UNITED NATIONS ENVIRONMENT PROGRAMME
Programme des Nations Unies pour l'environnement Programa de las Naciones Unidas para el Medio Ambiente
Программа Организации Объединенных Наций по окружающей среде برنامج الأمم المتحدة للبيئة
联合国环境规划署
UNEP

EMBARGOED: Not for Publication or Broadcast
Until After 1200 Noon Central European Summer Time on 14 July 2009

# Greening the World's Multi-Trillion Dollar Investments Gets Asset Managers' and Legal Backing

## UNEP-Supported Report Says Ignoring Environmental, Social and Governance Issues May Open Door to Court Cases

Geneva/Nairobi/Sydney, 14 July 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.

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.*"

"*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,*" he said.

"*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.

In the report's Foreword, **Kristin Halvorsen, the Norwegian Minister of Finance**, writes: "*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.*"

The Norwegian Ministry of Finance is the formal owner and has overall responsibility for the management of the Government Pension Fund – Global which, with assets of more than USD 370 billion, is the second largest pension fund in the world. The fund is a signatory to the Principles of Responsible Investment (PRI), an investor initiative in partnership with UNEP FI and the UN Global Compact that provides a framework through which institutional investors can publicly commit to incorporating ESG issues into mainstream investment decision-making and ownership practices.

The Minister added: "*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 ESG issues, such as the risks and opportunities associated with climate change, into different parts of the management of the Fund.*"

The new UNEP FI report is released the day before the Principles for Responsible Investment (PRI) Annual Event in Sydney, Australia, which will convene many of the world's largest institutional investors and where the report's findings will be 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 initiative incubated by UNEP FI and the UN Global Compact between 2003 and 2006. 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.

The 2009 report, entitled—***Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment*—**is a much-awaited sequel to a 2005 legal interpretation published by UNEP FI that explored the complex relationship between fiduciary law and ESG issues in investment policymaking and practice.

That 2005, 150-page report provided a legal interpretation of ESG issues in the context of fiduciary law in nine major capital market jurisdictions, and was produced for UNEP FI by the international law firm, Freshfields Bruckhaus Deringer. The report has since been known as the **"Freshfields Report"** which, until now, 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.

**Paul Q. Watchman**, an internationally-recognised fiduciary law expert and the principal author of the original Freshfields Report, is a major contributor to the new, follow-on report termed **"Fiduciary II."** **(**Please see some of the key findings of the multi-faceted Fiduciary II report under "Notes to Editor.")

He explained: "*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.*"

Mr. Watchman stressed: *"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 duty of care to the client by failing to raise and take into account ESG considerations."*

"*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…investment consultants and asset managers must be **proactive** rather than **reactive**,"* he clarified.

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  *Paul Watchman is the principal author of the 2005 "Freshfields Report," which was produced for the UNEP FI Asset Management Working Group by the international law firm, Freshfields Bruckhaus Deringer. Mr. Watchman was formerly a Partner at the law firms, Dewey & LeBoeuf and Freshfields Bruckhaus Deringer. He is the lead legal expert of and is a major contributor to this follow-on 2009 "Fiduciary II" report of the UNEP FI Asset Management Working Group.

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## Notes to Editor

The new, follow-on 2009 UNEP FI "Fiduciary II" report—***Fiduciary Responsibility – Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment*****—**can be found at: http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf

The original 2005 UNEP FI "Freshfields Report"—***A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment***—can be found at: http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

### Additional Quotes from UNEP FI and Fiduciary II Project Team Members

*"The Fiduciary II report provides the legal ESG keys for those institutional investors wishing to enter the responsible investment arena. There is no legal excuse now not to invest responsibly."*
**—Paul Clements-Hunt, Head, UNEP Finance Initiative**

*"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. As a founding signatory to the UN Principles for Responsible Investment, Aviva Investors believes all asset managers should embed ESG issues into their legal contracts."*
**—Dr. Steve Waygood, Head of Sustainability Research and Engagement, Aviva Investors**
*Fiduciary II Project Initiation and Design*

*"In North America, we have 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'."*
**—Paul Hilton, Director, Advanced Equities Research, Calvert Investments**
*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."*
**—Mary Jane McQuillen, Director & Portfolio Manager, Socially Aware Investment, ClearBridge Advisors**
*Fiduciary II Co-Project Lead*

*"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 organisational DNA. Fiduciary II offers a legal roadmap for responsible investing and marks an enlightened step towards a green, inclusive and sustainable global economy."*
**—Butch Bacani, Programme Officer, Insurance & Investment, UNEP Finance Initiative**
*Fiduciary II Project Manager & Chief Editor*

Some of the key findings of the multi-faceted 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.

## UNEP Green Economy Initiative

Mobilising and refocusing the global economy towards investments in clean technologies and 'natural' infrastructure such as forests and soils is the best bet for real growth, combating climate change and triggering an employment boom in the 21st century.

On 22 October 2008, UNEP and leading economists launched the Green Economy Initiative (GEI) aimed at seizing an historic opportunity to bring about tomorrow's economy today. The GEI, which will initially run for a period of two years, has three key elements: the Green Economy report, that will provide an overview, analysis and synthesis of how public policy can help markets accelerate the transition towards a green economy; The Economics of Ecosystems and Biodiversity (TEEB), a partnership project focusing on valuation issues; and finally the Green Jobs report, published in September 2008, that looked at employment trends.

More information at: http://www.unep.org/greeneconomy

## UNEP Finance Initiative (UNEP FI)

UNEP FI is a strategic public-private partnership between UNEP and the global financial sector. UNEP works with over 180 banks, insurers and investment firms, and a range of partner organisations, to understand the impacts of environmental, social and governance issues on financial performance and sustainable development. Through a comprehensive work programme encompassing research, training, events and regional activities, UNEP FI carries out its mission to identify, promote and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information at: http://www.unepfi.org

## UNEP FI Asset Management Working Group

The UNEP FI Asset Management Working Group is a global platform of asset managers that collaborate to understand the ways that environmental, social and governance (ESG) issues can affect investment value, and to advance the integration of ESG issues into investment decision-making and ownership practices.

Member institutions include: Acuity Investment Management, Aviva Investors, BNP Paribas Asset Management, Calvert Investments, ClearBridge Advisors, Eurizon Capital (Intesa Sanpaolo Group), Groupama Asset Management, Henderson Global Investors, HSBC Global Asset Management, Mitsubishi UFJ Trust & Banking Corp., Nikko Asset Management, Pax World Management Corp., RCM, and Santander Brasil Asset Management.

More information at: http://www.unepfi.org/work_streams/investment/amwg

## The Principles for Responsible Investment

The Principles for Responsible Investment (PRI) is an investor initiative in partnership with UNEP FI and the UN Global Compact. Convened by UNEP FI and the UN Global Compact, the PRI was established as a framework to help investors achieve better long-term investment returns and sustainable markets through better analysis of environmental, social and governance issues in the investment process and the exercise of responsible ownership practices.

More information at: http://www.unpri.org