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Integrated Governance

A NEW MODEL OF GOVERNANCE FOR SUSTAINABILITY

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“The world’s largest 1’000 publicly listed companies represent more than 50% of the world total market capitalization. There is an increasing concentration of economic activity in a relatively small number of corporations and the growing impact on the environment and society of these entities is now huge. Making governance for sustainability a reality at companies’ board level will depend on the work of many actors including asset owners, investment managers, shareholders, and proxy voting service firms that must play an active role in realizing a long-term, low carbon and sustainable economy,”

Charles Anderson
Director UNEP FI

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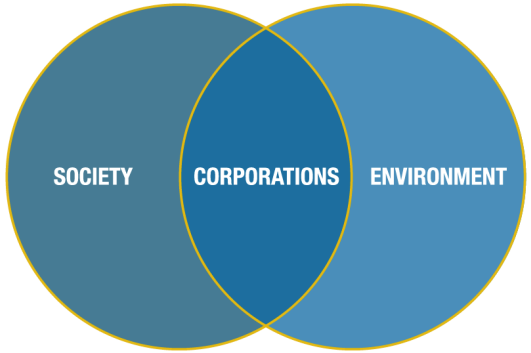
The large corporation today

Dow estimates that it is consuming on a daily basis as much energy as Australia does.

Food supply is concentrated in a handful of multinationals which have been accused for consciously contributing to the increasing problem of obesity.

Out of 206 countries recognized by the United Nations only 26 had GDP higher than the sales numbers of Shell and Wal-Mart.



The Socioeconomic ecosystem

	Revenues	Market Cap	Employees
1980	$7.0 trillion	$900 billion	21 million
2012	$34 trillion	$28 trillion	73 million

World's largest 1,000

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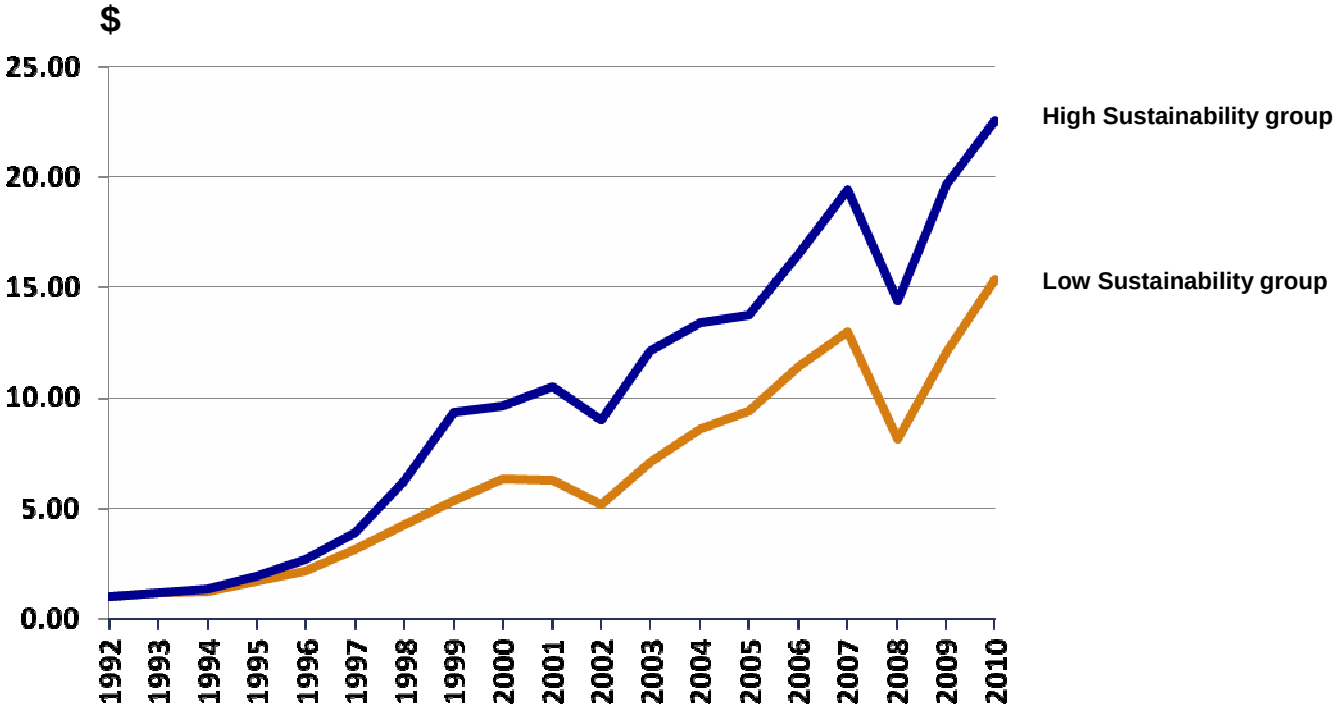
The need for a sustainable strategy

Sustainable strategy: Does it pay off?



Evolution of $1 invested in the stock market in equal-weighted portfolios

Source: Robert G. Eccles, Ioannis Ioannou and George Serafeim, 2011. "The impact of Corporate Sustainability on Organizational Processes and Performance"

Corporate governance is the mechanism for a sustainable strategy

The role of the board in the creation of a sustainable strategy

- Market pressure
- Regulatory environment

- Set the overall direction
- Establish boundaries and controls
- Recruit and motivate talented executives
- Oversee the operation of the business
- Align performance management
- Create ethical culture

- Company culture
- Objectives
- Performance targets
- Incentive schemes

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The role of governance

Are current governance practices adequate?

Expertise

Do board directors have the expertise to govern an organization?

NVIDA: generated 78%, 83% and 84% of total revenue for years 2012, 2011, 2010 from sales to customers outside US. NVIDIA has a nine-person board yet only one member has international work experience

Time

Are directors spending enough time governing?

Sirius XM Radio: 13 board members, 7 meetings a year. Members sit on an average 2.9 boards with 3 directors sitting on more than 4 boards. In 2011 one member failed board attendance minimum (75%)

Compensation Incentives

Are compensation incentives, especially for the CEO aligned to serve long-term competitiveness?

By examining a list of CEO's who have profited the most from stock options in the period 1992-2005 we identified that they have not positioned their firms for long term success (12 out of 20 companies have underperformed their competitors)

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The challenge

- How corporate governance interacts with sustainability?
- How can corporate governance promote the formation of sustainable strategies?
- How can some of the current weaknesses in governance practices be addressed?

Integrated Governance definition

Integrated governance is “the system by which companies are directed and controlled, in which sustainability issues are integrated in a way that ensures value creation for the company and beneficial results for all stakeholders in the long term.”

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Integrated Governance

PHASE 1	PHASE 2	PHASE 3
Sustainability outside of board's agenda	**Governance for sustainability**	**Integrated Governance**
▪ Sustainability is not one of the agenda items during the board meeting ▪ There might be some sustainability initiatives taking places as independent projects.	▪ Sustainability issues are included in the board's agenda ▪ The governance body sets up a committee to think about a strategy for sustainable initiatives or assigns that responsibility to a chief sustainability officer ▪ Metrics and KPIs to measure performance against these sustainability incentives are being set up	▪ Oversight of a sustainable strategy is overseen by the board ▪ Sustainability risks and opportunities are seamlessly part of the strategic agenda for the firms ▪ No need for a sustainability committee ▪ Integrated reporting is used as the means to measure progress in both financial and non-financial targets
STEPS REQUIRED FOR NEXT PHASE		
▪ Create Sustainability Committee ▪ Understand the value of creating a governance for sustainability	▪ Each member of the board is responsible for contributing to the formulation of a sustainable strategy ▪ Adopt integrated reporting	▪ Innovate through sustainability ▪ Extending the Performance Frontier
Sustainability and strategy are disconnected	**Sustainability strategy**	**Sustainable strategy**

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Integrated Governance

The four main components of Integrated Governance

INVESTOR LONG TERM ACTIVE OWNERSHIP

INDIVIDUAL LEVEL

- Expertise
- Time
- Ethics
- No affiliation

GROUP LEVEL

- Size
- Diversity

ALIGN INTERESTS

- Long term compensation incentives

Proxy voting firms

Glass Lewis views the Integrated Governance concept as a positive step in helping shareholders partner with directors, executives and regulators to improve corporate governance and engagement. We believe this will lead to enhanced, sustainable company performance and will help companies maintain good stakeholder relationships.

Robert McCormick
Chief Policy Officer, Glass Lewis

ISS already has and will continue to develop services and options for investors that help enable them to implement the approaches of their choosing, including approaches in line with an Integrated Governance concept.

Dr. Martha Carter
Managing Director, Global Head of Research, ISS

We certainly support the UNEP FI report proposal to integrate sustainability into all Board activities so that it becomes a general practice among the asset management community.

Pierre-Henri Leroy
Director, Proxinvest

Conclusions

Adopting an Integrated Governance model requires a collective effort from companies, asset owners, asset managers and regulators

Companies

- Companies need to go through a journey of adapting its corporate governance practices
- The target would be assigning sustainability oversight to each member of the board and integrate it seamlessly in the board's strategic agenda and decision-making progress

Investors

- Asset owners can promote integrated governance by reducing any short-term incentives that lead to short-termism. This can be achieved by increasing the capital allocation to asset managers based on long-term performance
- Asset managers need to integrate ESG issues in their capital allocation decisions
- Investors should act as long term active owners by using the power of their votes and engaging with the management of companies

Regulators

- Governments can ensure that all national corporate governance codes promote integrated governance
- Governments can also call for proxy advisors to integrate corporate sustainability performance into their advice to asset managers and asset owners on director (re-)election and remuneration

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The United Nations Environment Programme Finance Initiative (UNEP FI) was established in 1992 as a partnership between policymakers and financial intermediaries. With over 200 members representing banks, insurers and investors from around the world, UNEP FI contributes the perspectives of financial institutions to the United Nations and global activities on sustainable finance. UNEP FI's mission is to bring about systemic change in finance to support a sustainable world by "changing finance, financing change".

www.unepfi.org

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KKS Advisors LLC is an advisory services firm focusing on assisting financial institutions and corporations to develop a strategy and operating framework that will support them in the execution of a sustainable strategy

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