decision-making. Entitled The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing (Materiality 1), the report found that "environmental, social and corporate governance criteria impact both positively and negatively on long-term shareholder value. In some cases these effects may be profound."

The report derived two far-reaching conclusions from the finding that ESG criteria do impact shareowner value. The first, that "research to determine the financial materiality of these criteria should use longer time spans than is currently the norm for financial analysis", is one of the central tenets of sustainability investing.

The second conclusion, that "Governments can reduce barriers to environmental, social and corporate governance analysis by mandating and standardizing the inclusion of these criteria in national and international financial disclosure frameworks", anticipates the growing call for mandatory reporting that we now see in the adoption of carbon pricing schemes in most developed countries.

While Materiality 1 conclusively established a business case for the incorporation of ESG criteria into investing, it did not address the legal ramifications of ESG incorporation to be considered by asset managers. In response to legal interpretations that in some cases suggested that investors were prevented from incorporating ESG criteria into investments, the AMWG commissioned the law firm of Freshfields Bruckhaus Deringer, which in 2005 produced a landmark report entitled A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment.

The authors of the report concluded that "decision-makers are required to have regard (at some level) to ESG considerations in every decision they make. This is because there is a body of credible evidence demonstrating that such considerations often have a role to play in the proper analysis of investment value." Therefore, according to the authors, the consideration of ESG criteria falls within the bounds of fiduciary duty.

Dr. Gorte said of the Freshfields report, "The report looked at the infrastructure of institutional investing in nine countries, and concluded that there were not only no legal impediments to integrating sustainability into institutional investments, but there were arguably and in some cases assuredly a requirement to do so. Institutional investors that failed to do so could be breaching their fiduciary responsibility."

The business and legal cases for ESG incorporation that were supported by these early reports helped lead to the formation by UNEP FI and the United Nations Global Compact of the PRI, which was launched in 2006. Today, the PRI includes 560 signatories, representing over $18 trillion in assets under management.

According to UNEP, the Freshfields report has been "considered by key opinion formers in the investment industry as the single most effective document for promoting the integration of ESG issues into institutional investment."

Fiduciary II, the report produced by the AMWG in June, serves as a sequel to the Freshfields report, and is intended by the AMWG to "provide a roadmap for fiduciaries looking for concrete steps to operationalize their commitment to responsible investment." The findings of Fiduciary II will be explored in the second of this series of articles.

July 23, 2009

ESG Issues Should be Embedded in Legal Agreements Between Investors and Advisors, Report Finds

by Robert Kropp

A new report by the Asset Management Working Group of the United Nations Environment Program Finance Initiative argues that advisors who fail to raise ESG issues with clients face the risk of lawsuits. Second in a two-part series.

In 2005, the Asset Management Working Group (AMWG) of the United Nations Environment Program Finance Initiative (UNEP FI) commissioned the law firm of Freshfields Bruckhaus Deringer to author a landmark report entitled A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment. The report broke important new ground in its finding that the consideration of environmental, social, and governance (ESG) criteria falls within the bounds of the fiduciary duty of asset owners.

According to Paul Watchman, the senior author of the Freshfields report, "Far from preventing the integration of ESG considerations, the law clearly permits and, in certain circumstances, requires that this be done."

In July, the AMWG published a follow-up to the Freshfields report, entitled Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment (Fiduciary II). The new report builds upon its predecessor by arguing that "Advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position."

Furthermore, according to the report, investment advisors that fail to incorporate ESG issues into their investment services face "a very real risk that they will be sued for negligence." In order to avoid such a scenario, "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 client reporting."

Fiduciary II consists of three major sections. The first of these examines the legal perspective on the incorporation of ESG criteria into the investment process, and concludes with several recommendations. In addition to recommending that the incorporation of ESG issues become a routine part of the investment process, the report recommends that asset managers that are signatories to the Principles for Responsible Investment (PRI) should commit to proactively raising ESG issues within their advisory processes.

Referring to the findings in the legal section of Fiduciary II, Paul Hilton, who is the Director of Advanced Equities Research at Calvert Investments and served as Co-Project Lead for Fiduciary II, said, "Pension fund trustees and other institutional investors should consider having their asset managers adopt the PRI, and ask that their asset managers demonstrate active participation in the development of the PRI."

"This report specifies how institutional asset owners should begin to operationalize their responsibility to integrate ESG considerations into their investment analysis," Hilton continued. "It also highlights the related responsibilities of investment advisors to be more proactive in raising such issues."

The second section of the report analyzes the responses by investment management consulting firms to a survey from the AMWG. While the report notes an increase in demand for ESG services since the advent of the PRI in 2006, it also finds that the industry has not yet developed ways to measure the competence of asset managers relating to ESG integration and engagement.

Furthermore, the report finds that in some cases, the responses of investment advisors conflict with the legal advice contained in the report. While the report states that it is "the professional duty of institutional investment consultants and asset managers to proactively raise ESG considerations with their clients", respondents to the survey indicated that they generally wait for their clients to raise ESG issues. Respondents also differed with the report's finding that ESG considerations should be embedded in investment services contracts.

Mary Jane McQuillen, the Director and Portfolio Manager of Socially Aware Investments at ClearBridge Advisors and a Fiduciary II Co-Project Lead, said, "To wait for trustees or managers to raise this issue may be a breach of consultants' professional duty to their clients."

As an example of good practice by investment consultants, McQuillen referred to the answer provided by Mercer to the question, "Do you consider that integration of ESG matters is a requisite aspect of investment management as part of fiduciary duty?"

Mercer's response was, "Yes. An increasing body of evidence exists to show that ESG factors can impact investment performance. Therefore, fiduciaries concerned with long-term preservation and growth of capital should have some understanding of how ESG factors may affect their portfolios."

The third section of the report finds that while laws regarding fiduciary duty have changed little since the Freshfields report, "many institutional investors are beginning to see their fiduciary duty as allowing for, or even requiring, a more sustainable investment approach." The section examines several initiatives among pension plans and institutional investors that explicitly incorporate ESG issues into their processes, and cites numerous studies that provide guidance for institutional investors wishing to do so.

The third section of Fiduciary II also describes the integration of ESG criteria into new asset classes, such as private equity and property investment, and financial sectors such as insurance.

Butch Bucani, Program Officer for Insurance and Investment at UNEP, and the Fiduciary II Project Manager and Chief Editor, said, "Many leading institutional investors are adopting longer-term and more responsible and sustainable investment strategies, and in fact are moving toward greater integration of ESG issues into overall investment philosophy and practice."

Bucani continued, "In order to achieve the original vision of the Freshfields report, ESG issues should be embedded into the legal contracts between asset owners and asset managers. The report makes the case that asset managers have a duty to proactively raise ESG issues with their clients."

He concluded, "Taking ESG issues into account will align institutional investors with the interests of society."

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Advisors Must Raise Environmental, Social & Governance Issues with Clients - New Report

By *Sivonne Binks*
Created *23/07/2009 - 13:21*

A group of US asset managers, representing approximately $US2 trillion in assets under management, say that integrating environmental, social, and governance (ESG) considerations into investment decisions should be a legal responsibility.

This follows the publication of a new report called *Fiduciary Responsibility - Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment*, produced by the Asset Management Working Group of United Nations Environment Programme Finance Initiative (UNEP FI), which is a partnership between the UN's environmental arm and over 180 financial institutions worldwide.

In the report Calvert Investments, ClearBridge Advisors, Pax World Investments, and UNEP FI experts revealed key findings and discussed the responsibility fiduciaries have to incorporate ESG factors into investment decisions.

Paul Hilton, Director of Advanced Equities Research at Calvert, and the Fiduciary II Co-Project Leader says the report makes the case that prudent fiduciaries should consider material ESG issues as an integral part of their investment decisions.

Hilton says this report takes the next step by making the case that advisors must be proactive in raising ESG issues with their clients, and by collectively calling on the investment industry, policymakers and civil society to move toward responsible and sustainable capital markets to help avert a 'Natural Resources Crisis'.

Dr. Julie Fox Gorte, Senior Vice President, PAX World Management Corp., Co-Chair of UNEP FI Asset Management Working Group says this report makes a powerful case that investment managers may be putting clients at risk if ESG issues aren't considered, and should be held responsible for those decisions. There must be a shift in investment philosophy to focus more on long-term, sustainable options, rather than short-term gains.

The report says professional investment advisors and service providers - such as investment consultants and asset managers--may have a legal obligation to incorporate ESG issues into their investment services or face a very real risk that they may open themselves up to legal liabilities if they do not.

The report also provides indicative legal language that can be used to embed ESG considerations in the investment management agreements and related legal contracts between institutional investors and their asset managers.

KEY HIGHTLIGHTS OF THE REPORT:

- The global economy has now reached the point where ESG issues are a critical consideration for all institutional investors and their agents.

- Investment consultants and asset managers have a duty to proactively raise ESG issues within their advice and services to institutional investors.

- ESG issues must be embedded in the legal contracts between institutional investors and their asset managers to hold asset managers to account, and that ESG issues should be included in periodic reporting by asset managers. Equally, the performance of asset managers should be assessed on a longer-term basis and linked to long-term incentives.

- Institutional investors will increasingly come to understand the financial materiality of ESG issues and the systemic risk they pose, and the profound long-term costs of unsustainable development and the consequent impacts on the long-term value of their investment portfolios.

- Institutional investors will increasingly apply pressure to their asset managers to develop robust investment strategies that integrate ESG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.

- Policymakers should ensure prudential regulatory frameworks that enable greater transparency and disclosure from institutional investors and their agents on the integration of ESG issues into their investment process--as well as from companies on their performance on ESG issues.

- Civil society institutions should collectively bolster their understanding of capital markets such that they can play a full role in ensuring that capital markets are sustainable and delivering responsible ownership practices.

- Market incentives that reward long-term investment must be made to help create responsible and sustainable capital markets would help identify future challenges in the financial system, reduce the chances of further crises and help avert a "Natural Resources Crisis"--and accelerate the transformational process to a green, inclusive and sustainable global economy.

The 120-page report titled: *Fiduciary Responsibility - Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment* can be found at www.unepfi.org [1]

Source URL: http://www.probonoaustralia.com.au/news/2009/07/advisors-must-raise-environmental-social-governance-issues-clients-new-report

Links:
[1] http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf

Is Responsible Investing a Must, or a Should? UNEP FI on Fiduciary Responsibility

By: Alan Petrillo | Friday, July 24th, 2009

Institutional investors may have a fiduciary duty to consider environmental, social, and governance (ESG) factors, according to a new study from the United Nations Environment Programme Finance Initiative (UNEP FI). In reporting on "Fiduciary Responsibility," Social Funds' Robert Kropp expressed the uncertainty that still surrounds the question of ESG-related fiduciary responsibilities:

"The report argues that consultants may well have a legal duty to proactively raise ESG issues with their clients. The report also recommends that ESG issues be embedded into legal contracts between asset owners and asset managers."

As the case for managers' ESG-related obligations under securities and trust law is still open, UNEP FI says, ESG proponents should encourage clients to demand integration from their advisors. For now, asset owners, not courts, must drive ESG integration – though lawmakers may yet embed responsible investing into managers' obligations.

"We need to live off the interest"

In his introduction to the 101-page report, Achim Steiner of UNEP FI says that the economic crisis "requires us to review the economic models this century has inherited from the last one." He places particular emphasis on the environment, declaring that "we are living off the Earth's capital – we need to live off the interest."

Towards this end, "Fiduciary Responsibility" describes how some shareholders have begun to consider the ESG performance of the companies they invest in. While the report does not prove that ESG integration is a fiduciary duty, it does offer practical reforms that would help create such duties. For example, UNEP FI calls out signatories of the Principles for Responsible Investment (PRI): "…In order to maintain their membership, all asset manager and asset owner signatories [should be required to] embed ESG issues in their legal contracts."

UNEP FI also says that government should redefine the work of fiduciaries:

"Global capital market policymakers should also make it clear that advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position.

"Furthermore, policymakers should ensure prudential regulatory frameworks that enable greater transparency and disclosure from institutional investors and their agents on the integration of ESG issues into their investment."

Commentary on ESG and Fiduciary Duty

"Fiduciary Responsibility" is the sequel to a 2005 UNEP FI study, called the "Freshfields report" after the consultants who prepared it, that helped spur the creation of the PRI.

The new report includes a literature review of "practical developments" in ESG integration; the results of a survey of how major investment managers approach the topic; and commentary from UK and US experts in fiduciary law.

Quayle Watchman Consulting describes how attitudes and laws have changed since 2005. In the UK, the law now impels corporate directors to consider the broader effects of their decisions:

"Under current United Kingdom company law legislation, the Companies Act 2006 (the '2006 Act') imposes duties on company directors to report on the environmental and social impacts of their business activities.

"[Guidance] on the duty of directors to promote the success of the company under section 172 of the 2006 Act, which is the principal replacement duty for the common law fiduciary duties of company directors, also adds that 'success' is to be judged in terms of long-term increase in the value of the company rather than short-term gains."

The obligations of directors have changed, but Quayle Watchman notes that "the government declined to introduce amending legislation to clarify the position of pension fund trustees." While trustees may consider ESG factors in their investment decisions, there is no legal imperative to do so. Quayle Watchman considers the roots of trustees' "short-termism":

"There appears to be resistors to responsible investing which relate to deeply-rooted characteristics of the investment decision-making system including: the mandates that pension funds and their investment consultants set; the systems for measuring and rewarding performance (which focus on peer comparison and beating benchmarks rather than on fulfilling the long-term liabilities of pension funds); and the competencies of service providers (e.g. sell-side analysts).

"The effect of this resulting short-termism is that less attention is paid to responsible investment matters than is appropriate—these issues are too long-term in nature to affect the day-to-day behavior of fund managers."

Asset Owners Must Lead Their Managers

Quayle Watchman explains how investors, "in the absence of government legislation or regulations, codes of practice or guidance," can build a long-term perspective into capital markets. They note the impact of the PRI program, which has attracted more than 550 signatories, representing approximately $18 trillion in assets under management.

Responsible investment, conducted at this scale, has helped shift the financial sector's priorities. "Fiduciary Responsibility" cites Bloomberg's placement of carbon emissions data on its terminals as evidence that sustainability is now a mainstream concern.

In the aftermath of the global financial crisis, fiduciary duties may undergo a broader philosophical shift. According to Quayle Watchman:

"The courts accept, despite the widespread use of mathematical modeling, that investment is an art rather than a science, and that there is a wide spectrum of opinion on investment which may be held by advisers without an adviser acting negligently."

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ESG integration – a legal requirement?

July 24, 2009, 12:51 pm

A report by the Asset Management Working Group of the United Nations Environment Programme Finance Initiative links the integration of ESG (environmental, social and corporate governance) issues into investment processes with legal responsibilities of fiduciaries (including pension trustees, asset managers and investment advisors). It also calls into question whether the institutional investment industry responsible ownership activities have, to date, actually been fit for purpose.

The report, entitled 'Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment' follows on from the 2005 Freshfields Report by the same group and the establishment of the UN PRI in 2006. It encompasses a legal commentary on fiduciary duty and the implementation of ESG in investment mandates, a survey of investment consultants on ESG integration and a summary of practical developments on ESG integration. It lays down a number of challenging provisions and observations designed to raise the profile and demand for Responsible Investment (RI).

With respect to investment mandates, asset owners and their advisors are challenged to:

- Establish RI as a default requirement of investment mandates instead of an optional add-on;
- Embed ESG issues into legal contracts and regulatory documentation (this could be made a part of the UN PRI requirements for signatories);
- Pro-actively raise ESG issues during take-on processes; and
- Report to clients their UN PRI performance assessments.

The investment advisor industry survey revealed the enduring overall impression of a 'tick box' mentality to ESG issues, which needs recognition both by regulators and civil society. The impact of Principle 4 of the PRI (inclusion of ESG in requests for proposals and the alignment of monitoring, performance indicators and incentive structures accordingly) is a "notable increase in the overall levels of ESG integration

and engagement among asset managers" despite the fact that many signatories have some way to go on its' implementation.

The report saves its most incisive assertion for last: "Some have argued that the ongoing financial crisis may not have been so deep or so protracted if institutional investors had been collectively willing to challenge the financial institutions that were at the heart of creating the systemic risks within the financial system. We also believe that one of the most important lessons from the crisis is that institutional investors' responsible ownership needs to be strengthened in order to be fit for purpose".

Much lip service has been paid to the importance of integrating ESG into investment processes. This report importantly raises the bar from ESG integration being a 'nice to have' to the point of becoming an integral part of legal fiduciary responsibility and fitness for purpose of investment ownership strategy.

'Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment'

Freshfields Report

UN PRI

Pensions&Investments

Report predicts legal threat if ESG factors are ignored

By Barry B. Burr
Source: Pensions & Investments
Date: July 27, 2009

Some pension funds, investment managers and consultants that ignore environmental, social and corporate governance factors in their investment decisions do so at their own risk, according to a new U.N. report.

Pension fund fiduciaries under ERISA are “arguably required” to integrate ESG issues into their regular investment decision-making process, Paul A. Hilton, director of advanced equities research, Calvert Investments and co-leader of the project that produced the report, said at a July 21 teleconference on the report.

And investment managers and consultants could face negligence lawsuits if they don't consider such factors when making investment decisions for pension funds and other clients, the report noted.

“These ESG issue are increasingly becoming very real and material issues that have bottom-line impacts on companies,” Mr. Hilton said at the teleconference. “And so with that understanding, it's clear, unlike (using only) a simple value approach, an approach that integrates these (factors) as part of the regular investment process is arguably required by any major fiduciary and that certainly holds true” under the Employee Retirement Income Security Act of 1974. “ERISA language says if it is a material issue, it needs to be considered (in the investment process), and a lot of these ESG factors are material issues,” Mr. Hilton said in an interview after the teleconference. “Within the report is a call to policymakers to be more clear on the responsibility of (fiduciary) investors,” he continued.

Butch Bucani, program officer-insurance and investment of the United Nations Environment Program, said at the teleconference that the report makes the case of “consultants and asset managers having a duty to proactively raise ESG issues within their advisory services to asset owners.” Mr. Bucani was the project manager and chief editor of the report.

“In tendering for investment mandates, it would be expected that the investment consultant or asset manager would raise ESG considerations as an issue to be taken into account and discussed with the client, even if the pension fund had not specified ESG considerations as material to the tender,” Paul Watchman, CEO of Quayle Watchman Consulting, said in the report. Mr. Watchman was a legal consultant on the report.

“If the investment consultant or asset manager fails to do so, there is a very real risk that they will be sued for negligence on the ground that they failed to discharge their professional duty of care to the client by failing to raise and take into account ESG considerations,” he said.

Among the recommendations in the report, “Advisers to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position. Therefore, responsible investment, active ownership and the promotion of sustainable business practices should be a routine part of all investment arrangements, rather than the optional add-on which many consultants appear to treat it as.”

The report, “Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment,” was prepared by the asset management working group of the United Nations Environment Program's Finance Initiative, which is a partnership of the U.N. and some 180 investment firms, banks, and insurance companies.

EthicsWorld Business Ethics . Governance . Anti-Corruption

July 28, 2009

"A New Green Deal" - UNEP Asset Management Working Group Report

* * *

Calling for a 'Global Green New Deal'

Sustainable Investing -- Report Points to Progress and Critical Issues

550 fund firms have signed key Principles for Responsible Investment (PRI), representing over US$18 trillion under management - but critical "green" issues are still not top priority for most of the industry, says the study by the Asset Management Working Group of the united Nations Envoironmental Program (UNEP) - The report: Fiduciary Responsibility – Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment

The PRI, formulated in 2006, is an investor initiative in partnership with UNEP FI and the UN Global Compact, and
provides a framework through which institutional investors can publicly commit to incorporating Environmental, Social, and Governance (ESG) issues into mainstream investment decision-making and ownership practices.

Important endorsement from Norway's Finance Minister (Norway manages one of the world's largest sovereign wealth funds)

Kristin Halvorsen
Minister of Finance, Norwegian Ministry of Finance

"Given the strength of the scientific evidence linking human activity with climate change, and the associated economic, social and political risks, I believe it is prudent for fiduciaries of financial institutions to consider the implications of climate change for strategic asset allocation decisions. The Ministry of Finance has recently detailed plans to establish a new environmental investment programme—aimed at investments that can be expected to yield indisputable environmental benefits, such as climate-friendly energy, improving energy efficiency, carbon capture and storage, water technology and management of waste and pollution. In addition, the Ministry is going to participate in a comprehensive research project managed by the consulting firm Mercer, which aims at assessing the impact of climate change on financial markets, as well as implications for strategic asset allocation. This is set up as a collaborative project where other investors are encouraged to join in."

UNEP's Perspective

Achim Steiner
United Nations Under-Secretary-General and Executive Director, United Nations Environment Programme

"To be able to sustain their wealth creation role, investors and companies have a fundamental role to play in supporting the transition to a green economy. The recent crisis cannot be an alibi for inaction, but a call for action."

As UNEP points out, " 2009—A powerful group of asset managers, representing around USD 2 trillion in assets under management, are arguing that integrating environmental, social and governance (ESG) considerations into investment decisions is no longer just a luxury, but a legal responsibility. The new report with the United Nations Environment Programme (UNEP), underlines how the world's largest institutional investors—such as pension funds, insurance companies, sovereign wealth funds, mutual funds and foundations—have a central role in assisting the transition to a low carbon and resource efficient Green Economy."

The Report's Key Messages from the Working Group

(also see report press releases from UNEP and from the Calvert Group press release)

We believe that through the integration of ESG issues into investment policymaking and decisionmaking, institutional investors—and the companies that they invest in—will be able to sustain their wealth creation role and play their fundamental role in the creation of a more sustainable global economy that invests in real and inclusive long-term growth, genuine prosperity and job creation, in line with UNEP's Green Economy Initiative4 and the broad objectives of its 'Global Green New Deal':

Make a major contribution to reviving the world economy, saving and creating jobs, and protecting vulnerable groups;
Reduce carbon dependency and ecosystem degradation, putting economies on a path to clean and stable development;
Further sustainable and inclusive growth, achieve the Millennium Development Goals, and end extreme poverty by 2015.

We are collectively calling for the following actions:

Advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position. Therefore, responsible investment, active ownership and the promotion of sustainable business practices should be a routine part of all investment arrangements, rather than the optional add-on which many consultants appear to treat it as.
The Principles for Responsible Investment (PRI) should specify that—in order to maintain their membership—all asset manager and asset owner signatories will be required to embed ESG issues in their legal contracts—such as investment management agreements, and Statements of Investment Principles or Investment Policy Statements. The PRI requires that 'where consistent with fiduciary responsibilities' signatories should commit to integrating ESG issues into investment analysis; to being active, responsible owners by promoting good corporate practice in these areas; and to reporting on what actions they have taken. We believe that embedding ESG issues in their legal contracts will help asset owners hold asset managers to account for delivering on this important aspect of asset management.
Similarly, all consultants, asset managers and other service providers that are signatories to the PRI should make a commitment to proactively raise ESG issues within their advisory and client take-on process.
Critically, the PRI monitors the performance of its signatories in delivering the six principles via a relatively detailed questionnaire. This involves an annual assessment that benchmarks each signatory's performance in relation to each principle. This analysis is then shared with signatories, many of whom unfortunately do not share it with their clients, whose assets they manage. While reporting on performance to the PRI is one principle of the PRI, signatories are not required to share these performance assessments with their clients. As asset owners have a fiduciary duty in this area, their agents should be required to make this information available to them at no additional cost. Ultimately, this will lead to more informed market demand for responsible investment.

The most important aspect of the PRI is arguably that institutional investors, collectively representing approximately USD 18 trillion in assets under management to date, have endorsed Principle 4, which states that:
'We will promote acceptance and implementation of the Principles within the investment industry', including possible concrete actions such as but not limited to following: 'Include Principles-related requirements [ESG integration and engagement requirements] in requests for proposals (RFPs); and 'Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term horizons when appropriate).'

Concluding views on fiduciaries, policymakers and civil society:

1. Fiduciaries have a duty to consider more actively the adoption of responsible investment strategies.

2. Fiduciaries must recognise that integrating ESG issues into investment and ownership processes is part of responsible investment, and is necessary to managing risk and evaluating opportunities for long-term investment.

3. Fiduciaries will increasingly come to understand the materiality of ESG issues and the systemic risk it poses, and the profound long-term costs of unsustainable development and its consequent impacts on the long-term value of their investment portfolios.

4. Fiduciaries will increasingly apply pressure to their asset managers to develop robust investment strategies that integrate ESG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.

5. Global capital market policymakers should also make it clear that advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position. Furthermore, policymakers should ensure prudential regulatory frameworks that enable greater transparency and disclosure from institutional investors and their agents on the integration of ESG issues into their investment process, as well as from companies on their performance on ESG issues.

6. Finally, civil society institutions should collectively bolster their understanding of capital markets such that they can play a full role in ensuring that capital markets are sustainable and delivering responsible ownership.

The key question is whether these current trends among fiduciaries, along with commensurate actions from policymakers and civil society institutions, will reach a tipping point where the asset management industry is sufficiently engaged to help avert the Natural Resources Crisis. Some have argued that the ongoing financial crisis may not have been so deep or so protracted if institutional investors had been collectively willing to challenge the financial institutions that were at the heart of creating the systemic risks within the financial system. We also believe that one of the most important lessons from the crisis is that institutional investors' responsible ownership needs to be strengthened in order to be fit for purpose. In conclusion, we believe that the global economy has now reached the point where ESG issues are a critical consideration for all institutional investors and their agents.

The UNEP FI Asset Management Working Group

Acuity Investment Management, Canada
AIG Investments, United States
Aviva Investors, United Kingdom
BNP Paribas Asset Management, France
Calvert Investments, United States
ClearBridge Advisors, United States
Eurizon Capital (Intesa Sanpaolo Group), Italy
Groupama Asset Management, France
Henderson Global Investors, United Kingdom
HSBC Global Asset Management, France
Mitsubishi UFJ Trust & Banking Corp., Japan
Nikko Asset Management, Japan
Pax World Management Corp., United States
RCM, United Kingdom
Santander Brasil Asset Management, Brazil

Invest Responsibly – It's the Law

Added: July 29, 2009

"There is no legal excuse now not to invest responsibly." Paul Clements-Hunt, Head, UNEP Finance Initiative

July 20, 2009 - A powerful group of asset managers, representing around USD 2 trillion in assets under management, are arguing that integrating environmental, social and governance (ESG) considerations into investment decisions is no longer just a luxury, but a legal responsibility.

The case, outlined in a new report with the United Nations Environment Programme (UNEP), underlines how the world's largest institutional investors-such as pension funds, insurance companies, sovereign wealth funds, mutual funds and foundations - have a central role in assisting the transition to a low carbon and resource efficient Green Economy.

Indeed, the report says that professional investment advisors and service providers-such as investment consultants and asset managers - to institutional investors may have a far greater legal obligation to incorporate ESG issues into their investment services or face "a very real risk that they will be sued for negligence" if they do not.

This much-awaited sequel to the 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) issues into institutional investment, was produced by the Asset Management Working Group of UNEP Finance Initiative (UNEP FI), a unique partnership between the UN's environmental arm and over 180 financial institutions worldwide.

This 2009 follow-on report, "Fiduciary responsibility -- Legal and practical aspects of integrating environmental, social and governance issues into institutional investment," provides a legal roadmap for fiduciaries looking for concrete steps to make operational their commitment to responsible investment.

One of the major contributors to the new report is internationally-recognised fiduciary law expert, Paul Watchman, the principal author of the Freshfields Report.

Watchman notes in the report, "It is necessary for investment management agreements or the equivalent contract between pension funds and asset managers to use ESG language in order to clarify the expectations of the parties to the contract. In particular, it is important that it is made absolutely clear to beneficiaries, pension fund trustees and asset managers that ESG is regarded as a mainstream investment consideration."

Key findings of the Fiduciary II report:

* The global economy has now reached the point where ESG issues are a critical consideration for *all* institutional investors and their agents.

* Investment consultants and asset managers have a duty to proactively raise ESG issues within their advice and services to institutional investors-and that an investment option that takes into account ESG issues should be the *default* position. Global capital market policymakers should also make this duty clear.

* ESG issues must be embedded in the legal contracts between institutional investors and their asset managers to hold asset managers to account, and that ESG issues should be included in the periodic reporting by asset managers. Equally, the performance of asset managers should be assessed on a longer-term basis and linked to long-term incentives.

* Institutional investors will increasingly come to understand the financial materiality of ESG issues and the systemic risk it poses, and the profound long-term costs of unsustainable development and its consequent impacts on the long-term value of their investment portfolios.

* Institutional investors will increasingly apply pressure to their asset managers to develop robust investment strategies that integrate ESG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.

* Policymakers should ensure prudential regulatory frameworks that enable greater transparency and disclosure from institutional investors and their agents on the integration of ESG issues into their investment process-as well as from companies on their performance on ESG issues.

* Civil society institutions should collectively bolster their understanding of capital markets such that they can play a full role in ensuring that capital markets are sustainable and delivering responsible ownership practices.

* Market incentives that reward long-term investment must be made to help create responsible and sustainable capital markets that would help identify future challenges in the financial system, reduce the chances of further crises and help avert a "Natural Resources Crisis"-and accelerate the transformational process to a green, inclusive and sustainable global economy.

These issues will be discussed at the upcoming UNEP FI 2009 Global Roundtable taking place in Cape Town, South Africa on October 22-23 2009. Thematic discussions during the Global Roundtable will build around research and genuine ideas on sustainable finance including proposals on financing climate change mitigation articulated in the Green Paper - Financing Global Deal on Climate Change, reality check and promotion of integration of ESG issues in asset management, insurance, pension funds articulated in the Fiduciary II report, showcasing real-life effective ESG risk identification and positive sustainability impact of fund management complied through Environmental and Social Responsibility Observatory from across the globe, and much more.

These issues will also be a major topic at GLOBE 2010 taking place in Vancouver, March 24-26, 2010.

The Executive Summary of the report is available for download.

SOURCE: UNEP-FI

July 2009

UNEP releases sequel to its landmark report on fiduciary responsibility

UNEP: Fiduciary responsibility - legal and practical aspects of integrating environmental, social and governance issues into institutional investment (Jul 09)

EUROPE - The United Nations Environmental Program Finance Initiative (UNEP FI) Asset Management Working Group has launched the much-awaited sequel to its landmark 2005 report, which has arguably been the single most effective document for promoting the integration of environmental, social and governance (ESG) issues into institutional investment. This follow-up report provides a legal roadmap for fiduciaries looking for concrete steps to operationalise their commitment to responsible investment.

TRILLIUM ASSET MANAGEMENT® Investing for a Better World® Since 1982

July 2009

UN Report on Fiduciary Responsibility Released; Sr. Analyst Jonas Kron Acknowledged for Contribution

The United Nations Environment Program Finance Initiative (UNEP-FI) just issued its follow up report to the ground breaking "Freshfields Report." "Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues Into Institutional Investment" is intended to provide tangible recommendations to fiduciaries and give them a legal roadmap with which to achieve their commitment to responsible investment.

The report acknowledges the contribution's of Trillium Asset Management Corporation Senior Analyst Jonas Kron.

The report is another important step in encouraging the integration of environmental, social and governance (ESG) issues into institutional investment and management decisions. We are proud of our contributions to the report as a member of the legal team and look forward to continuing our support of similar efforts at the United Nations.

The report can be viewed here.

THE GREEN PAGES

August 2009

Build a good green economy – or get sued

"As investors return to the markets, the question remains whether the funds will only go to the brown economy of yesterday - or to a new Green Economy," says Achim Steiner, UN Under-Secretary-General and UNEP Executive Director.

But a powerful group of asset managers, representing around USD 2 trillion in assets under management, are arguing that green investment is no longer just a luxury, but a legal responsibility.

The case, outlined in a new report, Fiduciary Responsibility - Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment, with the United Nations Environment Programme (UNEP), underlines how the world's largest institutional investors -such as pension funds, insurance companies, sovereign wealth funds, mutual funds and foundations -have a central role in assisting the transition to a low carbon and resource efficient Green Economy.

However, investors have a legal obligation to raise environmental, social and governance (ESG) considerations or face legal repercussions. "In tendering for investment mandates, it would be expected that the investment consultant or asset manager would raise ESG considerations as an issue to be taken into account and discussed with the client even if the pension fund had not specified ESG considerations as material to the tender," says Paul Watchman, principal author of the original 2005 "Freshfields Report", the prequel to this new Fiduciary Report. "If the investment consultant or asset manager fails to do so, there is a very real risk that they will be sued for negligence on the ground that they failed to discharge their professional duty of care to the client by failing to raise and take into account ESG considerations." He emphasises that financial professionals on all levels need to "proactive" on the relevant issues of ESG.

The original "Freshfields Report", was one of the first legal interpretations of ESG issues in the context of fiduciary law in nine major capital market jurisdictions, and is considered by key opinion formers in the investment industry as the single most effective document for promoting the integration of ESG issues into institutional investment.

Financial institution and government bodies are recognising the need to marry fiscal responsibility with ESG issues on both a macro and micro level. "By virtue of our long-term investments in a large number of the world's companies, we have a responsibility for and an interest in promoting good corporate governance and safeguarding environmental and social concerns," says Kristin Halvorsen, the Norwegian Minister of Finance who wrote the Foreword for the report.

Source: UNEP

KOREA CAPITAL MARKET INSTITUTE

Fiduciary responsibility – Legal and practical aspects of integrating environmental, social and governance issues into institutional investment

2009-07-30 10:45:23
UNEP/FI
http://www.unepfi.org/publications/investment/index.html
fiduciaryII.pdf (1030 KB)

This report is a sequel to the UNEP FI Asset Management Working Group's 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) issues into institutional investment. This 2009 follow-on report provides a legal roadmap for fiduciaries looking for concrete steps to operationalise their commitment to responsible investment.

The report—termed "Fiduciary II"— has three main elements. The first is an exploration of the legal perspective on how best to operationalise 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 responses to a pioneering survey questionnaire 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 focuses on 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 new UNEP FI report was released just a few days before the Principles for Responsible Investment (PRI) Annual Event in Sydney, Australia, which convened many of the world's largest institutional investors and where the report's findings were deliberated. Over 560 institutions from the global investment community, representing more than USD 18 trillion in assets, have now signed on to the PRI, an investor initiative in partnership with UNEP FI and the UN Global Compact. The PRI was launched in 2006 by then UN Secretary-General Kofi Annan and endorsed in 2007 by current UN Secretary-General Ban Ki-moon.

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FEATURE ARTICLES

Fiduciary duties - the CSR mantra?

by Erin Lyon elyon@csr-asia.com

Fiduciary duties may not seem a sexy topic to many but to those focused on CSR it is and will increasingly become a key phrase. Developing legitimate arguments to promote CSR is a continuing challenge for those who work in the industry. "Why should we do it?" is always the starting point for many companies, and rightly so. There is a growing spectrum of arguments as to why companies should be looking to create sustainable growth, but one of the crucial drivers going forward is the role that pension funds will play. A recent report titled 'The time to lead is now - The Adoption of ESG analysis by Asian Government Pension Funds' (the Report) by the Association for Sustainable and Responsible Investment in Asia (ASrIA) makes this argument very clearly.

It is evident that Asia is currently experiencing an enormous demographic shift: the population of Asia and the Pacific over 65 is set to double between 1995 and 2050 this will result in much of the region facing enormous social changes. Public pension funds are designed to be structured in a way that meets the needs of a retired population. The Report finds that pension funds across Asia have significant liabilities and face serious future funding problems. It further argues that managing a fund for the long term offers pension fund trustees a framework through which to examine country level challenges. Long term management means that a responsible investment framework inevitably comes into play.

So what is a "fiduciary duty", and why is it/ should it become music to our ears? A fiduciary duty is a duty imposed upon a person or organization that exercises some discretionary power in the interests of another person in circumstances that give rise to a relationship of trust and confidence. For pension funds the primary fiduciary duty is to carry out investment decisions in the interest of its beneficiaries (those who contribute to their pension pot!) acting prudently and in accordance with its governing documents. Effectively if you are in a position where you have this duty you have to act in the best interest of those you represent, not a duty to be taken lightly.

A 2005 research report commissioned by UNEPFI has been instrumental in making the argument that for pension funds to meet their fiduciary duty (in the markets reviewed Australia, Canada, France, Germany, Italy, Japan, Spain, UK and US) that the integration of Environment, Social and Governance (ESG) issues into investment analysis in order to predict financial performance more reliably is clearly permissible, and is under some circumstances required. There is no reason to believe that other pension funds in Asia would have any different governing systems that would mean that integrating ESG criteria into investment decisions is not a fiduciary duty. In fact, arguably both government investment

companies and sovereign wealth funds could equally find that they have similar fiduciary duties if they are deemed to be an organization representing the best interests of a nation (their beneficiaries). In fact UNEPFI has recently commissioned a further report 'Fiduciary II' which goes even further in making the argument for the fiduciary duty of pension funds and the responsibilities of their service providers.

Those commissioning Fiduciary II have concluded that:

1. Fiduciaries have a duty to consider more actively the adoption of responsible investment strategies.

2. Fiduciaries must recognise that integrating ESG issues into investment and ownership processes is part of responsible investment, and is necessary to managing risk and evaluate opportunities for long-term investment.

3. Fiduciaries will increasingly come to understand the materiality of ESG issues and the systemic risk it poses, and the profound long-term costs of unsustainable development and its consequent impacts on the long-term value of their investment portfolios.

4. Fiduciaries will increasingly apply pressure to their asset managers to develop robust investment strategies that integrate ESG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.

5. Global capital market policymakers should also make it clear that advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position. Furthermore, policymakers should ensure prudential regulatory frameworks that enable greater transparency and disclosure from institutional investors and their agents on the integration of ESG issues into their investment process, as well as from companies on their performance on ESG issues.

6. Finally, civil society institutions should collectively bolster their understanding of capital markets such that they can play a full role in ensuring that capital markets are sustainable and delivering responsible ownership.

The Report argues that Asian pension funds have a fiduciary duty, a clear responsibility, to integrate ESG analysis. What does this mean for business and for civil society in Asia as a result? In order to be able to meet their fiduciary duties pension funds will need more information from companies – better ESG disclosure will be a requirement and there will be increased pressure to incorporate long term and ESG issues into strategic planning as standard. It will be interesting to see how this develops in each market – will leading businesses take their ESG performance to their institutional investors and force them to value it, or will these pension funds drive ESG performance into companies in which they invest? Arguably, a blend of the two.

In short if Asian pension funds begin to accept and fulfill their ESG fiduciary duties, companies will need to disclose more, that disclosure will have to meet accepted international practices for ESG disclosure in order to be relevant and valued. For civil society in Asia it will mean a need to develop sophisticated mechanisms to measure the impact of business on society and the environment and to develop a system to partner with both institutional investors and business to create value to assist with creating sustainable growth.

Copies of the reports mentioned in this article can be found here:

The Time to Lead is Now – The Adoption of ESG Analysis by Asian Government Pension Funds July 2009 www.asria.org

Fiduciary II - Fiduciary Responsibility – legal and practical aspects of integrating environmental, social and governance issues into institutional investment July 2009 www.unepfi.org

Fiduciary I – A legal framework for the integration of environmental, social and governance issues into institutional investment Oct 2005 www.unepfi.org

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August 2009

Responsible Investing

Fiduciary Responsibility

One of the debates in trustee circles currently is what to do with the "SRI" issue. Is there a legal obligation on them to take into account Environmental, Social and Governance factors (ESG) in overseeing the assets of the members? Connected to this is the question on whether their advisors, predominantly the consulting industry, have any legal obligation to provide advice on the role of material ESG factors in Fund strategy designed, mandate construction and overall fund management.

In 2005 a report research by Freshfields (The Freshfields Report), published under the auspices of the United Nations Environment Programme's Finance Initiative (UNEP FI see http://www.unepfi.org/) argued compellingly for the integration of material ESG factors into investment management.

This last month an updated report with more specific recommendations was released. "Fiduciary II" , as the report is being referred to, gives us an view on the state of play within the investment world today with a particular focus on the materiality of ESG factors within pension fund management and more importantly the role of key Fiduciaries in the process. The report reaches 6 key conclusions:

"Fiduciaries have a duty to consider more actively the adoption of responsible investment strategies.

- Fiduciaries must recognise that integrating ESG issues into investment and ownership processes is part of responsible investment, and is necessary to managing risk and evaluating opportunities for long-term investment.
- Fiduciaries will increasingly come to understand the materiality of ESG issues and the systemic risk it poses, and the profound long-term costs of unsustainable development and its consequent impacts on the long-term value of their investment portfolios.
- Fiduciaries will increasingly apply pressure to their asset managers to develop robust investment strategies that integrate ESG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.
- Global capital market policymakers should also make it clear that advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position. Furthermore, policymakers should ensure prudential regulatory frameworks that enable greater transparency and disclosure from institutional investors and their agents on the integration of ESG issues into their investment process, as well as from companies on their performance on ESG issues.
- Finally, civil society institutions should collectively bolster their understanding of capital markets such that they can play a full role in ensuring that capital markets are sustainable and delivering responsible ownership."

We think this report is likely to become a key reference document for SA Fiduciaries, as the need to achieve a more sustainable capital market heats up.

Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment

Publisher	UNEP Financial Initiative
Publication date	July 2009
Type	Reports
Language	English
Link	Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment
Free/Pay for content	Free

Fiduciary has three major elements:

- The first part is an exploration of the legal perspective on how best to operationalise the integration of ESG issues into the investment process, particularly with respect to investment mandates and investment management contracts.
- The second part is an analysis of responses to a pioneering survey questionnaire 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 part is a literature review that focuses on 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

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Links:
[1] http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf

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Engaged in ESG

September 18, 2009 | Doug Watt

Martin Grosskopf understands why pension plan sponsors might be reluctant to include environmental, social and governance (ESG) issues in their investment decision-making process. But the director of sustainability research and fund manager at Acuity Investment Management strongly believes that ESG adds value to investment returns over the long term. And he agrees with the recommendations of a new UN report, which suggests that plan sponsors who are not willing to assess ESG issues are leaving themselves open to potential legal liability.

Grosskopf may be somewhat biased: he's been a member of the United Nations Environment Programme Finance Initiative Asset Management Working Group since 2003. This summer, that group released "Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment." The report, Fiduciary II for short, is a follow-up to a UN report on the same topic released in 2005.

Responsible Regulation

Fiduciary II suggests that asset managers or investment consultants who fail to raise ESG issues with their clients and embed those issues in legal contracts run "the very real risk of being sued for negligence"—even if the pension fund had not specified ESG considerations as a material concern. "Institutional investment consultants and asset managers have a professional duty of care to proactively raise ESG considerations with their clients and failure to do so may have serious consequences," the report warns.

However, pension plan sponsors needn't push the panic button. Although legal action is a possibility in such cases, it's a fairly unlikely scenario.

"There is little relevant jurisprudence to indicate a liability, but this can only be established through a case being brought forward," says Jordan Berger, head of responsible investing with Mercer Canada. "That's one of the interesting issues about fiduciary obligation; there is very little case law to either support or oppose including responsible investment in the investment process," Berger adds. "I really don't think that an absolute legal obligation has been established, but there is a best practice expectation that I think is quite justified."

Professor Benjamin Richardson of Osgoode Hall Law School in Toronto says the report's recommendations raise the question of what is "responsible" and whether or not that should be legally regulated.

"To really transform financial markets, we may need some standardization of the notion of being responsible," he remarks. "Otherwise, it will likely remain only an instrumental business case consideration (i.e., consider ESG issues only when they are financially material to your own portfolio)."

“Canadian courts have hardly considered the relationship between SRI and fiduciary duties, unlike U.S. and U.K. courts,” Richardson adds. “However, there have been some significant Canadian cases concerning the fiduciary duties of company directors, which are indirectly relevant to this debate. Those cases have created a more favourable legal climate for corporate social responsibility in Canada.”

Grosskopf points out that focusing too much on the legal liability aspect misses many important messages in the 101-page report. He says the report highlights some of the inadequacies of the current interpretations of fiduciary duty. For instance, many pension funds retreat to the position that ESG issues cannot—or, at least, should not—be considered in any weighting above financial value to the portfolio.

“I think the main recommendations that are critical in this report are that [ESG] issues are as relevant as financial issues if they are material to the investment returns,” Grosskopf says. “What it really highlights is that investment committees cannot say that ESG is an external issue and cannot be integrated into the investment process.”

As a consultant, Berger supports the report’s recommendation that advisors to institutional investors have a duty to proactively raise ESG issues as part of the advice they provide.

“I think that’s important—it’s a best practice,” he says. “Although one might quibble with the strength of the conclusions, I think they have highlighted a critical issue, which is the responsibility of advisors to be informed of recent trends in dealing with ESG factors and to recognize their responsibility to proactively raise concerns with their clients. So it shifts the focus from, 'You cannot look at responsible investment' to 'You really have an obligation to incorporate responsible investment insights when they can have a material impact on return and risk.'”

Talking Points

Both Grosskopf and Berger note that, if nothing else, the report provides some important points for pension funds and their advisors to consider. “It’s going to take the discussion of [ESG] issues to another level within investment committees,” says Grosskopf.

Rachel Davies, an investment analyst with Acuity, says some corporate pension plans haven’t been actively integrating ESG because they don’t have the appropriate legal language. “That was another goal of this report: to give [pension plans] some tools so they can incorporate ESG issues into investment management contracts,” Davies says.

For example, the report notes that if ESG considerations are relevant and material investment considerations for pension funds, it then becomes necessary for those funds to use ESG language in order to clarify the expectations of all parties to the investment contract. “In particular, it is important that it is made absolutely clear to beneficiaries, pension fund trustees and asset managers that ESG is regarded as a mainstream investment consideration.”

As well as embedding ESG language in contracts, ESG considerations and their application in practice should be included as part of regular portfolio reviews, the report suggests. Pension fund trustees could also adopt—and require their asset managers to adopt—the UN’s Principles for Responsible Investment. And the Investment Policy Statement could be amended to include examples of international laws/treaties and voluntary guidelines or principles that the investment industry has accepted as having a material effect on investment value, such as the Universal Declaration of Human Rights, the Equator Principles and the Carbon Principles.

“Pension fund trustees should seek expert advice on their proposed investment strategy for each pension fund, including expert advice on how best to incorporate ESG considerations into investment analysis and decision-making processes,” the report states.

Grosskopf concedes that finding that “expert advice” won’t be easy, simply because there aren’t a lot of people in the investment community with financial and ESG expertise. “That has to change,” he says. “You have to be hiring people that are able to bring these issues into the investment decision-making process. That's clearly a skill gap that will need to be breached over the next few years.”

Starting Fresh

The first UN report on fiduciary responsibility—commonly referred to as Freshfields—provided important guidance for pension plans considering ESG implementation. The report also looked at the legal barriers to ESG integration, with some discussion of materiality, Grosskopf explains.

“Can you actually establish a link between ESG issues and value in the investment process? The original Freshfields report was the first time the issue had been looked at in that kind of scale.”

“I think the importance of Freshfields is that it cleared up an issue that seemed quite real in the investment community but the report argued was not an issue at all: the supposed conflict between fiduciary responsibility and responsible investment strategies,” Berger adds. “So it was saying, ‘Let's clear that obstacle to responsible investment.’”

After Freshfields was released, the assets under management of institutional investors that incorporated ESG issues into their investment process increased dramatically. However, perhaps the most significant development that arose in the wake of Freshfields was the launch of the Principles for Responsible Investment (PRI) in 2006 by former United Nations Secretary General Kofi Annan.

The PRI now has nearly 600 signatories from the institutional investment community, including many of the world's largest pension funds, representing about 18 trillion U.S. dollars in assets. Canadian signatories include:

• the Canada Pension Plan Investment Board,
• the Caisse de dépôt et placement du Québec,
• the British Columbia Municipal Pension Plan,
• the Public Service Alliance of Canada Pension Fund,
• Ethical Funds,
• Growthworks Capital, and
• Inhance Investment Management.

“The PRI is helping identify best practices among investors,” Fiduciary II states.

Growing Pains

Yet despite the success of the PRI, there have been some challenges. The report notes that very few asset owner signatories to the PRI are adopting one of its main principles: the promotion and acceptance of PRI within the investment industry, including ESG integration, the alignment of investment mandates, monitoring procedures, performance indicators and incentive structures.

“The culture within many consultants and asset managers can be to neglect these issues and to treat them with a “tick box” mentality, rather than an issue of substance which needs to be measured and appraised,” the report states.

Some signatories are not adequately following all of the PRI's principles, says Osgoode Hall's Professor Richardson, but it's difficult to quantify the extent of the problem. “As a voluntary code, without robust compliance and enforcement machinery, some perfunctory implementation of the PRI should not be surprising.”

Grosskopf says he would like to see asset owners who are signed up to PRI, or even those who are not signed up, incorporate ESG issues within their investment mandates as a standard practice. “Certainly, this has been a focus within our process.”

Berger says it's important to recognize the worldwide scope of the PRI and the advantages that come with that scale.

“It covers all asset classes, there are a huge number of participants and they have a strong internal dialogue, so smaller institutions as well as larger institutions can learn from each other. It's a strong vibrant community,” he notes. “Secondly, there's a commitment by PRI signatories to report on their progress and to essentially undergo

an audit process. So for critics who worry about greenwashing, the PRI's insistence on taking these commitments seriously is really quite critical."

"The PRI unites institutions and people from a variety of countries whereas regulatory responses are usually worked out nation by nation," Berger points out. "There hasn't been a great amount of cooperation among international regulators until the recent crisis. The PRI really is a global phenomenon."

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ESG as a legal obligation?

IPE.com **30 September 2009**

The UN's Fiduciary II aims to take ESG integration to the next stage, while a shift in US policy is pushing demographic concerns up the agenda. Nina Röhrbein reports

ESG issues must be embedded in the legal contracts between institutional investors and their asset managers to hold asset managers to account, and ESG issues should be included in the periodic reporting by asset managers. This is a key finding of the 'Fiduciary responsibility – Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment' report by the Asset Management Working Group (AMWG) of the United Nations Environment Programme Finance Initiative (UNEP FI), a partnership between the UN's environmental arm and over 180 financial institutions worldwide.

The study, known as Fiduciary II, is a follow-up to the AMWG's 2005 Freshfields Report, which provided a legal interpretation of ESG issues in the context of fiduciary law.

"The Freshfields Report became a critical document in the formation of the UN Principles for Responsible Investment (PRI)," says Steve Waygood, head of sustainability research and engagement at Aviva Investors and chair of the UK's Sustainable Investment and Finance association (UKSIF), who was responsible for the initiation and design of the Fiduciary II project. "It helped establish the argument that ESG issues are investor-relevant and investors legally can and arguably should integrate those issues into their investment process. However, what was overlooked at the time were the different roles trustees and fund managers have and the different ways in which ESG issues are relevant to their roles and responsibilities. It fell short of showing trustees how to hold their external managers to account on their ESG performance."

The new report aims to help asset owners and managers, as well as consultants and policy-makers, find their way through the ESG jungle.

"It gives them guidance on how they should integrate and govern ESG issues," says Waygood. "For trustees, the main conclusion of the report is to embed a legal provision in their RFPs, RFIs and investment management agreements, which also requires their external managers to sign up to the UN PRI and use the performance measurement tool within the PRI as the governance structure for an ongoing investment assessment. This will enable trustees to make informed decisions at their board meetings."

The report also warns that professional investment advisers and service providers face "a very real risk that they will be sued for negligence" if they do not incorporate ESG issues into their investment services.

Fiduciary II is split into three major elements consisting of a legal review of fiduciary duty and the implementation of ESG in investment mandates, a survey of investment consultants and an update on literature and practical developments of ESG integration in the investment process.

Controversy has surrounded the claim that investment consultants have to pro-actively raise ESG issues in their advice to institutional investors. Although Waygood believes that some consultants struggle to update their view on ESG, which is still based on the 1990s notion of negative screening despite the seismic shift in ESG strategies since, he stresses that this is not the only conclusion of the report.

More important, he says, are the eight recommendations by Quayle Watchman Consulting for pension funds to implement ESG integration in investment mandates. These give advice on how a pension fund should compose

its mandate structure, what kind of reporting they should look for from their fund managers and how they can structure incentives in this area.

Fiduciary II also provides sets of questions investors can use to challenge providers with regards to ESG integration, engagement, positive and avoidance or negative screening. “This should speed up the challenge trustees face and make ESG integration more efficient and a lot more effective,” explains Waygood. “It will increase the sophistication of the demand environment for responsible investment, while rewarding good and sanctioning poor practice among asset managers.”

The AMWG recommends that the PRI ‘should specify that, in order to maintain their membership, all asset manager and asset owner signatories will be required to embed ESG issues in their legal contracts – such as investment management agreements, and Statements of Investment Principles or Investment Policy Statements.’

“While the PRI has made huge progress since 2004 it now needs to build on those first steps by obtaining that informed, high-quality demand from institutional investors and make it much more systematic within signatories,” says Waygood. “It means that PRI signatories will make very informed decisions about who their providers are. The market would then signal in turn that this is important for providers – whether it is asset managers, data providers or consultants – to be delivering on.”

Fiduciary II also tries to make use of the PRI’s analysis tool. “Respondents to the questionnaire receive a detailed performance chart showing how they perform relative to their peers in each of the principles,” says Waygood. “But if it is not put to further use it wastes a huge amount of work on evaluating performance. Trustees need to be able to compare and contrast performance of their providers, so their fund managers should be required to share this analysis with them. The PRI should require their signatories to embed it in their investment management agreements.”

Waygood does not view the legal side of ESG as a problem. “If the legal provision (see box) was an absolute standard on what exactly should be done, how and by whom, then it would be an issue,” he explains. “However, the proposal is a requirement to be transparent to trustees and to present them with a performance analysis, using the mechanism that already exists within the PRI. In other words, it requires PRI asset managers to share their score and questionnaire with their clients. It does not define what should be done.”

Author: Nina Roehrbein

Asset Management

Environmental, social and governance issues create potential legal liabilities

An extract from AM News September 2009

PRICEWATERHOUSECOOPERS

Environmental, social and governance issues create potential legal liabilities

A recent UN report outlines the fiduciary duty of investment consultants and asset to managers to raise environmental, social and governance issues – highlighting the risks of not doing so.

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Four years after an initial report which established fiduciary responsibility for asset managers to consider environmental, social and governance (ESG) issues, the United Nations Environment Programme Finance Initiative (UNEPFI) published a follow-up report in July, revealing the potential liability in failing to consider ESG issues.[11] As investment processes are reviewed following the financial crisis, and we approach the United Nations international climate change negotiations in December, the context is changing rapidly. New frameworks for regulatory and market actions on both carbon emissions, and governance of financial institutions are expected. These will surely force these issues up the agenda, and create new drivers for risk management.

Investment chain

The most progressive asset owners make explicit statements regarding their approach to ESG issues in their investment mandates. This gives a very clear signal of the requirements for the asset managers, and can drive demand down the chain. The UNEPFI report suggests, however, that as professional advisors, both investment consultants and asset managers have a fiduciary duty to raise ESG issues proactively. If they fail to do so, there could be "a very real risk that they will be sued for negligence".

Investment horizon

Many institutional investors, particularly pension funds and others with long-term liabilities, should be looking at an investment period of decades. In practice, however, they are taking a much shorter term approach. Typically, it is institutional investors, such as pension funds, sovereign wealth funds and private equity funds, who are interested in expanding their horizons. The increasing government ownership of financial institutions also poses interesting challenges. How do these banks reflect governments' long-term climate change policy positions in their investments? And what duty do governments have to ensure that they do?

Implementation of approach

There are a number of options available to translate positions on ESG issues into investment approaches. Having started as a niche area for specialist funds, ESG issues are becoming increasingly mainstream. Depending on the asset class and investment horizon, managers can apply voting policies, develop engagement strategies or revise portfolio weightings. Asset owners then need to ensure they have a clear picture of how their managers are applying their policies, through requiring regular reporting and periodic audits of the investment mandate's implementation. Matching the reward structure to long-term performance goals is one way of improving alignment to a longer term investment timeframe.

11 Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment (2009) UNEP Finance Initiative Asset Management Working Group http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf

In 2006, the UN established the Principles for Responsible Investment, (PRI), which 538 financial institutions responsible for $18 trillion in assets under management have signed.

Impact on returns?

Some members of the investment community perceive addressing ESG issues as potentially restrictive and likely to reduce returns. As a result, they are reluctant to apply ESG factors as a default position. The alternate view is that companies that fail to address ESG issues will perform poorly financially to the detriment of the funds investing in them. Integrating ESG factors into investment decision-making is increasingly seen as a means of improving performance and reducing risk. It is important here to distinguish between integration of ESG factors across mainstream investment and negative ethical screening. Simple negative screening can restrict portfolios and is an approach based purely on principles, rather than financial performance, (e.g. exclusion of companies involved in weapons, alcohol, tobacco, etc).

Asset manager expertise

Trustees need to ensure they are up to date on the analytical methods available to inform investment decisions and to fulfil mandates. Likewise, where investment consultants help select asset managers, they need to understand the expertise of different managers. There are several initiatives focusing on improved transparency in how ESG issues are addressed. In 2006, the UN established the Principles for Responsible Investment, (PRI), which 538 financial institutions responsible for $18 trillion in assets under management have signed.[12]

After three years, there is increasing pressure on signatories to demonstrate how they are applying the principles. UN PRI report that 85% of signatories have policies referring to ESG issues, but only 34% say this is being translated into a plan of action. In 2007, the UK Association of British Insurers launched its ClimateWise initiative, which requires members to incorporate climate change into investment strategies. At the time of a 2008 review, less than half of the 41 members were substantially or fully compliant.

What next?

Investors need a more systematic way of responding and adapting their strategy to climate change risks and opportunities. Through valuation and modelling techniques it is possible to build a stronger understanding of exposure to ESG factors – particularly climate change risk – at a portfolio level. It is often possible to quantify physical, regulatory and market risks in monetary terms. The objective is to facilitate data-driven, informed, decision making.

UNEPFI's report urges asset managers to do the following:

1. Fiduciaries have a duty to consider more actively the adoption of responsible investment strategies.
2. Fiduciaries must recognise that integrating ESG issues into investment and ownership processes is part of responsible investment, and is necessary to managing risk and evaluating opportunities for long-term investment.
3. Fiduciaries will increasingly come to understand the materiality of ESG issues and the systemic risk it poses, and the profound long-term costs of unsustainable development and its consequent impacts on the long-term value of their investment portfolios.
4. Fiduciaries will increasingly apply pressure on their asset managers to develop robust investment strategies that integrate ESG issues into financial analysis, and to engage with companies in order to encourage more responsible and sustainable business practices.

Asset managers should be considering how they are responding to these challenges to get ahead of the game, and be better placed to win business.

12 UN Principles for Responsible Investment http://www.unpri.org/

TRUCOST

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Investment

CLIMATE CHANGE BRIEFING PAPER

September 2009

A recent study by the United Nations Environment Programme Finance Initiative (UNEP FI) concluded that asset managers and investment consultants have a legal duty to take account of environmental, social and governance issues .[10] This is likely to spur further integration of issues such as climate change into investment analysis.

In a separate report on the materiality of climate change, the UNEP FI has called for investors to 'routinely include climate change as a factor in asset management practice'.[11] In this report, it also warns that 'corporate management has not yet grasped the immediacy of the issue'.

10. Asset Management Working Group of the UNEP FI, *Fiduciary Responsibility – Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment*, 2009.

11. Asset Management Working Group of the UNEP FI, *The Materiality of Climate Change – How Finance Copes with the Ticking Clock*, July 2009

VIII. NEW REPORT ON "FIDUCIARY RESPONSIBILITY" BY UNEP FI

A new report by the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (UNEP FI) looks at legal and practical aspects of integrating environmental, social and governance issues into institutional investment.

The report is called *Fiduciary II* and can be downloaded from:
http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf.

One of the more effective documents for promoting the integration of environmental, social and governance (ESG) issues into institutional investment has been the "Freshfield Report" published in 2005, which the UNEP FI Asset Management Working Group (AMWG) commissioned from Freshfields Bruckhaus Deringer, a leading international law firm.

Freshfields covered nine jurisdictions (i.e. Australia, Canada, France, Germany, Italy, Japan, Spain, the U.K. and the U.S.) 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."* This clear conclusion has served to clarify the legality behind the consideration of ESG issues with respect to pension funds, insurance company reserves and mutual funds, as well as foundations.

In the four years since the launch of the original Freshfields Report by the AMWG, there has been more innovation and evolution in the field of ESG integration than in any other similar time span in history. Perhaps the most significant development in this time period was the launch of the Principles for Responsible Investment (PRI) in 2006 by then UN Secretary-General Kofi Annan. Now, with over 550 signatories from the institutional investment community, including many of the world's largest pension funds, collectively representing approximately US$ 18 trillion in assets under management, the PRI is helping to identify best practices among investors.

The latest UNEP FI/AMWG report, termed *Fiduciary II,* serves as a sequel to the Freshfields Report by providing a legal roadmap for fiduciaries looking for concrete steps to operationalise their commitment to responsible investment. It has three major elements:

1. The first part is an exploration of the legal perspective on how best to operationalise the integration of ESG issues into the investment process, particularly with respect to investment mandates and investment management contracts.
2. The second part is an analysis of responses to a pioneering survey questionnaire 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 questionnaire can be found in its entirety in Appendix C.
3. The third part is a literature review that focuses on 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 Geneva Association has been collaborating with the UNEP FI for several years in an informal but continuous manner and has tackled the ESG issues and investments for the insurance in various of its internal and external fora. It supports discussions on the record and analysis of integrating environmental, social and governance issues into institutional investment.

BSR

ESG in the Mainstream:

The Role for Companies and Investors in Environmental, Social, and Governance Integration

Laura Gitman, Director, BSR; Blythe Chorn, Associate, BSR; and Betsy Fargo, Associate, BSR

September 2009

Institutional Investors Leading Integration

There seems to be a general sense among investors, academics, and experts that ESG issues are beginning to be integrated by more mainstream investors into their valuations and investment decisions.[28] However, mainstream investors aren't a monolithic group. Integration appears to be moving fastest within the institutional investment community, rather than within the retail investor community.

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[24] KPMG International. "KPMG International Survey of Corporate Responsibility Reporting 2008."
[25] Interview with Zachary Karabell, President, River Twice Research. June 8, 2009.
[26] Kropp, Robert. "Activist Shareowners Tally Victories in 2009 Proxy Season." Sustainability Investment News.
[27] UN PRI. "PRI Report on Progress 2009."
[28] See for example: Mercer. "2008 in Review: Responsible Investment Isn't Just for Christmas." 12 January 2009. Brewster, Deborah. "Investors: Institutions Lead the Way in Investments." Financial Times. June 3, 2009.

There are many drivers specific to institutional investors that explain this trend. First, for institutional investors such as pensions or foundations, fiduciary duty doesn't hamper explicit consideration of the economic, environmental, and social impacts of investments—many view it as part of their duty. In some cases, integration of these impacts is even legally required. A recent UN-backed report states that institutional investors are at serious risk of being sued for negligence if not proactive in incorporating ESG factors into contracts with pension funds.[29] A primary example of a mandated fund is the Norwegian Government Pension Fund. Since 2004, the fund has been required to meet ethical requirements set by the Norwegian Ministry of Finance through exercise of active ownership in the companies in the portfolio and exclusion of companies from the investment universe of the fund. In April 2009, the ministry announced that the fund will further expand integration of environmental and social aspects and good corporate governance as relevant factors in all aspects of the fund's management. Among signatories to the UN PRI, the number of owners including responsible investment criteria in fund management contracts rose 25 percent between 2007 and 2008, and there is an expectation among many asset owners and managers that this trend will continue to increase.[30] To meet this rising demand, institutional investors have had to develop their capacity to integrate ESG criteria.

Similarly, even when consideration of investment impact on ESG issues isn't explicitly mandated, the longer-term focus of most institutional investors means that ESG integration is of greater interest. The time horizon for ESG criteria to impact financial performance is appreciably longer term than traditional financial indicators, and the value of ESG integration consequently requires more lasting investments to be realized. The California Public Employees' Retirement System (CalPERS) believes that as a "permanent owner—a long-term beyond long-term investor," improved or best practices in corporate governance (including environmental and social practices) will lead to better financial performance in its funds. As a result, CalPERS invests with partners that use corporate governance strategies to earn value for the fund to meet its objective to achieve returns not available in traditional public markets.[31]

In addition to a longer time horizon, institutional investors often represent government employees, teachers and academics, unions, or medical practitioners, who may be predisposed to considering broader societal and environmental issues.

This trend is particularly pronounced in Europe, where institutional investors comprise a higher proportion of total investors than in the United States. Institutional investors in Europe also typically have had more historical experience with ESG issues as a result of their client base (European government and pension funds) and the larger unmet market need resulting from the lack of socially responsible investment firms.

Currently, integration of ESG factors by institutional investors seems to be focused predominantly in equity investments. Although some investors like CalPERS have succeeded in integrating some facet of ESG performance into each of their asset classes —alternative investments, global equity, global fixed income, inflation-linked, and real estate—most integrated investment strategies are directed toward global equity. One recent survey by Mercer of ESG integration by asset class revealed that almost 70 percent of investment strategies incorporating ESG were in listed equities.[32] Listed equity was also the most common asset class subject to integration by UN PRI signatories. Ninety-four percent of UN PRI investment manager signatories reported incorporating

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[29] Asset Management Working Group of the United Nations Environment Finance Initiative. "Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment." July 2009.
[30] United Nations Principles of Responsible Investing. "PRI Report on Progress 2009."
[31] Interview with Anne Simpson, Senior Portfolio Manager for Corporate Governance, and Bill McGrew, Portfolio Manager-Corporate Governance, CalPERS. July 7, 2009.
[32] Guyatt, Danyelle. "Mercer's ESG Rating Pool Continues to Grow." Mercer. September 30, 2008.

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A Securities Fraud and Corporate Governance Newsletter

Eye on the Issues

LEGISLATIVE/REGULATORY AND JUDICIAL UPDATES AND DEVELOPMENTS OF INTEREST TO EUROPEAN INVESTORS

By Takeo Kellar

UN Issues Report on Funds' Fiduciary Obligation to Invest Responsibly

In July 2009, the United Nations Environment Programme Finance Initiative's ("UNEP FI") Asset Management Working Group followed up on its influential 2005 "Freshfields Report" with a new report entitled "Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues Into Institutional Investment." This report provides a "legal roadmap for fiduciaries looking for concrete steps to operationalise their commitment to responsible investment." Significantly, the report states that there is a "very real risk" that investment advisors "will be sued for negligence" if they fail "to raise and take into account ESG considerations." Several large European pension funds have since formalized the duty to invest responsibly. For example, on April 3, 2009, the Norwegian Ministry of Finance on behalf of the Norwegian Government issued a press release stating that "[t]he Government wants the Government Pension Fund — Global to take an even stronger stance in its role as a responsible investor" and that "the Ministry of Finance is signing up to the UN Principles for Responsible Investment (PRI) and is going to participate directly in other international initiatives, so as to be involved in putting on the agenda how the concerns of environmental and social responsibilities and good corporate governance can be safeguarded by financial investors." *Report available at http://www.unepfi.org/fileadmin/documents/fiduciaryll.pdf*

Pension Funds Lodge Opposition to Proposed EU Hedge Fund Rules

In April, the European Union unveiled proposals to introduce new restrictions on hedge funds, private equity funds and real estate products to address concerns following the financial crisis. The draft legislation demands that those funds register and disclose certain information to regulators and also restricts the ability of non-EU managers to sell funds in Europe. Because the affected funds are largely domiciled off-shore or run by US entities, the draft legislation has provoked criticism from the British government, US Treasury officials, as well as lobbyists for the funds such as the Alternative Investment Management Association (AIMA). Recently, British pension funds have begun to voice concern over the proposed legislation as well. Kathryn Graham, a director at Hermes Pension Fund Management, which acts as direct advisers to trustees of the more than 30 billion pound BT Pension Scheme, said it was time for the industry to speak up: "There are unintended consequences from the structure of the directive which would lead us to have substantially smaller choice in terms of the investments we're able to make, but also, I would imagine, a significantly increased cost to the investments we are able to make," she told Reuters. Similarly, Joanne Segars, Chief Executive of the National Association of Pension Funds, told Reuters that "The directive, if passed in its current form, will reduce investment choice and mean that the return pension schemes can get for any level of risk will be reduced," and that "[e]ven a small reduction in return will have an impact on the affordability of defined benefit pension schemes." Many observers predict changes before the draft rules become law. *Reuters, August 4, 2009; European Commission draft Directive on Alternative Investment Fund Managers (April 30, 2009)*

11th Circuit Rules Securities Class Action Settlement Covers Foreign Plaintiffs

The United States Court of Appeals for the Eleventh Circuit recently ruled that it had jurisdiction over claims brought by foreign purchasers in a securities class action against CP Ships Ltd. Allen Germain, a Canadian plaintiff in the case, challenged the jurisdiction of the Court to approve a settlement of $1.3 million. CP Ships is a container shipping company, organized under Canadian laws and operating in several countries. Although officially headquartered in England during the class period, relevant operations and personnel central to the alleged fraud (i.e., the accounting department and executive officers) were located in Florida. Roughly eighty percent of CP Ships' shares are traded on the Toronto Stock Exchange ("TSX") and twenty percent are traded on the New York Stock Exchange. Germain argued that the settlement could jeopardize claims he and other Canadian plaintiffs had brought in related actions in the Canadian courts, alleging that they had been harmed by purchasing CP Ships' stock on the TSX and that the settlement was inadequate. The Eleventh Circuit rejected those arguments, finding that the district court's decision was in line with several similar cases in which U.S. courts had exercised jurisdiction over the claims of foreign purchasers. The Court held that the complaint alleged "ample facts sufficient to establish subject matter jurisdiction under the 'conduct test' over unnamed foreign class members who purchased on the TSX," because CP Ships' allegedly fraudulent conduct took place in the United States. The Court also ruled that any class member wishing to pursue the Canadian actions had been adequately notified that they could opt out of the settlement, and that the settlement was fair. *In re CP Ships Ltd. Securities Litigation, No. 08-166334, 2009 WL 2462367 (11th Cir. Aug. 13, 2009)*

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swissHEDGE

Responsible investment and alternative asset classes: Forecasting the future for hedge funds

By: Dr. James Gifford, Executive Director &
Tom Rotherham, Special Advisor I UN PRI

The UN-backed Principles for Responsible Investment (PRI) aims to find synergies between the goals of institutional investors and those of society at large. The PRI is a set of guidelines for asset owners, managers and service providers, designed to assist in the incorporation of environmental, social and corporate governance issues into the investment processes. With over 570 signatories representing USD 18 trillion in assets, it is one of the most important initiatives related to the sustainable and responsible investment field. In this article, we have asked them to share their views, experiences, as well as what they expect from the future for responsible investment in the context of alternative investments in particular.

In November 2002, representatives from four global banks met in London to discuss how they could collectively improve decision-making on project finance. The eventual outcome of their discussion was the «Equator Principles« – a set of environmental, social and governance (ESG) criteria that has since been voluntarily adopted by over 60 financial institutions. Today, eight years later, over 75% of project finance deals worth more than USD10m comply with the Equator Principles.

Could the same thing happen to hedge funds? Could access to investment capital one day require compliance with an internationally recognized, but voluntary, framework of ESG-related criteria?

There are a number of reasons why this is unlikely to happen – including that the diversity of hedge fund strategies makes standardization almost impossible. In addition, the short time horizons across which some hedge fund investment decisions are made are inconsistent with most current understanding of materiality of ESG factors – which is generally understood to have impacts in the mid- to long term.

But if ESG factors are to become more important for hedge fund managers, then the UN-backed Principles for Responsible Investment (PRI) will probably share the credit (or the blame, depending on your perspective). And while standardization is unlikely, the evolution of the PRI suggests that hedge funds should start paying attention.

The PRI

The PRI is an investor-led, membership organization based around a set of six principles.[1] The initiative was launched

1 For more information on the PRI and the 6 Principles, see www.unpri.org

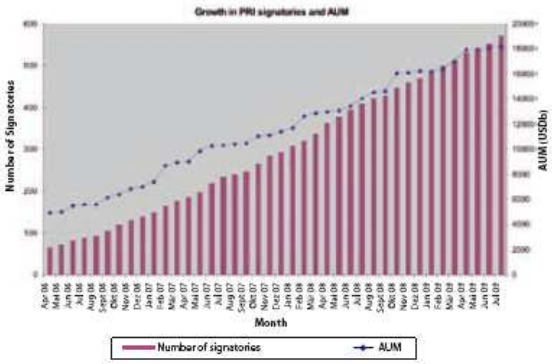
in 2005 by then UN Secretary-General Kofi Annan, who invited 20 of the world's largest institutional investors to consider the overlap between their long-term interests as investors and the UN's sustainable development goals.

The six principles that emerged from these discussions were launched in 2006. Membership is open to any asset owner, asset manager or service provider that commits to do two things:

› over time, apply a set of 6 principles to all asset classes; and
› every year, report on their progress.[2]

It is up to each PRI signatory to decide how best to implement the principles, based on their investment approach and asset allocation. The objective is to achieve improved long-term risk-adjusted returns by having more and better information in the investment decision-making process.

Graph 1 I Growth in PRI signatories and AUM



Source: PRI Annual Report, 2009 www.unpri.org

What does this mean for hedge funds?

Whereas the Equator Principles were designed to address only project finance, the PRI addresses all asset classes, including hedge funds. While most PRI signatories began applying the PRI to their investments in public equities, we are now seeing more attention to other asset classes. But what does this mean in practice?

BlackRock is a PRI signatory. With the acquisition of BGI, they now have USD2.7 trillion under management. In 2009, BlackRock will develop an approach to responsible investment to guide their investments in hedge funds. This will not lead to fundamental change overnight, but increasingly, there will be large funds such as BlackRock enhancing their ESG capabilities, and over time, many will require the same of their hedge fund managers.

BlackRock is not the only PRI signatory to invest in hedge funds.[3] Table 1 shows the value of investments in different asset classes to which the PRI principles are applied, including as a share the total market.

This data tells two stories. First, PRI signatories do not yet integrate the Principles into allocation decisions for all of their assets. At the moment, this is done for roughly USD3.4 trillion of the total USD18 trillion (less than 20%). Second, only USD60b of these assets are invested in hedge funds.

Table 1 I ESG integration relative to total market

Asset Class	Asset subject to integration via PRI signatories (USD in trillions)	Total market size (USD in trillions)	Share of total market subject to integration by PRI signatories (%)
Listed equities, developed markets	1.29	27.2	5
Listed equities, emerging markets	0.17	5.4	3
Fixed income, excl corporate	0.67	22.9[a]	3
Fixed income, corporate	0.77	6.2[b]	12
Listed real estate	0.06	0.4	15
Unlisted real estate	0.19	10.0[c]	2
Private equity	0.12	2.5[d]	5
Hedge funds	0.06	1.5[e]	4
Infrastructure	0.04	18.9[f]	<1

a Sovereign plus quasi-sovereign
b Corporate plus high yield but excluding asset-backed
c Real estate currently owned by professional investors for an investment purpose. Inclusion of assets that are currently owner-occupied but which may in time become institutionally-owned raises the total to USD16 trillion. Figures are as at December 2006.
d Overall assets under management by private equity firms including an estimated USD 1 trillion in funds raised but not yet developed.
e A similar figure (USD1.4 trillion) was provided by Bank of New York Mellon Casey Quirk
f Estimated total stock of infrastructure assets, including assets in public ownership.

Source: PRI Report on Progress, 2009 www.unpri.org

Table 2 shows the percentage of signatories who integrate the PRI into their investment decisions for externally managed assets across different asset classes. Hedge funds are the lowest percentage for investment managers (19%) and the second lowest for asset owners (24%).

Table 2 I Proportion of signatories stating that some externally managed assets incorporate integration

Asset Class	Externally managed (IM)		Externally managed (AO)	
	Some RI integration	Median % of assets integrated	Some RI integration	Median % of assets integrated
Listed equity (developed markets)	71%	50%	82%	80%
Listed equity (emerging markets)	50%	60%	63%	90%
Fixed income (excl corporate issuers)	45%	100%	19%	100%
Fixed income (corporate issuers)	50%	100%	34%	100%
Private equity	43%	80%	61%	50%
Listed real estate or property	45%	100%	43%	100%
Non-listed real estate or property	50%	88%	59%	37%
Hedge funds	19%	40%	24%	50%
Infrastructure	50%	100%	57%	100%

Source: PRI Report on Progress, 2009 www.unpri.org

2 More information on the PRI is available in an article by PRI Executive Director James Gifford in swissHedge Q3 2007 and at www.unpri.org.

3 http://www.unpri.org/files/rpt09/BlackRock.html

So while the PRI's recent annual assessment survey of its signatories found that relatively few have developed specific RI policies for their hedge fund investments, it also suggests the potential for growth. Amongst signatories who responded both this year and last year, the percentage stating that they integrate ESG considerations increased for each of listed equity, private equity, and hedge funds.

Like BlackRock, each PRI signatory has implicitly committed to integrate the Principles into their hedge fund investments in some way, at some point in the future. It is the PRI's role to support the signatories in doing so – for instance, by starting a work stream on hedge funds.

For a rough indication of whether responsible investment is something that will affect hedge funds in the coming years, compare your list of investors with the list of PRI signatories.[4] If they have not already done so, at some point they will make plans to develop an approach to implementing the Principles in their hedge fund investments.

The PRI's private equity workstream

While alternative investment asset classes lag relatively far behind public equities in the integration of ESG issues, the PRI's experience with private equity suggests that momentum can build quickly. 18 months ago, the PRI had only a handful of private equity signatories – primarily sector leaders like Doughty Hanson and Pantheon Ventures. Today, after bringing together a group of 30 international investors and private equity houses to develop a guide for responsible investment in Private Equity,[5] there are over 35 private equity signatories, including giants like KKR, BC Partners and Hamilton Lane.

Moreover, the sector itself is beginning to consider the relevance of ESG factors to their investments. The US-based Private Equity Council, which represents 13 of the world's biggest private equity houses, has adopted Guidelines for Responsible Investment. A number of national associations have committees on responsible investment, and intend to provide guidance to their members. On 14 August 2009, the Australian Private Equity and Venture Capital Association (AVCAL) Council passed a resolution asking it's General Partner members to seriously consider becoming PRI signatories.

But all of this activity does not necessarily suggest that the private equity sector is universally convinced that ESG issues will drive better long-term returns. At the moment, it is probably safe to say that most general partners at the upper midmarket and large buyout end of the market see ESG issues as an investor relations issue: i.e. an emerging requirement for fund-raising. This perception is supported by anecdotal evidence suggesting that roughly 15% of investors are asking ESG-related questions during fundraising rounds. But it is unclear how many also believe ESG factors will have significant impacts on returns when realizing investments

The lessons for hedge funds

Private Equity's underlying assets (companies) and investment style (buy, build and sell) is much more consistent with public equities than are hedge funds. As a result, it has been relatively easy to extrapolate an approach to responsible investment in private equity from the vast experience in public equities.

It would be wrong to suggest that the drivers for, or approach to, responsible investment in hedge funds will track the rapid rise of responsible investment in the private equity sector. Nonetheless, a number of lessons can be drawn from the PRI's work on private equity and other recent developments.

Fiduciary duty demands it. For many years, the received wisdom has been that a fund trustee's fiduciary duty restricted the degree to which they could look at anything other than financial performance. The responsible investment hypothesis is that non-financial performance, including ESG factors, can have a material impact on financial performance, and so it falls within the duty of fiduciaries to pay attention to material ESG factors.

On 14 July 2009, the UN Environment Programme Finance Initiative published a report by leading fiduciary law expert Paul Watchman,[6] who stated:

"In tendering for investment mandates, it would be expected that the investment consultant or asset manager would raise ESG considerations as an issue to be taken into account and discussed with the client ***even if the pension fund had not specified ESG considerations as material to the tender.*** *If the investment consultant or asset manager fails to do so, there is a very real risk that they will be sued for negligence on the ground that they failed to discharge their professional*

4 A current list of PRI signatories is available at: www.unpri.org/signatories

5 «Responsible Investment in Private Equity: A Guide for Limited Partners» is available at www.unpri.org/privateequity

6 «Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment» is available at: http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf

duty of care to the client by failing to raise and take into account ESG considerations." (emphasis added)

The economic crisis does not reduce the demand for responsible investment. In our recent survey, PRI signatories were asked if the recent global financial market turmoil caused them to change their approach to the consideration of ESG factors or active ownership. The most common response was that the financial market turmoil has had no impact on their approach. Many signatories commented that they were dedicated to RI long before the emergence of the global financial crisis and that, if anything, the market turmoil has reaffirmed their (and, in some cases, their clients') belief that ESG issues are important. A number of signatories did indicate that new budget constraints may slow down some planned RI activity.

The biggest obstacle is perception. The PRI's initial discussions with the private equity sector were lukewarm. Many of the general partners had not been exposed to the concept of responsible investment, and thought that it was an effort to impose ethics at the cost of returns. As soon as they understood that this was an investment agenda (i.e. improving returns) and not a public policy or NGO agenda (i.e. saving the world), we managed to develop the Limited Partners' Guide in a relatively short time.

Funds of funds will lead the way. As an intermediary, it is arguably easier for a fund of funds to deal with a responsible investment mandate than it is for a general partner (or hedge fund). Also, a number of private equity funds of funds see this as competitive differentiator: «by investing in our fund you'll also have your responsible investment mandate taken care of«. Some of the world's biggest funds of funds are PRI signatories: Pantheon Ventures, PCG Asset Management, Hamilton Lane, Partners Group and Capital Dynamics. We anticipate that more funds of hedge funds will follow leaders like Harcourt by offering RI products and becoming PRI signatories.

Collective engagement. Many commentators have referred to the economic crisis as a crisis in governance, sparked by, among other things, the failure of investors to act as true owners. As a recent report by UK-based think tank Tomorrow's Company and the BT Pension Scheme states:

«With every new intermediary in the value chain that links savers to investment performance, there is an inevitable erosion of the sense of stewardship. In the global investment landscape, the value chains are now heavy with intermediaries, some of whose motives are unclear and some of whose activities can be destructive to long-term wealth creation and sustainability. As the casino economy develops, a conscious effort is needed to review its impact on the rest of the economy, and on the health of the society and the environment on which we all depend.[7]*«*

Driven by regulators, public pressure and an increased understanding of the need to work together to exert ownership and protect long-term investments, institutional investors are becoming better at identifying and acting in their collective interests.

Looking ahead: the PRI in 2012

The PRI has real momentum and clients are increasingly using it as one of the tools in their toolbox for manager selection. However, the potential of the PRI Initiative to be a real driver of change within the investment industry as a whole including the hedge fund sector is yet to be fully realised.

Last month, the PRI initiative announced that in the next five years it plans to improve the asset-class specific guidance it publishes, and this will include a work stream supporting responsible investment in hedge funds. This work will create resources to help hedge fund investors integrate ESG issues into all relevant areas of their investments and to understand the business case behind taking such action.

The PRI itself aims to expand into a global hub of responsible investment best practice, capacity building and outreach. This will include building an in-house ESG think tank to support its various initiatives and to provide a network for investment professionals, economists, service providers and issue specialists to identify ESG issues and develop concrete collaborative investor activities to address them.

An important part of this is the PRI Academic Network, which was launched earlier this year, and brings together academics, students and investors to consider cutting-edge thinking and research on responsible investment practice. Another new work stream is a Public Policy Network, which brings together public sector representatives with investors to collaborate on areas of common interest, such as the enhancement of corporate standards of ESG disclosure.

In summary, expect responsible investment and the PRI to grow significantly in the coming years across global markets and across asset classes. As the market shifts, it will be interesting to see how the hedge fund sector responds to the challenge.

7 Tomorrow's Owners: Stewardship of tomorrow's company« is available at: http://www.businessinsociety.eu/resources/3017

SocialFunds
The largest personal finance site devoted to socially responsible investing

October 02, 2009

Investment Advisors Explore Ways to Incorporate ESG Issues into Their Services

by Robert Kropp

The Boston College Institute for Responsible Investment produces a paper that summarizes the concepts and goals explored in a meeting of investment consultants and asset managers.

SocialFunds.com -- In April, the Boston College Institute for Responsible Investment convened a meeting of 35 investment consultants and asset managers, well as other stakeholders, on the "premise that there are an increasing number of investors – institutional and individual – who seek investment value, and environmental, social, and governance (ESG) benefits, through the incorporation of ESG information into their investment decisions, referred to as responsible investing."

In retrospect, the meeting seems to have been well-timed, considering developments surrounding corporate ESG disclosure, and the advisability of incorporating ESG issues into investment decision-making, that have occurred since then. In July, the Social Investment Forum (SIF) submitted a proposal to SEC Chairman Mary Schapiro, calling for "a uniform standard for mandatory ESG reporting using the Global Reporting Initiative's (GRI) framework," that has been signed by more than 80 domestic and international organizations.

Also in July, the United Nations Environment Program Finance Initiative (UNEP FI) issued a report entitled Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment (Fiduciary II), in which it states, "Advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position."

Furthermore, according to Fiduciary II, investment advisors that fail to incorporate ESG issues into their investment services face "a very real risk that they will be sued for negligence."

Steven Lydenberg, Chief Investment Officer of Domini Social Investments, told SocialFunds.com, "Investment consultants serve as intermediaries between institutional investors and money managers. They are gatekeepers, and have immense influence on the institutions. Their familiarity with ESG and the options available is crucial."

According to Lydenberg, the intention behind the April meeting at Boston College was to "Cultivate interest and understanding among consultants about what is going on in the social investment world. The intent of the meeting was not to define responsible investing (RI), but to survey current practices in the field."

Indeed, a point made in a recently published paper about the meeting entitled The Evolution of Responsible Investment Consulting was that "the field of responsible investment does not to date have a common language or clearly defined metrics." Instead, several motivations for social investment were identified at the meeting.

Investors may believe that investment in sustainable companies offers opportunities for long-term outperformance, and may want to find products that capitalize on social or environmental macrotrends. They may want their investments to achieve beneficial social or environmental ends that align with their values, and may desire to use shareowner rights to engage with companies on ESG issues. Finally, investors may seek to reduce regulatory and reputational risk.

Attendees at the meeting agreed "that a relatively robust universe of RI products either available or coming to market now exists," although clear definitions of what constitutes RI products are lacking. In the absence of clear definitions of RI products, the ability to apply a consistent ratings system to them faces challenges. According to the paper, many attendees "felt the lack of objective metrics was hindering the development of RI among institutional clients." On the other hand, mission investors did not seem to find the lack of metrics or rating to be limiting, according to the investment consultants who work with them.

Because one fundamental role of investment consultants is develop asset allocation strategies with their clients, the question of relating RI to asset allocation strategies played an important role in the conversations that took place at the meeting. Attendees identified several problems they have had to confront when seeking to incorporate RI into the investment strategies of their clients.

As a still-emerging field, RI products often have a short track record, which has led some consultants to eliminate them from consideration. Furthermore, the traditional asset allocation model views the ESG issues that form the heart of RI investment to be tangential to purely financial considerations, and the research tools needed to assess ESG factors are yet to be fully developed. Finally, according to the paper, a new allocation framework that takes ESG considerations into account in the construction of entire portfolios may be necessary.

The paper listed several ideas that attendees though were worthy of further consideration. The ideas include the formation of a sustained network of consultant practitioners, working groups on benchmarking, ratings, and social impact, and publicizing aspects of the discipline of RI consulting. Attendees also found that an open-source catalog of RI managers and products across asset classes could be helpful.

Lydenberg described the meeting as "An exploratory conversation to open dialogue among people who do not normally have the chance to talk with each other."

"We hope this was the start of a series of conversations among consultants," he said. In fact, the paper noted that "Research into the experiences of asset owners, managers and consultants, with a community beyond just those who attended this first meeting, might expand on these initial impressions of the field, and clarify the opportunities for, and barriers to, the evolution of responsible investment consulting."

"This initial conversation should help spur new research, network-building and collaboration among consultants and other stakeholders, and help shape this emerging field," the paper concluded.

responsible investor

South African fund managers warned on ESG fiduciary duty ahead of UN-sponsored conference

Leading lawyer says principles-based law could see court cases linked to King Report on corporate governance.

by **Hugh Wheelan** | October 13th, 2009

South African fund managers need to "up their game" on environmental, social and governance (ESG) issues or risk court cases based on the country's King Reports on corporate governance, which set a high standard on social responsibility in corporate behaviour, according to Paul Watchman, author of the internationally renowned Freshfields report on fiduciary duty. Speaking to Responsible-Investor.com ahead of a United Nations Environment Programme Finance Initiative (UNEP FI) global round table in Cape Town on October 22, Watchman, chief executive of Quayle Watchman Consulting (QWC) and a former partner at law firm, Freshfields Bruckhaus Deringer, said South African fiduciary law was likely to take its lead from corporate law, bearing in mind South Africa's principles-based legal system. Watchman said: "Given South Africa's legal DNA and leadership on responsible investment generally, it is especially the case in South Africa that the fiduciary duties of pension fund trustees require them to be prudent and to take professional advice on their investments." South Africa's King Report on governance was first issued by former high court judge Mervyn King in 1994. In a 2002 update, the King II report placed a high onus on companies to broad consider social and stakeholder responsibility in their business and reporting following a number of corporate governance scandals in the country.

Responsible investment issues have been high on the agenda of South African asset managers since the country's largest institutional investor, the Government Employees Pension Fund, became one of the first PRI signatories when it was launched by Kofi Annan, the former Secretary General of the United Nations, at the New York Stock Exchange, in April 2006.

However, the $18 trillion (€12.7 trillion) United Nations Principles for Responsible Investment (UNPRI) recently kicked out five signatories, including two South African fund managers, Oasis Group Holdings, and Trinity Holdings, the South African resources investor, after they failed to report progress on implementing its six environmental, social and governance investment principles.

Link to UNEPFI conference: Financing change, Changing finance

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The long road to sustainable investing

By Sophia Grene
Published: October 18 2009 11:06 | Last updated: October 18 2009 11:06

Writing about sustainable investing used to be easy. There were a small number of people involved, a few funds whose policies were relatively clear and you could easily put a number on the assets that were managed in accordance with environmental, social and governance criteria.

Now it is hard even to get started without switching off e-mail and phone to stop being deluged with press releases about new climate change funds, microfinance initiatives, and analyses about the alpha added by sustainable investment policies.

A bandwagon that started rolling a few years ago has now built up juggernaut momentum and those who do not jump on it risk being flattened.

Although there may be a large element of "greenwashing", lip-service paid to environmental concepts as a marketing ploy, in all of this, it is hard to escape the impression that a substantial proportion of investment professionals in Europe at least are changing their ideas about the intersection between investment and responsibility.

"Convinced that taking account of environmental, social and governance criteria brings a better understanding of businesses and a better evaluation of our risks as investors, we have decided to integrate this approach into our traditional financial analysis of companies."

This statement is on the website of French asset manager Financière de l'Echiquier and is indicative of how much both investment management and attitudes to responsible investing have changed.

A number of factors have combined to bring this about. The most obvious is a massive increase in awareness of climate change and its possible impact. Even the sceptics (who abound, particularly in the US) are starting to accept they may have to pay attention to regulation, whether or not it is based on good science.

One eminent convert to investing for climate change is Stanley Fink, formerly of Man Group, who last year set up Earth Capital Partners, a venture capital fund aiming to invest in energy security and climate change.

Earth Capital's wish-list, which covers solar, waste-to-energy, agriculture and new technologies in the first instance, with infrastructure, carbon trading and energy arbitrage to come at a later date, shows just how broad the opportunity range is. And climate change is just one element of sustainable investing.

The earlier scepticism about sustainable investing – "are investors really prepared to forego returns just to feel good?" – is still around, but a wide array of research is emerging to show the sceptics are not asking the right question. There may be no need to forego returns.

According to research by Meir Statman and Denys Glushkov, which won the 2008 Moskowitz Prize for Socially Responsible Investing and was published in May's issue of the Financial Analysts' Journal, socially responsible investment wins on the swings what it may lose on the roundabouts, putting it, in aggregate, on a par with conventional investment.

Specifically, the negative impact on investment returns of refusing to invest in "sin stocks" such as tobacco or arms manufacturers is outweighed by the positive effect of tilting the portfolio to companies that are good at corporate governance and managing their impact on the environment in which they exist.

This research does not stand on its own – the academic verdict seems to be, apart from simple negative screening techniques that are mostly only used by minority investors such as religious groups, sustainable investment processes offer returns at least as good as normal investing.

Goldman Sachs's Sustain team, which uses the concept of sustainability as a filter for analysing companies within sectors, is referred to with respect both by SRI practitioners and traditional investment managers, while Allianz Global Investors' equity specialist RCM has made its sustainability analyst a member of its general investment committee.

Another factor that is helping bring SRI into the mainstream is the establishment of the United Nations principles of responsible investment. This set of six principles asks signatories, who now represent some $18bn (£11bn, €12bn) in assets, to manage those assets with an eye to ESG issues, and also to promote such practices in the asset management industry.

Because both asset owners and asset managers can sign up to the PRI, managers are less likely to have the excuse of not wanting to do something their clients would not like. The PRI, together with the UN Environment Programme Finance Initiative, has sponsored a number of legal reports that put paid to the fear that responsible investment could be at odds with the fiduciary duties of either pension trustees or their managers.

October 27, 2009

Fiduciary Duty and ESG: Myths, Aspirations and Realities

Sarah Cleveland Senior Consultant, Watson Wyatt *Presenter*
Peter Kinder JD President, KLD Research & Analytics *Presenter*
Jonas Kron Senior Social Research Analyst, Trillium Asset Management *Presenter*
Brian Rice Investment Officer, California State Teachers' Retirement System (CalSTRS) *Presenter*
Paul Hilton CFA Director, Advanced Equities Research, Calvert Group *Moderator* **View**

Description

It has been an eventful year in the evolution of fiduciary duty for investors. This panel will take a provocative look at recent developments, spotlighting a major new United Nations report entitled "Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment." This report includes new guidance on how institutional asset owners can implement a fiduciary commitment to ESG and provides a survey of best practices by institutional consultants. In addition we will review recent developments in legal language pertaining to fiduciary duty and SRI, such as ERISA, and explore what might be on the horizon given the new administration. Drawing from the perspective of a major institutional asset owner, an institutional investment consultant, and two legal experts, we will debate the implications for various audiences interested in SRI.

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CONSIDER US
Rock singer and children speak out on climate change
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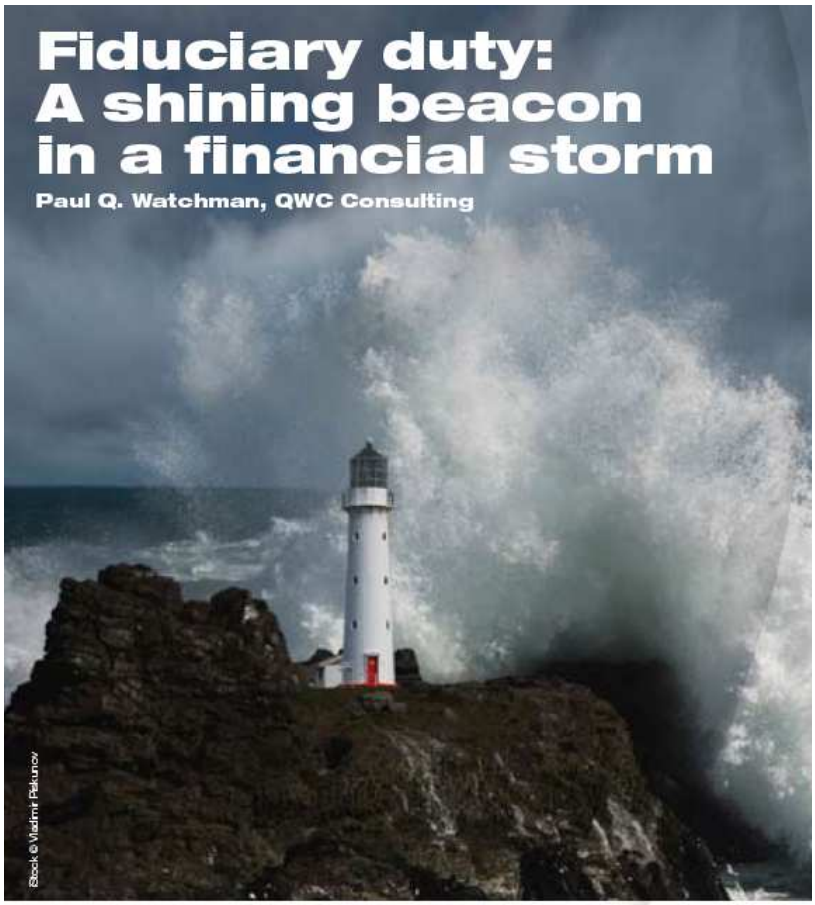
UNEP FI, Issue 9, October 2009
The golden ratio... building quantity without sacrificing quality

Fiduciary duty: A shining beacon in a financial storm

Paul Q. Watchman, QWC Consulting



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

continued on page 10

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]

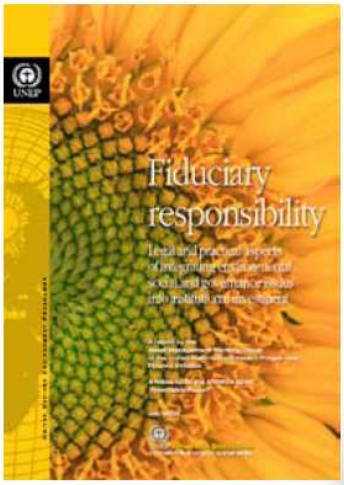
Without doubt there is some truth in these observations. For example, banks recently bailed out by the public purse have sought to justify the pay out of substantial bonuses, and there have been personal attacks on regulators for criticizing banking activities. Add to these developments the re-emergence 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

continued on page 13

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.

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.

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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,

Butch Bacani Is program officer for Insurance & Investment at the United Nations Environment Programme Finance Initiative.

Greening institutional investment

If integrating environmental, social and governance practices into institutional investment is confusing, the sequel to the landmark Freshfields Report provides a fresh view.

In July, the UN Environment Program Finance Initiative launched the much-awaited sequel to its 2005 *Freshfields Report*, arguably the single most effective document promoting the integration of environmental, social and governance (ESG) into institutional investment.

That report explored the complex relationship between ESG issues and fiduciary duty in nine major capital markets, including Australia, 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".

This clear conclusion is routinely cited worldwide to clarify the legality behind the consideration of ESG issues with respect to pension funds, insurance company reserves and mutual funds.

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

It is timely, given the argument of some that the ongoing financial crisis may not have been so deep or so protracted if institutional investors had been collectively willing to challenge the financial institutions that were at the heart of creating the systemic risks within the financial system.

> "The report also highlights the culture among many consultants to neglect ESG issues and treat them with a 'tick box' mentality"

Mainstreaming ESG

Fiduciary II has three main elements: a legal assessment, a pioneering survey of investment management consulting firms, and a literature search focusing on developments on the integration of ESG into the investment process.

The legal perspective looks at how best to operationalise the integration of ESG issues into the investment process through investment mandates and management contracts.

This is of practical importance because a root cause of short-termism is the mandates set by asset owners – and their consultants – that evaluate asset managers on short-term criteria. The report recommends longer-term assessment of asset managers' performance linked to long-term incentives, with periodic ESG-inclusive reporting.

Paul Watchman, a renowned fiduciary law expert, also notes that embedding ESG language in investment management contracts and statements of principles is essential to mainstreaming it in investment consideration.

Furthermore, he stresses that institutional investment consultants and asset managers have a professional duty of care to proactively raise ESG issues with their clients, and that failure to do so presents "a very real risk that they will be sued for negligence".

The second part of the report sheds light on the gatekeeping role of investment management consultants, who exercise considerable authority as they advise asset owners on which managers can best meet the investment mandate.

While asset managers *can* influence how well investee companies are run, whether they *do* use this influence to improve ESG performance largely depends on whether investment consultants and their clients assess their performance in this area.

The survey highlighted one best practice response from Mercer, which routinely carries out ESG ratings in parallel with its overall investment rating and looks at how ESG issues impact idea generation, portfolio construction, management and implementation. This needs to become the industry norm.

Other good practices include the routine investigation of ESG issues in the proxy voting and engagement record of asset managers, and the integration of ESG issues into requests for proposals (RFPs) in selecting managers.

All consultants surveyed agreed there was no single method in exercising ESG-related fiduciary duties. A variety of methods were raised, including exercising voting rights, engagement activities of varying intensities, specific investment decisions and moderated outcomes of investment analysis according to issues such as company management's ability to execute strategy.

The survey also revealed that some consultants still confuse ESG integration – which is an economic assessment and valuation tool to improve investment analysis and decision-making from a risk-return framework – with traditional negatively screened ethical approaches.

The report also highlights the culture among many consultants to neglect ESG issues and treat them with a 'tick box' mentality, rather than issues of substance that need to be measured and appraised.

In a nutshell, the key conclusions of Fiduciary II are that in order for trustees to integrate ESG issues into their decision-making, they 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.

Find the report at www.unepfi.org

SOCIAL INVESTMENT ORGANIZATION
The Canadian Association for Socially Responsible Investment

November 2009

Best practices in responsible investment for Canadian pension funds

- **To view the full report:**

http://www.socialinvestment.ca/documents/PensionsReport_Nov2009_ENGL.pdf

- **AMWG-specific extract:**

concerns listed above may help mask a basic lack of interest in or commitment to exploring responsible investment or simply competing priorities.

Nonetheless, the passage of time – and the growth of responsible investment combined with a lack of contrary jurisprudence – has weakened the most fundamental objection: the fiduciary case against responsible investment. The number of cases in which, for example, a trustee is legally pursued for the application of ethical considerations is vanishingly small, in Canada and in other jurisdictions. As the UN Environment Program Finance Initiative notes:

> *investment, financial and business institutions have adopted a number of voluntary obligations which provide for ESG considerations to figure highly in investment, financial and business decision-making without legal challenge or concerns being voiced over a breach of fiduciary duties. For example, the Principles for Responsible Investment, the Equator Principles, and the UN Global Compact Principles, have been adopted by over 550 investment institutions, 60 lending institutions and thousands of companies, respectively, without sparking controversy about the fiduciary limits of such institutions and companies.*[9]

In the next section, the report focuses briefly on the issues of materiality and fiduciary duty, in general, and in the Canadian context.

Materiality and Corporate Disclosure

In assessing a company's investment eligibility, investment managers study published corporate documents, meet with company management and conduct site visits (among other due diligence steps). In reviewing all of this information, investment managers need to decide what information in their research findings is material in order to determine a valuation and make an investment decision.

In Canada, securities law falls within provincial jurisdiction. However, the definition of what is considered 'material' information is essentially the same across the country. In Ontario, the materiality test consists of whether the fact "would reasonably be expected to have a significant effect on the market price or value" of an issuer's securities [10]. Given the focus on market price, some could argue that the definition lends itself to an interpretation that focuses on the short-term.[11]

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[9] Asset Management Working Group (UN Environment Programme Finance Initiative), "Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment," July 2009, page 25.

Source: http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf, retrieved on August 31, 2009.

[10] "Bill 198 and Ontario's Securities Act: Giving Investors and the OSC Added Muscle," H. Garfield Emerson, Q.C.; Geoff A. Clarke; Fasken Martineau DuMoulin LLP presented at the 3rd Annual Directors' Governance Summit (November 17, 18 & 19, 2003).

[11] Some examples of developments likely to require prompt disclosure include: take-over bids or issuer bids, major corporate acquisitions or dispositions, new issuance of securities, significant discoveries by resource companies, significant changes in management, significant litigation.
http://www.tsx.com/en/pdf/PolicyStatementOnTimelyDisclosure.pdf

While there is increasing interest in having corporations address ESG issues, a sustained focus on RI-related disclosure has yet to be embraced by most brokerage house analysts. Although many of leading firms have distinguished themselves with their research, others perceive a gap in sell-side research and analysis and this can be a significant practical and psychological barrier to increased industry uptake.

In response, the United Nations Environment Program Finance Initiative (UNEP FI), in 2004, launched a "*Materiality Series*" initiative. This project encouraged leading brokerages to examine internal and external research on how ESG issues impact company share price and to report back to the group. This led to the publication in 2004 of "The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing."[12]

The follow-up publication, titled *Show Me the Money*, was released following a review of 1,000 pages of analyst research drawn from more than 20 global financial service firms. Illustrating the links between ESG issues, financial value and company profitability across eight industry sectors, the report provides strong independent support for the view that effective attention to environmental, social and governance issues can enhance shareholder value.[13]

The highlights of the report are three key findings:

- T are material as there is robust evidence that they affect shareholder value in both the short and long term;
- That the impact of ESG issues on share price can be valued and quantified; and
- That material ESG issues are becoming apparent, and that their importance can vary between sectors.

This approach has recently received a measure of support from the Ontario Securities Commission (OSC) which, in responding to a call for greater disclosure from the Ontario Legislature in 2009, has announced a review of the materiality of governance and environmental factors. The increasing interest of regulators regarding the materiality of ESG factors is another encouraging sign.

RI and Fiduciary Duty

There is a growing body of evidence that ESG issues can have a material impact on financial returns.[14] Despite the increasing recognition of the importance of evaluating

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[12] http://www.unepfi.org/fileadmin/documents/amwg_materiality_equity_pricing_report_2004.pdf, retrieved on August 31, 2009.

[13] http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf, retrieved on August 31, 2009.

[14] See for example, the two previously cited documents, *The Materiality of Climate Change* (2009 - http://www.unepfi.org/fileadmin/documents/MatIII_executive_summary.pdf), and the CFA Institute's 2008 *Environmental, Social, and Governance Factors at Listed Companies: A Manual for Investors*, discussed below and available online: http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2008.n2.1, retrieved on August 31, 2009.

and incorporating ESG related risks into investment decision making, some investment managers that are interested in taking ESG issues into account within their portfolios do not do so, or feel it necessary to cloak this aspect of due diligence, precisely because of lingering concerns within institutions about fiduciary duty.

This ambiguity stems from the fact that trustees of pension funds have a fiduciary duty to act prudently and in accordance with the purpose for which their investment powers are granted.[15] Therefore, absent a specific mandate to invest ethically and consider ESG issues, some investors and lawyers believe that in order to comply with these duties, investment intermediaries must only choose investments that maximize financial returns for beneficiaries. Failure to do this, they believe, would lead to a breach in their duty. However, fiduciary responsibilities evolve over time and the relationship between portfolio management and ESG analysis continues to develop.

Historically, fiduciaries were expected to evaluate the risks and returns of each individual investment, with emphasis of portfolio management being on income and capital preservation. This was known as the Prudent Man Rule and later the Prudent Investor Rule.

Today, mainstream investment theory – adherence to which would presumably be prudent – is strongly influenced by Modern Portfolio Theory, in which investments are considered based on their overall risk and return contribution to the portfolio as opposed to focusing solely on the risk and return of an individual security Under this theory, portfolio diversification is a key priority and a well diversified portfolio can offer a higher rate of return with lower overall risk than a portfolio where investments are combined without consideration to how their returns are correlated. Diversification is created through the use of different types of assets (e.g. equities, bonds, and real estate) as well diversification across geographies and industrial sectors.

As mentioned above, fiduciary duty has generally been interpreted to mean that trustees must make investment decisions based exclusively on maximizing the financial interests of beneficiaries. However, possible "benefits", from a beneficiary's perspective, may arguably extend beyond immediate financial returns. If beneficiaries share a moral objection to a particular form of investment, it could be considered to their benefit if the trust avoided that investment, possibly even at the cost of lower financial returns[16]. There is no reason why an investment strategy should not include investments with positive ESG characteristics as long as the decisions are motivated by the interests of

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[15] For an excellent overview of the concepts discussed in this section, see Freshfields Bruckhaus Deringer, "A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment," prepared for the Asset Management Working Group (UN Environment Programme Finance Initiative), October 2005.

Source: http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf, retrieved on August 31, 2009.

[16] Benjamin J. Richardson, Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?. Banking and Finance Law Review, Forthcoming. Source: http://ssrn.com/abstract=970236, retrieved on August 31, 2009.

the fund's beneficiaries and not the personal views of the decision-maker[17]. Certainly, there is little jurisprudence to suggest otherwise.

It should be remembered that these questions are moot for many institutional investors that have concluded that ESG analysis can improve investment decision making and ownership practices.

Another approach to fiduciary duty is most applicable to large institutional investors that, because of their size, own holdings across entire markets and have limited ability to divest easily and economically. These large investors are diversified across asset classes, sectors and geographies and are therefore tied to the economy as a whole. As a result, their returns – and their ability to meet their fiduciary duty – depend on the health and sustainability of the entire economy, rather than on the profitability of any company[18]. This is consistent with the long-term nature of pension funds' financial liabilities. Since liabilities are long-term, pension fund administrators have a fiduciary obligation to consider actions that might protect and enhance their long-term returns.

Furthermore, given that institutional investors own large cross-sections of the economy, their large investment portfolios will internalize both the financial and non-financial externalities[19] created by individual company action or inaction on ESG issues. Given the interactive effects of firm or industrial sector behavior on other firms and/or sectors, the interests of members and beneficiaries are likely best served when ESG issues are considered.[20]

Arguably, institutional investors that completely ignore ESG issues may be breaching their fiduciary obligations. Some environmental and human rights issues are becoming so pervasive and serious it is difficult to see how investors can continue to be indifferent to their impact.[21] This seems especially true of climate change scenarios – which could radically reshape human existence on the planet. However, even investment managers that decline to take a position on the reality and implications of climate change recognize that government and consumer decisions, both announced and anticipated, related to climate change will have a tremendous impact on investment risks and opportunities.

Leading practices in some asset classes already incorporate certain ESG factors. In real estate, for example, it is largely accepted that higher upfront costs to bolster energy efficiency pay future dividends in the form of lower utility bills and higher client demand.

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[17] Freshfields Bruckhaus Deringer, op. cit.

[18]. Richardson, op. cit.

[19] Externalities are costs or benefits arising from an economic activity that affect somebody other than the people engaged in the economic activity. Source: www.economist.com. Emitting greenhouse gases would be an example of externality.

[20] This concept – that externalities for long-term institutional investors are difficult, if not impossible, to avoid – is explored in greater detail in *Universal Ownership: Exploring Opportunities and Challenges* (2006). Source: http://www.community-wealth.org/_pdfs/articles-publications/sri/report-hawley-williams.pdf, retrieved on August 31, 2009.

[21] Richardson, op. cit.

The private equity industry association has adopted a voluntary code of responsible investment practices and some of its leading members have become PRI signatories.[22]

Finally, consider infrastructure; an asset class of great interest to both pension plans, with their long-term, inflation-sensitive, liabilities, and to policy makers anticipating future public demand. For both parties – and the managers that seek to identify and capture investment opportunities – the importance of labour unions to public policy debates as well as ongoing operations of many utilities is increasingly obvious.

In summary, as recognized by the UN PRI, ESG considerations are relevant to every asset class, but not necessarily in the same manner or consistently over time. The duty of the analyst should be to be familiar with responsible investment strategies, ESG factors, and related risks and opportunities but to apply this knowledge appropriately for the investments being considered or monitored.

Many of the points above were reflected in the "Freshfields Report", the most influential recent review of fiduciary duty. This report was commissioned by the United Nations Environment Programme Finance Initiative (UNEP FI) Asset Management Working Group and completed by Freshfields Braukhaus Deringer, a London-based global law firm. The study focused on the largest capital markets in Australia, Canada, France, Germany, Italy, Japan, Spain, the United Kingdom and the United States and concluded that, "... integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably requiired in all jurisdictions."[23]

The UNEP FI Asset Management Working Group has recently published a sequel to the earlier Freshfields Report in which the impetus for integration is given a major boost. The legal analysis reflects on developments since 2005 and argues, in the overview, that the financial services industry may have a positive obligation to facilitate a responsible investment approach to avoid, "a very real risk that they will be sued for negligence."[24] The report is also notable for the emphasis it places on a proactive approach to RI for investment consultants and other advisors. Finally, it provides practical guidance to assist with the incorporation of RI strategies and monitoring in standard investment management contracts.

Finally, as a measure of the mainstream acceptance of RI insights the Chartered Financial Analyst (CFA) Institute -- the self-regulatory body for investment professionals – has recently published a guide outlining ESG issues, identifying materiality, and providing numerous case studies to guide analysts in the appropriate incorporation of ESG information.[25]

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[22] See http://www.privateequitycouncil.org/ for more information. PRI signatories can be viewed here: http://www.unpri.org/signatories/

[23] Freshfields Braukhaus Deringer, op. cit., page 13.

[24] Asset Management Working Group, op. cit., page 15.

[25] CFA Institute, *Environmental, Social, and Governance Factors at Listed Companies: A Manual for Investors*, 2008. Source: http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2008.n2.1, retrieved on August 31, 2009.

MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

November 2009

Shedding light on responsible investment: Approaches, returns and impacts

Introduction

In October 2007, Mercer published *Demystifying Responsible Investment Performance*, a joint report with the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (AMWG UNEP FI). The report highlighted academic research examining the relationship between environmental, social and corporate governance (ESG) issues and financial performance. The report helped to dispel the preconception that integrating ESG factors into investment analysis and decision making leads to financial underperformance.

Two years later, the debate about ESG factors and investment performance has intensified, due in part to changes in regulatory standards (especially related to climate change and corporate governance), new corporate disclosure guidelines for ESG factors, further reassurance about the link to fiduciary duty,[1] and the large number of new signatories to the Principles for Responsible Investment (PRI) initiative, which seeks to integrate ESG factors into investment processes for both asset managers and asset owners. The PRI initiative has also established an academic network that is forging ahead with new research and ideas in this field. Several members of this network offered suggestions for articles to include in this review, and we are grateful for their assistance.

This report presents a summary of some of the new academic studies released since the 2007 AMWG UNEP FI/Mercer joint report. We have reviewed 16 academic studies that focus on the link between E, S or G factors and firm or portfolio performance.

As the 2007 report highlighted, the belief that responsible investment (RI) will automatically limit the investment universe and thereby limit returns is narrow in its focus and conclusion. RI is a broader practice, and a number of tools are available for integrating ESG into the investment process, including voting, engagement, collaboration, negative and positive screening (sometimes referred to as "best in class") and ESG integration into valuation metrics. A full assessment of the merit of taking a long-term responsible approach to investment needs to consider the relative merit of each approach and the preferences of the beneficiaries that asset owners represent and then balance those considerations against the available evidence on the performance implications of each approach (in terms of risk/return and an improvement to the capital and resource allocation process).

[1] See the Asset Management Working Group of United Nations Environment Programme Finance Initiative's July 2009 report: *Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment.*

Note → The framework of the pioneering survey of investment management consulting firms on the integration of ESG into the investment process, which was conducted by the UNEP FI Asset Management Working Group and is a key element of the Fiduciary II report, helped as the initial background information for a more detailed survey that was subsequently conducted by the European Sustainable Investment Forum, and thereafter, the US Social Investment Forum.

Investment consultants and responsible investment study (European Sustainable Investment Forum)

November 2009

To view the report: http://www.eurosif.org/publications/investment_consultants_ri

Investment consultants and responsible investing – Current practice and outlook in the United States (US Social Investment Forum)

December 2009

To view the report: http://www.socialinvest.org/resources/pubs/documents/Investment_consultant.pdf

responsible investor

Investment consultants starting to get ESG message

89% of consultants anticipate an increase of clients' interest in ESG matters in the next three years.

by **Responsible Investor** | December 2nd, 2009

Investment consultants appear to be getting the message about the importance of environmental, social and governance (ESG) factors, if a new survey by Eurosif is anything to go by.

It found that 89% of consultants it polled anticipate an increase of clients' interest in ESG matters in the next three years. Between September 2008 and September 2009, 64% saw an increased client interest in ESG – despite the financial crisis.

A companion survey in the US came to similar conclusions. The Pensions & Investments/Social Investment Forum survey found that 56% of consultant respondents reported increasing client interest in ESG investing in the last year – with 88% predicting growing interest in the next three years. "This isn't a flash in the pan," said SIF research director Meg Voorhes.

However, more needs to be done – especially at the mandate level – to counter what Eurosif calls a "split between RI and mainstream investing". It found that 42% of RFPs include questions on RI only when they are specific RI mandates. Just 36% of consultants evaluate asset managers' ability to incorporate ESG.

And just 33% of respondents were aware of the CFA Institute report "Environmental, Social and Governance factors at Listed Companies" Only 44% knew of the recent UNEP FI report "Fiduciary Responsibility, legal and practical aspects of integrating ESG issues into institutional investment".

Speaking at the launch of the Eurosif findings, Environment Agency pension fund head Howard Pearce said he was shocked at this lack of awareness. He argued ESG should not be client driven but driven instead by the principles of investment risk and opportunity.

Roger Urwin, global head of investment content at consultants Watson Wyatt, said responsible investment is "subject number 10 on the agenda of most of the funds I deal with". There was no "homogenous block" of consultants and asset managers were not getting clear cut explicit guidance from clients. Clients were asking consultants to make ESG easier for them, he said. Urwin saw a role for investment consultants in helping to facilitate ESG collaboration across funds. He told of his own 'personal journey' to see the importance of ESG.

One consultant, KPMG's head of investment advisory Patrick McCoy, told Eurosif that clients find it impossible to form a view on ESG. He was quoted saying: "They only take them into account when they impact the financial performance of their investment. For example, even on the delicate issue of child labour, they do not want to form a view unless it will have an effect on the performance – they shy away from making this type of judgement."

The Environment Agency's Pearce said some consultants are "missing a trick" by not signing up to the UN PRI.

Neither Watson Wyatt nor KPMG are signatories unlike rivals Mercer, Hewitt, Hymans Robertson and Aon.
Eurosif found consultants are less inclined to investigate the proxy voting and engagement records of asset managers concerning ESG issues – although it points out that Watson Wyatt has developed a manager monitoring service called "Active Ownership Watch".
Watson Wyatt's Jane Goodland said clients assume that asset managers are doing ESG as a matter of course, which is forcing asset owners to revisit their
expectations of their managers.
Melissa McDonald, head of responsible investment at report sponsor AXA Investment Managers, said the industry has moved on from just paying lip service to ESG. "Despite the low levels of interest in shareholder voting and engagement as revealed by the study, we believe that regulatory scrutiny combined with government pressure to adopt active ownership, will evolve the institutional investment process to encompass the breadth of ESG investment approaches in the future."

link to Eurosif survey

TUC trustee network
member trustee news
Winter 2009

Responsible investment briefs

UNPRI has delisted 5 signatories – but gained 93

Five financial institutions were delisted as signatories from the UN Principles for Responsible Investment Initiative (PRI) in August for not participating in the Initiative's annual reporting and assessment process. Participation in the annual survey is mandatory for asset owner and investment manager signatories. There were 93 new signatories this year: you can find out whether your fund managers and advisers are signatories by checking the list at www.unpri.org/signatories. There are now 573 signatories to the PRI, including 182 asset owners, and 282 investment managers.

FSA to allow collaboration between activist investors

Investors can work together to change a corporate board's behaviour without fear of breaching market-abuse rules, the FSA said in August. The regulator confirmed that collaboration would not be deemed market abuse as long as it was restricted to "ad hoc discussions between investors on particular corporate issues". The FSA's statement can be found in the library section of their website www.fsa.gov.uk

Shareholder voting is on the way up

Shareholders in the UK are increasingly making their voices heard at FTSE100 firms by voting at annual meetings, says Manifest Research. In the year to 31 July 2009, votes were cast by more than 67 per cent of investors, compared with 53 per cent in 2002–3.

ESG considerations a legal requirement for trustees

A report by the United Nations Environment Programme (UNEP) published in July, *Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment* argues that if investment consultants and others do not incorporate environmental, social and governance (ESG) considerations into their services, they face "a very real risk that they will be sued for negligence."

Fiduciary law expert Paul Watchman, one of two main contributors to the report, explained the implications for trustees. "It is necessary for investment management agreements to use ESG language in order to clarify the expectations of the parties to the contract. In particular, it is important that it is made absolutely clear to beneficiaries, pension fund trustees and asset managers that ESG is regarded as a mainstream investment consideration."

The report can be downloaded from www.unepfi.org

Mercer study shows ESG has positive effect on investment returns

ESG factors can have a positive impact on portfolio returns, according to a growing body of academic research, says investment consultant Mercer. *Shedding Light on Responsible Investment: Approaches, Returns and Impacts* summarises and comments on 16 peer-reviewed academic studies – the majority of which show a positive relationship between ESG factors and companies' financial performance. Only two showed a neutral-to-negative relationship, while four were neutral.

"The idea that responsible investment does not have to come at a cost to performance is becoming well established in the institutional investment industry. In fact, the Shedding Light report further builds the already strong case that considering ESG factors can add real and measurable value to an investment portfolio," say Mercer.

The report, and other ESG information, can be downloaded from www.mercer.com/ri

SocialFunds
The largest personal finance site devoted to socially responsible investing

January 07, 2010

Despite Improvements in Corporate Disclosure and Regulatory Oversight, Many Asset Managers Still Do Not Consider Climate Change in Analyses

by Robert Kropp

A survey of asset managers by Ceres finds that nearly half believe that climate risk is not material to their investment analysis, despite their fiduciary duty to evaluate risk as part of their due diligence review.

SocialFunds.com -- Despite the growing certainty that investment risks and opportunities associated with climate change will increase, few asset managers are including such risks and opportunities in their investment analysis, according to a survey conducted by Ceres, a national coalition of investors and others working with companies to address sustainability challenges.

The results of the Ceres survey are incorporated in a report published this week, entitled Investors Analyze Climate Risks and Opportunities: A Survey of Asset Managers' Practices. The survey was sent to the 500 largest investors, as identified in a 2008 survey conducted by Pensions and Investments. Eighty-four asset managers responded.

According to the report, Ceres found that 44% of asset managers do not consider climate risks at all in their investment analysis, because they do not believe the issue is material. According to Ceres, such a stance "stands in stark contrast from the increasing number of corporations who are identifying climate issues as material risks in their required financial reporting."

The Ceres survey was completed in early 2009, before the report of the Asset Management Working Group (AMWG) of the United Nations Environment Program Finance Initiative (UNEP FI), entitled Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issue into Institutional Investment (Fiduciary II), was published. Therefore, the findings of the Fiduciary II report were not incorporated into the Ceres report.

However, the findings of Fiduciary II sent a quite explicit warning to asset managers who do not incorporate such environmental, social, and governance (ESG) criteria as climate change into their investment analysis, stating, "Advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position."

Furthermore, according to Fiduciary II, investment advisors that fail to incorporate ESG issues into their investment services face "a very real risk that they will be sued for negligence;" therefore, "ESG issues should be embedded in the legal contract between asset owners and asset managers."

In its report, Ceres answered the assertion of those asset managers who do not consider climate change to be material with the statement, "The very core of fiduciary duty is that the fiduciary primarily consider the tradeoff between risk and return… investors and their asset managers must seriously consider climate risks as part of their due diligence review of their investments."

According to Ceres, "A key purpose of this report is to catalyze a closer dialogue between asset managers and other players in the investment community – the companies they own, their institutional investor clients, the SEC and others – to develop best practices for corporate disclosure, Wall Street analysts, rating agencies and other key market drivers."

Of the 84 respondents to the Ceres survey, 14 reported that they manage a green investment fund, defined by Ceres as "a fund with a strategic priority related to climate change." Ceres found that while managers of green investment products were more likely to analyze climate risk for all their investments, one-third did not necessarily do so. The survey also found that 20% of respondents who did not offer green investments assessed climate risk.

In stark contrast to the Fiduciary II recommendation that asset managers proactively address such ESG considerations as climate change with their clients, Ceres found that 60% of respondents did not do so. Of

these, 49% said they did not because investors did not ask for them.

Adding to asset managers' disinclination to address climate change in their investment analysis, according to Ceres, is the fact that "Incentive structures and benchmarks that asset owners use for evaluating asset managers are heavily weighted toward short-term performance focusing primarily on quarterly returns where climate risks are far less likely to show up."

But as one respondent noted, "Climate change, along with the governmental response to it, will fundamentally reshape valuation for a broad selection of the global economy."

When climate risk is incorporated into investment analysis, it is most often done so in response to regulatory or litigation risk, both of which were cited by two-thirds of respondents. Half of the respondents incorporated competitiveness for products and services relating to climate change. Only one-third cited the more long-term considerations of physical risk or greenhouse gas (GHG) emissions management as factors.

On the basis of its survey findings, Ceres provided a number of recommendations for asset managers. It recommended that asset managers assess climate risk for all investments, include a statement about climate risks and opportunities in their policies, and include climate risk in their evaluations of corporate governance.

Ceres also recommended that asset managers adopt proxy voting policies on ESG considerations, including climate change. Its survey found that only 29% of respondents have proxy voting policies for shareowner resolutions on climate change at present, and the report includes as an appendix a sample proxy voting policy.

Finally, Ceres recommended that asset owners engage with the Securities and Exchange Commission (SEC) and policymakers to encourage full corporate disclosure of climate risks and opportunities. As Ceres noted in its report, the SEC is currently considering investor requests that it offer interpretive guidance on corporate reporting of climate risks and opportunities, and has already issued guidance to make it easier for investors to file shareowner resolutions relating to climate change.

In its recommendations for institutional investors, Ceres also advised engagement with the SEC and policymakers. It also recommended that institutional investors analyze climate risks in their investment portfolios, train staff and managers to identify best practices in corporate governance relating to climate change, and adopt sustainability policies to provide guidance for advisors and asset managers.

Mindy Lubber, president of Ceres and director of the Investor Network on Climate Risk (INCR), a network of investors promoting better understanding of the financial risks and opportunities associated with climate change, said, "These findings make clear that the investment community is overly focused on short-term performance and ignoring longer-term business trends such as climate-related risks and opportunities. The recent subprime mortgage meltdown is a painful reminder of the fallout for investors who ignored 'hidden' long-term risks."

Doing well by doing good

Socially responsible investment is increasingly becoming a duty for trustees rather than simply an option argues Barbara Evans, RCM

In a nutshell

- the pensions management industry must pay due consideration to ESG risks and opportunities in their investment decision making to fulfil their fiduciary duties
- Northern and Western Europe is taking the lead in realising the potential of integrating ESG research into investment decisions
- ESG research needs to be carried out by experienced analysts in a credible manner.

In a world where 240 million people are alleged to be unemployed in 2009 (International Labour Organisation, Jan 2009); where unchecked global climate change could shrink global GDP by up to 20% (The Stern Review, 2006); and where consumers from both developing and developed markets report a propensity to buy from companies with a reputation for environmental and social responsibility (World Business Council for Sustainable Development, 2009), how can the pension management industry ensure it is behaving in a way that is prudent and for a proper purpose – their duty as fiduciaries?

The latest report from the UN Environment Programme Finance Initiative (UNEP FI) Asset Management Working Group, *Fiduciary responsibility: legal and practical aspects of integrating environmental, social and governance (ESG) issues into institutional investment*, published in July 2009, concludes that the industry should, and indeed must, pay due consideration to ESG risks and opportunities in their investment decision making to fulfil its duties in a rapidly changing society.

Landmark report

In 2005, the UNEP FI published what became a landmark report: *A legal framework for the integration of environmental, social and governance issues into institutional investment*. This report made the case that ESG considerations do not limit the tools available to pension schemes and asset managers to assess investments, but add powerful economic assessment and valuation methodology to longer standing metrics, thus improving investment decision making: "The object of ESG incorporation into mainstream investment decision-making therefore is not to exclude socially or ethically unacceptable stocks or shares but to focus a brighter light on the impact of all material considerations on investment value." The report concluded that, "fiduciary responsibility for the 21st century must require consideration of the social, environmental, political and cultural effects of investments, both positive and negative, over the short and long term as a fundamental part of the investment process".

But, at this time, the authors also noted that the attitude of institutional investors and their appetite for considering ESG issues as part of their decision making process varied materially, from those who saw no role for ESG issues in their decision making to those who believe ESG issues must inform investment decisions. For some, the view that a fund must focus solely on maximising financial returns, and the absence of irrefutable evidence positively linking performance on ESG issues with financial performance, has proven a significant impediment to the development of ESG investment practices. Four years on, what changes have we seen? Has either side been proven more correct?

Difference in perception

Perhaps the most notable development since 2005 is the apparent widening of the divergence between the ESG pioneers and the continuing laggards. In advance of the follow up study by UNEP FI published this summer, RCM commissioned a grassroots research study of more than 50 globally diversified asset owners in Europe and North America. The results showed that, where investors in Northern and Western Europe perceive sustainable investment strategies as viable tools for investment

risk managing, helping to identify those companies that have realised the financial consequences of resource inefficiency and mismanagement of human capital and are innovating according to emerging environmental and social trends, investors in North America still perceive sustainable investing as a limitation. US respondents stated: "Our fiduciary responsibility is to maximize returns ... anything that you do that restricts investment opportunities, lowers returns.

"We don't do that type of investing; we have a fiduciary responsibility to maximize benefits for our beneficiaries; you have to show that socially responsible investment results in higher performance on a risk-adjusted basis. We haven't seen evidence to demonstrate that."

Compare this with recent developments in the UK and the difference in perception is marked. The UNEP FI report highlights that, in October 2008, during the passage of the Pensions Bill through its House of Lords stages, Lord McKenzie, in relation to pension scheme considerations and pension schemes generally, stated: "There is no reason in law why trustees cannot consider social and moral criteria in addition to their usual criteria of financial returns, security and diversification. This applies to trustees of all pension funds." Lord McKenzie also added that the government's view on the need for pension schemes to have regard to ESG considerations was a duty rather than a right or option and that this requirement should be clearly stated in pension schemes' Statement of Investment Principles: "It is an obligation on pension fund trustees, not simply a right or option to state in their Statement of Investment Principles what the fund's guidelines are on responsible investment and to what extent social, environmental or ethical considerations are taken into account."

Positive returns

Disagreement over what the integration of ESG analysis means, how it impacts on performance and the potential conflict with fiduciary duty clearly remains a barrier to the broader adoption of sustainable investment strategies, despite the best efforts of the UNEP FI. Asset owners need to be convinced that this is a financial issue – one that identifies risks and opportunities not captured by conventional financial analysis. The goal of ESG integration should be to enhance and supplement (and not replace) an asset manager's investment decision making process, rather than to make an evaluation of the potential merits of investing in certain companies based on their business involvement. This is consistent with identifying the best possible investments from a risk-return framework.

Indeed if you adopt this approach, the academic research is beginning to support the case for improved returns. In August 2009 the University of Western Australia published a report which utilised long-run event study methodology to plot abnormal returns associated with firms being included in and excluded from the KLD Domini 400 Social Index (DS400). KLD established the DS400 in May 1990 as the first benchmark index constructed using ESG factors. The study concludes that there are positive and statistically different long-run abnormal returns for firms being included in the index. A 2008 report from Santa Clara University and Barclays Global Investors analysed returns during 1992 to 2007 of stocks rated on ESG by KLD and found that this ESG tilt gives "responsible" investors a return advantage relative to conventional investors. This has led to wider acceptance of the notion that investors can do "well" by doing "good".

We, as asset owners, owe our clients a duty of care that goes beyond providing robust investment products
Barbara Evans

Duty of care

After the fallout of the crisis, many fiduciaries will wisely look at the impact of the past 12 months on their investments and look for new approaches to stewarding and allocating their assets. In advocating the integration of ESG issues into asset ownership and management practices, the UNEP FI is offering a viable solution that is part of a responsible investment agenda and necessary in managing risks and evaluating market opportunities over the long term: all part of fiduciary duty. As asset managers, we can expect fiduciaries the world over increasingly to apply pressure for the development of robust and convincing investment strategies that integrate ESG issues into financial analysis and engage with companies to encourage more sustainable business practices.

Only those managers with long standing, credible expertise in ESG research will be able to respond to this pressure. In an article in *CFA Magazine*, entitled "Can investing based on environmental, social and governance factors enhance performance", the author points out that ESG and sustainability issues are a lot harder to quantify than book value or dividend yield. Is a good labour record worth more market cap than an independent board? Is excessive water use a greater risk than dependence on tobacco sales? Most questions of this type simply cannot be answered definitively – the skill, approach and intellectual capital of the investment team implementing the research become key. Some sustainability investment analysts now have over a decade of practical experience in investment management companies and this is resulting in a deeper understanding of how ESG research can help to meet the needs of investors.

UNEP FI's report argues that we, as asset owners, owe our clients a duty of care that goes beyond providing robust investment products and extends to include identifying future challenges in the financial system and doing what is within our power to reduce the chances of further crises. "The wall between financial performance and corporate citizenship has been breached and incorporating ESG into the analytical process is now seen as a way to identify competent, forward-looking management and to pre-empt big, external 'shock' events" (CFA, 2009).

To this end, it seems increasingly clear that integrating ESG issues into institutional investment is a part of fiduciary duty for us all and one that it may become increasingly difficult to ignore.

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Part II → Policy & advocacy

21 July 2009

ESG disclosure letter of the US Social Investment Forum to the US Securities & Exchange Commission

- **To view the full letter:**

http://www.socialinvest.org/documents/ESG_Letter_to_SEC.pdf

- **AMWG-specific extract:**

Fiduciary duty: In 2005, the law firm of Freshfields Bruckhaus Deringer issued a survey of the law of fiduciary duty in the United States, Europe, Japan, Canada and Australia, and concluded that the consideration of ESG factors in the investment process is clearly permissible in every jurisdiction. In fact, Freshfields concluded that the law arguably requires fiduciaries to take ESG factors into account when they may affect the long-term value of the portfolio. They also noted that the law of fiduciary duty accords fiduciaries wide discretion in making this determination.[16]

In July 2009, the United Nations Environment Program Finance Initiative (UNEP-FI) with the backing of asset managers representing $2 trillion in assets under management, issued a 120-page follow-up to the groundbreaking Freshfields report.[17] The report says that professional investment advisors and service providers to institutional investors may have a far greater legal obligation than outlined in the

[11] Social Investment Forum. (March 5, 2008). *Report on Socially Responsible Investing Trends in the United States*. Retrieved June 15, 2009, from http://www.socialinvest.org.
[12] Ibid. The *Trends* report counts the assets of institutions that incorporate one or more social or environmental criteria as part of a formal investment policy, sponsor or cosponsor shareholder proposals on environmental or social issues or corporate governance issues that "cross-over" into areas of social responsibility, as well as the assets of community investing institutions. The report counts assets managed using a screen on a single issue, which includes, for example, approximately 16 percent of the assets from socially screened funds and 37 percent of institutional investor assets.
[13] Heidi Welsh for RiskMetrics Group. (March 25, 2009). *Issue Report, Sustainability Topics, Sustainability Reporting*.
[14] Ibid.
[15] As You Sow Foundation. (April 6, 2009). *Proxy Preview 2009, Helping Foundations Align Investment and Mission*. Retrieved June 1, 2009, from http://www.asyousow.org/publications/Proxy%20Preview%20Release%204-6-09.pdf.
[16] Freshfields Bruckhaus Deringer for the Asset Management Working Group of the UNEP Financial Initiative. (October 2005). *A legal framework for the integration of environmental, social and governance issues into institutional investment*.
[17] The Asset Management Working Group of the UNEP Financial Initiative. (July 14, 2009). *Fiduciary Responsibility, Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment*. Retrieved July 14, 2009, from http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf.

original Freshfields report to incorporate ESG issues into their investment services or face "a very real risk that they will be sued for negligence" if they do not.

In 2006, 14 of the world's largest investment firms launched a groundbreaking report for the UNEP-FI titled *Show Me the Money*. The report highlighted the growing importance of ESG concerns to the global investment community and drew on research from leading brokerage firms, including Goldman Sachs, JP Morgan, Morgan Stanley and Merrill Lynch.[23] Covering the impact of several types of sustainability risks on company value, the report found that:

- "There is robust evidence that ESG issues affect shareholder value in both the short and long term." The report notes that over the course of its three-year research period, analysts "presented significant evidence of the positive and negative impacts environmental, social and governance issues can have on share price across multiple sectors," including the automotive, aerospace and defense, media, and food and beverage industries.

- "The impact of ESG issues on share price can be valued and quantified." It notes, "Using a range of valuation tools, including benchmarking, scenario analysis, proprietary valuation methodologies, and case studies, several of the reports incorporate ESG variables into company valuations." It cites nine analysts' reports containing "evidence of a link to materiality" for ESG factors, "of which six were explicitly quantified."

- "Key material ESG issues are becoming apparent, and their importance can vary between sectors." The report found common themes among ESG risk categories referenced by analysts, including "the importance of public policy and regulation in determining materiality; the importance of brand and reputation as emerging categories of risk (particularly to companies whose primary exposure is directly to consumers); the importance of global supply chains and the ability to manage outsourcing and supply chain risk; the importance of aging workforces, pension obligations, and healthcare costs; and the overarching significance of corporate governance."

A 2007 report by the UNEP-FI and Mercer, *Demystifying Responsible Investment Performance*, examines 20 academic studies that discuss the link between environmental, social or governance indicators, or all of them, and financial performance, and documents that half show a positive—and statistically significant—relationship, three show a negative relationship, and seven show neutral

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[22] The UN Global Compact. (December 2004). *Who Cares Wins: Connecting Financial Markets to a Changing World*. Retrieved June 17, 2009, from http://www.unglobalcompact.org/issues/financial_markets/who_cares_who_wins.pdf. The report was endorsed by ABN Amro, Aviva, AXA Group, Banco do Brasil, Bank Sarasin, BNP Paribas, Calvert Group, CNP Assurances, Credit Suisse Group, Deutsche Bank, Goldman Sachs, Henderson Global Investors, HSBC, IFC, Innovest, ISIS Asset Management (now F&C Asset Management), KLP Insurance, Mitsui Sumitomo Insurance, Morgan Stanley, RCM (a member of Allianz Dresdner Asset Management), UBS, Westpac and the World Bank Group. The working group that prepared the report also included Citigroup, Credit Agricole, State Street Global Advisors, the Conference Board, Columbia Business School and the UNEP Finance Initiative.

[23] UNEP Finance Initiative Asset Management Working Group. (July 2006). *Show Me The Money: Linking Environmental, Social and Governance Issues to Company Value*. Retrieved June 16, 2009, from http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf. ABN AMRO Asset Management, Acuity Investment Management, BNP Paribas Asset Management, Calvert Group, ClearBridge Advisors/Legg Mason Groupama Asset Management, Henderson Global Investors, Hermes Pensions Management, HSBC Halbis Partners, Insight Investment, Mitsubishi UFJ Trust & Banking Corp, Morley Fund Management, RCM (Allianz Global Investors) and Sanpaolo AM/Eurizon Financial Group commissioned and signed onto the report's findings.

results.[24] They conclude, "[A] variety of factors such as manager skill, investment style and time period are integral to investment performance. The argument that integrating ESG factors into investment analysis and decision-making will only lead to underperformance simply cannot be made." Moreover, in half the cases examined, integrating some environmental, social, and/or governance factors resulted in the portfolios outperforming.

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[24] Asset Management Working Group, UNEP-FI and Mercer. (October 2007). *Demystifying Responsible Investment Performance: A review of key academic and broker research on ESG factors.*
[25] Marc Orlitzky, Frank L. Schmidt and Sara L. Rynes. (n.d.). "Corporate Social and Financial Performance: A Meta-analysis," *Organization Studies* 24(3): 403-441.
[26] McKinsey. (n.d.). *Valuing corporate social responsibility, McKinsey Global Survey, 2009.*
[27] Joseph Blasi, Douglas Kruse and Aaron Bernstein for Basic Books. (2003). *In the Company of Owners: The Truth about Stock Options.*
[28] Olubunmi Faleye and Emery Trahan for Northeastern University, College of Business Administration. (May 2006). *Is What's Best for Employees Best for Shareholders?*
[29] Center for International Private Enterprise/Social Accountability International. (Feb. 11, 2009.) *From Words to Action: A Business Case for Implementing Workplace Standards.* Retrieved June 15, 2009, from http://www.cipe.org/publications/papers/pdf/SAI.pdf.

UKSIF

the sustainable investment and finance association

3 August 2009

UKSIF letter to the Personal Accounts Delivery Authority (PADA) Investment Consultation Team, in response to the PADA discussion paper, 'Building personal accounts: Designing an investment approach'

- **To view the UKSIF response:**

http://www.uksif.org/cmsfiles/responses/UKSIF_Response_to_PADA_investment_approach_discussion_paper_3_August_2009.pdf

- **To view the PADA discussion paper:**

http://www.padeliveryauthority.org.uk/documents/investment_discussion.pdf

- **AMWG-specific extract from UKSIF response:**

7.3 How should the trustee corporation interpret its fiduciary duty in relation to responsible investment while maintaining a commitment to low charges?

Fiduciary duty obliges pension schemes to act "in the best interests of members and beneficiaries". An effective responsible investment approach can help the trustee corporation fulfil its duty both in relation to maximising returns for scheme members (as addressed above) and in exercising its ownership responsibilities. As the discussion paper sets out, one key argument for this is universal ownership (sections 7.12 to 7.14).

The current financial crisis has raised questions of whether asset owners historically have devoted sufficient attention and resources to ownership issues[5]. The recent Walker Review proposal for a "stewardship obligation" for fund managers suggests that the trustee corporation as a large asset owner should consider itself to have a duty of stewardship[6].

The 2001 Myners Review and subsequent Investment Governance Group, the Institutional Shareholders' Committee and the NAPF all recognise that owners have a duty to hold directors accountable for governance and corporate responsibility, and that exercising this duty can protect financial value. The Pensions Regulator's 2009 draft revised guidance on the scope of the Trustee Knowledge and Understanding (TKU) requirements for defined contribution schemes includes a section on "the importance of responsible ownership of assets"[7].

As noted in Box 7.1 of the discussion paper, fiduciary duties evolve over time. We would encourage the trustee corporation to consider the proposals and recommendations of the "Fiduciary II" report published in 2009 by the UNEP FI Asset Management Working Group[8].

7.4 If responsible investment is pursued, will the members be best served by building in-house capability or outsourcing?

There is no one model for pursuing responsible investment. As with other aspects of the investment process, the most effective, and low cost, way of achieving this will be through a mix of in-house capability and outsourcing. Pension schemes have developed and applied a number of different models[9].

For any approach to be effective there needs to be sufficient knowledge and understanding of responsible investment amongst the trustee corporation and its staff. Leading UK pension funds have developed their knowledge and understanding through increased trustee training, appointing in-house responsible investment managers and use of consultants.

Principles for Responsible Investment (Sections 7.32 to 7.35)

UKSIF strongly recommends that the personal accounts scheme signs the PRI. The benefits of this were set out by James Gifford in his presentation to your Responsible Investment seminar.

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[4] "Responsible Business: Sustainable Pension" 2009
http://www.uksif.org/projects/sustainable_pensions/Corporate_Pension_2009
[5] For example Lord Myners and Hector Sans's speeches to the 2009 NAPF Investment Conference
[6] See Chapter Five of "A review of corporate governance in UK banks and other financial industry entities"
http://www.hm-treasury.gov.uk/walker_review_information.htm
[7] The TKU draft scope guidance documents, including the "Draft revised scope guidance: DC Schemes", are currently laid before Parliament http://www.thepensionsregulator.gov.uk/pdf/TKUscopeforDConly2009.pdf
[8] "Fiduciary responsibility – Legal and practical aspects of integrating environmental, social and governance issues into institutional investment" http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf

[9] The 2007 report by UKSIF and UNEPFI "Responsible Investment in Focus: How leading public pension funds are meeting the challenge" provides detailed examples of some of the most advanced approaches being adopted by public pension funds http://www.uksif.org/projects/sustainable_pensions/publications

SOCIAL INVESTMENT ORGANIZATION
The Canadian Association for Socially Responsible Investment

14 August 2009

ESG disclosure letter of the Canadian Social Investment Organization to the Pension Commission regarding proposed amendments to Manitoba's pension benefits regulation

- **To view the full letter:**

http://www.socialinvestment.ca/documents/ManitobaPensionRegulationsletter_14Aug2009.pdf

- **AMWG-specific extract:**

Research studies have also found that there is no sacrifice for investing in a socially responsible way. In fact, some research has found that attention to climate change and other ESG factors can result in portfolio outperformance. In October 2007, Mercer and the Asset Management Working Group (AMWG) of the United Nations Environment Program Finance Initiative released a major analysis of 20 academic and 10 broker studies on the issue of SRI and financial performance. The analysis, entitled *Demystifying Responsible Investment Performance* (http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf), found that 10 of the 20 academic studies established a positive relationship between ESG factors and performance. Two of the studies concluded that the relationship is neutral-positive, while four indicated a neutral relationship, one established a neutral-negative relationship, and three discovered a negative relationship. Of the 10 broker studies, three yielded a positive relationship; the rest were neutral.

Clearly, the traditional view that attention to ESG factors will result in negative performance is not correct. In fact, there is some evidence to show that such strategies will reduce risk and enhance return.

Furthermore, the legal environment for investment fiduciaries on the consideration of ESG factors is rapidly changing. The traditional view of the legal community is that consideration of strictly "non-financial" factors in investment analysis is not permissible, and may even leave fiduciaries open to liability. However, just in the last four years, the legal consensus has changed dramatically.

A comprehensive legal analysis published in 2005 conducted by the prestigious UK law firm of Freshfields Bruckhaus Deringer found the traditional consensus to be untrue. The study found that, contrary to widespread belief that incorporation of ESG factors is prohibited by fiduciary obligation, the law permits the integration of ESG issues and, arguably, requires such integration. (http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf)

The Freshfields Report received further support in a new document released in July, 2009, entitled *Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment*, that concluded:

> *Advisors to institutional investors have a duty to proactively raise ESG issues within the advice that they provide, and that a responsible investment option should be the default position. Therefore, responsible investment, active ownership and the promotion of sustainable business practices should be a routine part of all investment arrangements, rather than the optional add-on which many consultants appear to treat it as.*

The report can be found at http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf.