UNEP Finance Initiatives
Innovative financing for sustainability

UN Global Compact - UNEP Finance Initiatives Joint Workshop on Investors and Sustainability

"Mainstreaming Sustainable Investment"

Summary Report

Contact

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Joint Workshop on Investors and Sustainability

"Mainstreaming Sustainable Investment"

A group of leading authorities from the finance and industrial sectors came together in Washington, DC on September 17, 2003 to discuss the issue of sustainable investment initiatives and strategies for integrating sustainable investment into the mainstream financial community. The group included representatives from sell side SRI research, EMS departments, investor relations departments, rating agencies, institutional investors, NGOs, SRI networks, and portfolio managers. They provided unique insights to the discussion from a variety of perspectives. The workshop, chaired by Julie Gorte from Calvert Group, engaged participants in constructive and much-needed dialogue to advance the debate on the future course of action for the mainstream adoption of sustainable investment. This report is a summary of the proceedings of the meeting and is intended to serve as the basis for future work in this area.

Introduction

The overall objective of the workshop was to begin development on a global strategy for raising the awareness of mainstream investors by (1) providing the investment community with a consistent message that also provides a new means of understanding the value of sustainability performance and (2) laying the groundwork for further initiatives and tools that can help advance the debate.

Definition and focus

Discussion originally focused on the message of "sustainable investment". One of the major challenges discussed was the assumption that the broader public knows what sustainable investment is about. That lack of a clear, concise and common definition of the concept has hindered the progress of this debate. Initial discussions at the workshop were focused on deriving a working definition of "sustainable investment".

The presentation of sustainable investment to the financial community was also touched upon. Much of the discussion on the issue of sustainable finance has focused on the risk side of the equation and several participants questioned whether the business case for sustainability should concentrate on this risk perspective, or whether an opportunity perspective is more appropriate. This question was met with mixed responses, with some participants claiming that the focus should remain on the risk perspective, due to it's random nature making it an ideal approach for consideration by the mainstream financial community.

Business Case

A recurring theme throughout the meeting was the lack of a convincing "dollars and cents" business case that can sell the concept of sustainable investment to the mainstream financial community by providing a convincing set of numbers that can be easily incorporated into the balance sheet. It was suggested that a major obstacle to presenting a strong business case is the difficulty in establishing a direct causal relationship between sustainability and financial value over time, a relationship that money managers under pressure to perform would require. The question that participants posed was how to persuade investors of the need to allocate resources towards monitoring companies' social and environmental risks if monitoring involves incurring a "sustainability" cost.

One recommendation was for those promoting sustainable investment to engage in greater consultation with companies in order to refine the business case for sustainability by identifying specific intangible risks and values that are important to those companies. Analysts of extractive industries, it was claimed, are not interested in grading environmental and social risk, but are aware of the issue, despite the fact that this may not be priced in by the market. The suggestion was made that companies from industries with visible environmental and social risks could provide insight into the types of risk that analysts are demanding of them and how they are presenting these risks. Further academic research on the subject was also recognized as a desirable first step. Several recent studies that have demonstrated the value being placed on these intangibles by the mainstream financial community and the questions of how sustainable investment, which has been viewed as an "intangible" debate, might effectively tap into this sentiment was discussed.

The cost of SRI as an investment strategy was also raised as a challenge to the business case. One participant stated that SRI is one of the most costly investment categories and is thus unattractive to financial professionals. The participant also claimed that communication efforts to highlight the benefits of SRI to the mainstream community had obviously failed. Another view countered that it was modern portfolio theory (namely its assertion that limiting the investment universe must necessarily produce lower returns) still holds firmly in the minds of many investment managers. A greater focus on the positives in these communication efforts, such as branding and the higher level of loyalty among SRI investors compared with other investors from other categories, was suggested as a way of supporting the business case.

Building on Current Initiatives

Participants highlighted several initiatives currently underway to try to promote sustainability in the mainstream financial sector as examples for future group activities. The peer pressure effect of these initiatives was identified as a key area of focus for future initiatives. An institutional investor issue group was offered as an example of a how peer groups generated interest; namely by having a member proposing a specific issue to the group for further review and action. It was suggested that a working group evolving from the meeting

could build on similarly constructed initiatives and “multiplier“ organizations as an effective means of engaging institutional investors, who were identified as a key target group. The benefit of engaging proxy voting organisations was also supported, although the regional considerations (ie. proxy voting requirements and effectiveness) should be taken into account.

However, some participants felt that current stakeholder initiatives were generally ineffective and suggested that greater regulatory and governmental activity was required to progress the sustainable investment debate. The UK dialogues on the definition of “materiality” and pension requirements were cited as positive examples of how progress could be made to raise awareness of environmental and social issues through regulatory frameworks. The Nike v. Kasky case public disclosure case and subsequent internalisation of Nike’s sustainability report was offered as a contrary example that demonstrated the potential downside to this approach.

In either case, it was recognized that support for the group’s actions needed to be drawn from actors with strong voices on these issues and frameworks from established initiative in taking actions forward. The Social Investment Organisation in Canada cited their initiative to demand transparency of mutual fund proxy voting and disclosure of environmental and social risks, which is based on the work on UK pension requirements, as an example of the benefits of this approach. Based on this discussion, it was proposed to capitalise on the momentum of the corporate governance debate and explore future collaboration with active players to gain more traction for the social investment issue. Active US state pension funds, such as the State of Connecticut and the State of New York, which have been effective in promoting change in corporate behaviour values, were highlighted as key players to target for involvement. The accounting profession was also identified as a group to engage. The Affiliated Conference of Practicing Accountants (ACPA), which includes social and environment reporting in it’s guidelines, was cited as an example of a group that may be receptive to such engagement.

Tool Development

According to financial analyst surveys cited at the meeting, 20% of a firm’s value is tied up in intangibles. Participants spoke of a need to quantify these intangibles and construct a value-added framework that focuses companies on a long-range view of access and affordability, as opposed to lobbying efforts to limits regulatory requirements on sustainability issues. One suggestion for accomplishing this was to focus the group’s efforts on a reduced value calculation to account for intangibles. An alternate view was to cost out the environmental and social issues and discount these factors to present value to stimulate interest in corporate sustainability. Considerations for both these approaches emphasised the need to provide a large quantity of solid quantitative evidence and to take into account the amount of disclosure that can be expected from the markets, as without access to the relevant data either approach would become irrelevant.

It was agreed that the business case for developed metrics would need to be articulated in a manner that would be well received by the mainstream financial community. One such major intangible faced and recognized by companies was the exposure of companies to reputation risk (particularly those companies that position themselves as good corporate citizens). Due to the sensitivity of companies to reputation risk, it was proposed that this should be among the first intangibles to convert into metrics.

Other issues discussed in developing an effective tool included the lack of incentives for academics to conduct complementary research, the current lack of good parameters and definitions for such research, and the importance of issue of a timeframe for the research. Several participants suggested that the appropriate timeframe to establish a causal relationship in line with institutional investor timelines would be 3-5 years. The statement was made that the search for short-term gains is redundant because Wall Street does not buy the argument that sustainable investment produces greater gains than conventional investment and therefore investor value from such research is not being generated. It was pointed out that the short-term focus of Wall Street may present a separate challenge to establishing a value-based metric due to the long-term nature of the visible benefits of environmental/social performance. An example that was offered was the dividend discount model, where the majority of valuation is in the terminal value, as the dividend is tiny but increases over the long run. It was also suggested that analysis should be developed around sectorial risks and aligned with the accounting sector, in order to be more effective in closing the information gap and providing an incentive for buy side analysts (and subsequently sell side analysts) to examine these sustainability issues. .

Research currently available that supports the triple bottom line argument was discussed and it was determined that a tangible financial upside to from sustainability performance that could be used to develop a quantifiable metrics ahs been established. The International Finance Corporation submitted that their research has established links between environmental/social ratings and credit rating performance in developing countries, which was reflected in an investment rate of return that was 8% higher for projects scoring best on the environmental and social ratings. It was suggested that further analysis could be conducted on their data set to build upon this research, particularly given the large amount of data that they have available. Other research efforts, such as those currently being conducted by SustainAbility and the WBCSD, who are also currently working on quantifying the value of CSR, health and safety performance, were also identified for consideration. A recommendation was made that future research efforts concentrate on companies in the bottom quintile of financial performance to see how these companies are adversely affected by their lack of awareness of sustainability issues.

Role of Stock Exchanges

An examination of the role of stock exchanges and the securities industry in furthering the sustainability debate was offered as a key point of focus for the group. It was suggested that the goal of creating a metrics project should be to get the world's three largest stock exchanges to report on the key metrics identified. However, participants felt that securities administrators may pose a barrier to the enforcement of mandatory environmental and social reporting. The current enforcement of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) rules, which should reflect these issues, in the US and their adequacy in the area of risk disclosure was cited as an example of this barrier. The adequacy and lack of enforcement (especially in the area of risk disclosure) in the US was a major area for the concern of some participants for trying to work through securities administrators. In order to see change in risk disclosure in the US, it was suggested that organized pressure on the SEC may be required. It was proposed that a starting point for this pressure could be to demand guidelines from regulators that state what companies must report on in order to comply with MD&A rules.

A proposed means of facilitating these changes was to encourage cross-listings with exchanges that are advancing the sustainability issue. Some European exchanges already require more environmental/social disclosure and cross listings would promote a higher minimum level. Other suggestions included supporting international initiatives, such as the International Accounting Standards Board / Financial Accounting Standards Board's efforts to harmonize accounting rules, and coordination with the International Organisation of Securities Commissions to propose more comprehensive securities rules on continuous disclosure.

Communication

The issue of communicating the benefits of sustainability recurred throughout discussion. Modifying the sustainable investment optic by highlighting the upside possibilities of sustainable risk management and good corporate citizenship was suggested in order to change the perception of an incurred cost from SRI strategies. Mapping parameters of CSR to financial optics and reporting categories and metrics that can be quantified, such as those identified by the GRI, were advocated to facilitate the promotion of sustainable investment. Associating these metrics with well-received policy initiatives (ie. climate change) was also suggested.

The US was cited as a case where this may be particularly relevant, due to definitions and usage of terms having relegated the promotion of sustainable investment to actions engaged in by shareholders. Participants were also keen to get a "mainstream" financial institution to adopt a sustainability tool, such as the World Resources Institute metrics, in order to secure legitimacy and buy-in.

There was some debate as to whether the effort to get endorsements of sustainable investment should be effected as a top-down or bottom-up approach. While some felt that the top-down approach was better, others felt that this may in fact be counterproductive as it may only engage those with a political agenda as opposed to those who are able to come through on the fiscal agenda. Another issue brought up was to identify which group in the financial community needs to be addressed and at what level. The group agreed that the promotion of sustainable metrics to the financial community must be done in a targeted and appropriately sequenced manner, with different approaches required for different players. It was understood that this is a multi-stakeholder effort to engage a multi-stakeholder audience.

One avenue proposed for the top-down approach was to work through was the UN Global Compact, which was viewed as complementary to regulation. Considering the proposal that the role of the stock exchange in the sustainability debate needed to be examined, one initiative proposed to begin this process was to approach global stock exchanges for endorsement of the Global Compact principles.

Summary

Many obstacles exist for promoting sustainable investment to the mainstream financial community, including common definitions, disparate nature of results, and the lack of an effective business case. In order to reduce these issues and progress the debate, three major areas were identified for future work by the group: (1) the need to provide the financial community with more tools that can be easily incorporated into current financial models and help to assess the financial value of sustainability, (2) the need to achieve greater disclosure from companies in order to provide the data and context for these tools, and (3) more effective measures for communicating the value of sustainability to the financial community. Coordination with other initiatives may also prove beneficial in promoting sustainability.

Key Recommendations

- Future work by group participants to promote sustainability should concentrate on three areas: Tools, Consumables, Distribution
- Develop a numerically based business case that can effectively make the case for sustainable investment
- Encourage more academic research by placing the research in the realm that will provide incentives for academia i.e. longitudinal studies to develop a strong numerically based business case
- Solicit input from buy side analysts and rating agencies to assist in developing relevant tools and communication strategies for presentation to organized pension fund managers network groups
- Coordinate a meeting of institutional investors involved in various shareholder initiatives to coordinate and consolidate common elements of the initiatives and encourage greater global disclosure of environmental and social risk exposure

Next Steps

- Develop a similar workshop in Europe that will provide a more global perspective. Such a meeting should also have input from regions outside of Europe
- Organise a meeting of institutional investors involved in various shareholder initiatives to coordinate and consolidate common elements of the initiatives and encourage greater global disclosure of environmental and social risk exposure
- Stimulate a conversation with mainstream analysts to present some of the existing metrics and get feedback
- Develop a proposal for an ongoing working group to follow up on key recommendations

Attendees

1. Duncan Austin, Senior Economist, World Resources Institute
2. Alan Banks, CEO, CoreRatings
3. Elizabeth Beauvais, Director of Research, US SIF
4. Tim Brennan, Director of Development, CERES
5. Andrew Clearfield, Director of International Corporate Governance for TIAA-CREF, Global Institutional Governance Network
6. Nahla Durrani, Senior Research Analyst, ISS Proxy
7. Eugene Ellman, Executive Director, Canada SIO
8. Todd Elmer, US Coordinator, Africa Practice
9. Erika Harms, Resource Mobilisation Officer, United Nations Foundation
10. Susannah Goodman, Research Director, Rose Foundation
11. Julie Gorte, Director of Social Research, Calvert Group
12. Virginia Green, Vice President of Investment Policy, Overseas Private Investment Corporation
13. Farha-Joyce Haboucha, Portfolio Manager and Director of Socially Responsive Investing, Rockefeller and Company
14. Herbert Himberg, Director of Development Policy, Overseas Private Investment Corporation
15. Dag Hinrichs, Head of Marketing and Community Development, Good Company
16. Julie Hughes, Director of Outreach, United Nations Foundation
17. Eric Fernald, Director of Research, KLD Research
18. Duncan Marsh, Senior Program Officer-Climate Change, United Nations Foundation
19. Philip Moss, United Nations Global Compact Focal Point, UNEP Finance Initiatives
20. John Paluszek, Senior Counsel, Ketchum
21. Harry Pastuszek, Environment and Social Development, International Finance Corporation
22. Gavin Power, Head of Public Affairs, United Nations Global Compact
23. Manuel Rybach, External Affairs and Public Policy, Credit Suisse Group
24. Jeff Seabright, United Nations Foundation
25. Francis Scott, Research Manager, SustainAbility
26. Kamran Tavangar, Head of Investor Relations, Novartis Corporation

27. Jim Thomas, Executive Director of Health, Safety and Environment, Novartis Corporation
28. Carla Walker, Rapporteur
29. Peter Wall, Senior Vice President of Business Development, FTSE
30. Tim Wirth, President, United Nations Foundation

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