

BUILDING THE CAPACITY OF INVESTMENT ACTORS TO USE ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) INFORMATION



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ABOUT THE AUTHORS

PRI

The Principles for Responsible Investment were launched by the UN Secretary-General at the New York Stock Exchange in April 2006. The Preamble to the Principles states:

'As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society.'

The PRI's Mission Statement – agreed by the Advisory Council in March 2012 is:

We believe that a sustainable global financial system that is efficient in economic terms is a necessity for long-term value creation, rewards long-term responsible investment and benefits the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration for their implementation; fostering good governance, integrity and accountability; and addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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FOREWORD: PRI



By Dr James Gifford Executive Director, PRI

The European Commission's renewed strategy on Corporate Social Responsibility (CSR) sets out an ambitious agenda to drive deeper integration of sustainability issues into company strategies and operations by the end of 2014. It also recognises that the investment community has a critical role to play in this endeavour through better integration of environmental, social and governance (ESG) information within investment research and decision-making. While the Commission's goals are commendable, we believe they will ultimately remain beyond reach unless a number of barriers relating to the education, resourcing and capacity of various actors within the investment industry, and the quantity and quality of communication and knowledge sharing between them, can be overcome. Moreover, there are fundamental aspects of the way the capital markets and companies operate that impede greater integration – most notably short-termism.

This report provides a clear assessment of the current capacity of the investment industry to utilise ESG information in ways that adds real value for investors. It highlights that if this objective is to be achieved, investors must have access to the information necessary to make well-informed decisions; the skills, knowledge and expertise to analyse this information effectively; and the resources and institutional support to take effective action. It identifies a number of reasons why so many institutions operating at all levels of the investment chain still fail systematically to integrate ESG information into their valuations of companies. Deficiencies in the way investors account for the ESG performance of companies - which the Commission has itself identified as one determinant of the seriousness with which investee companies manage these issues – may impair their ability to value them accurately, particularly from a long-term perspective. Ultimately, this undermines the efficiency and stability of markets and causes them to function in a way that does not support the public good.

Encouragingly, many of these issues can be resolved, or significantly improved, through additional research, education, capacity-building, the deployment of additional resources, and better information flows between stakeholders. Many investors have already signalled their commitment to adopt more responsible investment practices - as evidenced by the ongoing growth of the United Nations-supported Principles for Responsible Investment (PRI) Initiative - and are incorporating ESG issues into their investment processes by implementing the six Principles. However, much work remains to be done. This report offers important proposals on how the industry's capacity might be strengthened.

The PRI, with its breadth of membership and global network, has a pivotal role to play in taking these proposals and recommendations forward. Over the coming years, the PRI will continue to:

- Provide clear guidance to demonstrate how ESG factors can affect the risk and return of investment portfolios, and support the development of new tools and knowledge that enable investors to integrate ESG issues into their practices and processes across the investment chain.
- Raise awareness, both within the investment community and more widely, of the critical role that responsible investment plays in building sustainable capital markets and, more generally, in contributing to the goals of sustainable development. PRI is in the process of developing a new work programme on more strategic barriers to the creation of a sustainable financial system. This will address issues such as short-termism and the financial implications of environmental and social externalities for long-term investors' portfolios.
- Conduct programmes to disseminate knowledge to investors

 including trustees, executives, analysts and portfolio
 managers that enable them to incorporate ESG factors into their evaluations of companies.
- Foster greater engagement between investors and companies, through the PRI Clearinghouse.
- Stimulate the development of academic research that adds real value to investors and practitioners via the PRI Academic Network
- Support the development of networks of investment stakeholders to share knowledge and develop the tools and expertise necessary to fully integrate ESG factors into investment practice.
- Increase the level of transparency and disclosure on responsible investment activities by encouraging investors to complete the PRI Reporting Framework and encouraging improvements in the quality of information being reported.
- Through an annual assessment process, stimulate ongoing learning and development within and between investors about responsible investment.

It is vital that the investment community builds its capacity to use ESG information better. It is in the public interest - as well as in the interests of investors - that markets value companies as accurately as possible. Integrating ESG information into investment decisions should enable investors to make better investment decisions and stimulate the flow of capital into companies with enhanced ESG performance. The more attention asset owners, asset managers and analysts pay to this information, the greater will be the alignment between their own financial interests and the European Commission's goal of driving more responsible and sustainable practices within companies.

EXECUTIVE SUMMARY

BACKGROUND

The European Commission (DG Enterprise and Industry) has commissioned the PRI to assess and clarify the capacity needs of key investment actors to analyse and use ESG information, with a particular focus on two issues. The first related to the manner in which investors use the ESG information provided by companies (or by intermediaries such as ESG research organisations or investment banks) in their investment research and decision-making, and in their engagement with companies. The second, reflecting the Commission's thinking in the wake of the global financial crisis, related to the wider interaction and relationship between the key actors in the investment system, and the contribution that capacity-building could make to improving and strengthening the dialogue between these actors about individual ESG issues and about structure and functioning of the investment system as a whole.

ABOUT THE PROJECT

This project involved a review of the capacity needs of the following actors; institutional investors (investment managers, insurance companies, asset owners), investment banks (the sell-side), ESG research providers, companies, business schools, policymakers and non-governmental organisations (NGOs). Information on the capacity needs of these various actors was gathered over the period August 2012 to January 2013 through a mix of interviews, workshops and desk-based research for each of the groups. In total, over 80 individuals contributed to this project, as interviewees, workshop participants and/or reviewers.

For each stakeholder group, the focus was on the following broad questions:

- How do they currently use ESG information?
- How do they assess their current capacity needs? That is, do they think they have the skills, knowledge and resources needed to effectively deliver on their objectives?
- How do they interact with other stakeholders in the investment system?
- How do they view the responsiveness and the capacity of these other stakeholders?
- How do they think that the investment system might work better? What contribution might improved capacity make?

KEY FINDINGS: INVESTMENT DECISION-MAKING

1. There are important reasons for investors to consider ESG issues in their investment decision-making

There are various reasons for investors to pay attention to ESG issues in their investment research and decision-making processes. A focus on ESG issues should enable investors to make better investment decisions, should facilitate more accurate valuations of businesses by the investment markets, should contribute to better dialogue between companies and their investors on drivers of long-term value creation, should incentivise companies to improve their governance

THE FIVE ELEMENTS OF CAPACITY

- Attitudes, values and belief systems, specifically that individuals and organisations recognise the importance of ESG issues to companies and to investors, and accept that they have a responsibility for (as relevant) company or investor performance and action on these issues.
- Skills, knowledge and expertise, specifically that individuals and organisations have sufficient knowledge and expertise to analyse the ESG information that is available, to make sense of this information in the context of their roles and their organisation's goals, and to make informed decisions about the actions that they should take.
- Resources, specifically that individuals and organisations have sufficient human resources, financial resources and organisational/institutional support to take appropriate action on the ESG issues that are relevant to them.
- Access to information, specifically that individuals and organisations have access to the tools, data and information that they need to deliver on their ESG-related goals.
- An enabling environment, specifically that approaches to investment focus on long-term financial returns and the factors – including ESG – that will deliver them.

and management of these issues, and should encourage investors to proactively seek out opportunities presented by these issues. In turn, this should result in capital being directed towards better governed and better managed companies, and towards companies that are better positioned to contribute to the goals of a sustainable society.

2. Investors have mixed views on the importance of ESG issues to their investments

Many institutional investors recognise the importance of ESG issues to investment performance, and are investing significant time and resources in researching how they can take account of these issues in their investment practices. However, many have yet to make significant progress on integrating ESG issues into their investment processes. The key reasons are that a significant number of investors continue to believe that ESG issues are simply not financially material (or financially relevant) to their investments, and that many investment analysts and fund managers believe that it is extremely difficult to add investment value through a focus on ESG issues.

3. For ESG integration, the key skills required relate to investment knowledge rather than ESG issues

There is a general consensus that the key attribute of analysts focusing on ESG issues is their understanding of investment decision-making, rather than their specialist knowledge of ESG issues. One interviewee, expressing a commonly held view, commented: "It is easier to teach ESG to a good analyst than to teach an ESG specialist to be a good equity analyst."

However, there was a general view that the integration of ESG issues into investment practices and processes is still a work in progress. In part this reflects the issues around data and market demand (see below) but it also reflects a general lack of experience in the investment industry, with the

possible exception of the sell-side, on how to integrate ESG issues into investment processes, compounded by a lack of guidance on how investors might approach this integration.

4. Most organisations have the resources they need for ESG integration

Overall, institutional investors, ESG research providers and the sell-side consider that they have a reasonable level of resources available to deliver on their responsible investment commitments. However, they noted that these resources are being stretched by increasing demands for them to do more work on ESG integration, and (in the case of investment managers) for them to provide more information on their approach to responsible investment to clients and the public and to engage with the companies in which they are invested.

Asset owners, however, face significant capacity constraints. While an increasing number take account of ESG capacity when appointing/re-appointing investment managers, most struggle to monitor their managers' approach to ESG integration.

5. Access to robust information is an issue for all stakeholders

While company reporting on ESG issues – both in terms of breadth and quality – has improved significantly over the past decade, this reporting is seen as falling short of the quality needed for investors to integrate this information into their investment research and decision-making processes. The major criticisms made of the ESG-related data provided by companies are that calculation methodologies are applied inconsistently, and that companies generally provide little information on the scope of reporting or even the meaning of the indicators being reported. Moreover, despite the growing interest in integrated reporting, most companies do not provide a robust account of the financial relevance of ESG issues to their business and are rarely clear about which, if any, ESG issues are important value drivers for their business.

6. The lack of asset owner demand is a key obstacle to progress

A common view amongst those interviewed for this project (in particular, interviewees from investment management companies) was that there is a systemic lack of demand from asset owners (e.g. pension funds, foundations), insurance companies, and individual investors (retail investors, highnet worth investors) for responsible investment. Many of the investment manager representatives interviewed for this project expressed frustration that their efforts on responsible investment did not seem to be a factor in the decisions made by clients in their fund manager appointment or reappointment processes. This lack of demand, in turn, weakens the case for investors to commit resources to responsible investment and to do high quality work in this area.

A somewhat different picture emerged from our interviews with the sell-side and with ESG research providers, both of whom noted that investment managers are starting to pay greater attention to ESG issues in their investment processes and are encouraging their research providers to support them in this endeavour. Interestingly, both ESG research providers and the sell-side pointed to the growth in the number of asset owner

signatories to the Principles for Responsible Investment as a key driver for change, noting that this has created pressure for investment managers to sign up to the Principles and, critically, to demonstrate that they are paying due attention to the ESG issues in their investment practices and research.

7. Investment timeframes Are Very Short-term

Project participants highlighted the short-term focus of most investment contracts (or mandates), and noted that this drives a focus on short-term financial performance, with investment decisions based on likely short-term movements in asset prices rather than on a view of the companies' longer-term strategy and prospects. This has a series of perverse consequences, as it incentivises companies to focus on activities that yield returns in the short term, rather than on activities that will lead to success over 10 or 20 years, it reduces the incentives for investors to engage with the companies in which they invest on issues that may provide longer-term benefits to the company, and it perpetuates short-term thinking among other investment actors (e.g. in interviews, ESG research providers and sell-side analysts noted that there is limited market demand for longer-term thematic research).

KEY FINDINGS: THE ROLE OF OTHER STAKEHOLDERS

1. Other stakeholders have a critical role to play in the effective functioning of investment markets

Actors other than companies, investors and research providers (ESG research providers and investment banks) have a critical role to play in the functioning of the investment system. For example, governments provide the incentives (through regulation and other policy interventions) that determine how companies respond to particular ESG issues; business schools provide graduates with skills to analyse the implications of ESG for business and for investment performance, and NGOs provide specialist knowledge on environmental and social issues, and scrutinise and challenge the performance of companies and investors on those issues.

Moreover, there is a dynamic and interactive relationship between actors in the investment system. For example, investors can encourage companies to improve their disclosures on ESG issues, which in turn can contribute to improvements in the quality of research and analysis provided by investment banks and ESG research providers and which enables NGOs and other stakeholders to have better informed discussions with companies on these issues. These influences, together with the lessons that companies learn during the reporting process, often lead to companies improving their performance on the issues in question.

2. Stakeholders recognise the importance of ESG issues to investors, but do not necessarily see this as a reason for them to engage with investors

There was a consensus among NGOs and policymakers that we interviewed that ESG issues are important to companies and that these issues are likely to be important influences on investment value over the longer-term. While these

organisations agreed about the importance of ESG issues, it was triking that this did not necessarily translate into a view that their organisations should engage with investors or contribute to wider debates on the capital markets more generally. For example, many NGOs are often reluctant to commit resources to this area of work because they are not convinced that it will lead to significant changes in the manner in which investors take account of ESG issues in their investment decisions or in the engagement that investors have with companies.

3. Stakeholders' understanding of the investment system is relatively limited

Many of the stakeholders interviewed acknowledged that their knowledge of the investment system and capital markets in the round is relatively limited. For example, the NGOs engaged with for this project acknowledged that they do not have all of the knowledge that they need in order to engage effectively with investors. In part, this is an issue of resources where individuals (or small teams in some of the larger NGOs) are required to cover multiple asset classes and multiple issues. It also reflects the lack of understanding within NGOs' management teams regarding the complexity of the investment/finance sector which means that these individuals are often required to cover a whole series of issues that fall well outside their core expertise.

4. Investors do not provide a robust account of their approach to responsible investment

Disclosure by investors is important to enable market participants and other stakeholders to differentiate between those organisations (asset owners and investment managers) who do a good job on responsible investment and those that do not. Some of those interviewed believed that the disclosures currently provided by investors are insufficient in this respect, noting that many investors do not report on their approaches to responsible investment and that many of those that do report provide limited information on how ESG issues are integrated into their investment processes, on how this influences the investment decisions that they make, or the outcomes that result from their engagement with companies.

5. NGOs see that their resources are significantly less than those available to other actors in the investment system

The NGOs that contributed to this project were very clear that their resources are significantly constrained. These constraints were seen as being in both absolute terms (i.e. relative to the goals that they set themselves) and relative terms (i.e. relative to the resources available to investors, which in turn are significantly less than the resources allocated by companies to investor and civil society engagement and, more generally, to brand and public relations).

MAKING PROGRESS

There is also a huge amount of time and effort being invested in capacity-building across the investment industry, by a whole range of actors including investor

organisations agreed about the importance of ESG issues, it was striking that this did not necessarily translate into a view that their organisations should engage with investors or contribute to wider debates on the capital markets more generally. For collaborations such as the PRI, professional bodies, research providers, consultants, universities and NGOs, as well as individual companies and investors. Among the initiatives and efforts identified in the course of this project are:

- There is a growing academic and practitioner effort being focused on developing the evidence that ESG issues are financially material at the individual company level and at the investment portfolio level, and that a focus on these issues can provide real investment benefits.
- ESG issues are an increasingly standard part of professional and on-the-job training for investment professionals.
- Various tools and guidance documents on how to integrate ESG issues into investment practice have been developed.
- Investors and other stakeholders are investing significant time and resources in improving the reporting provided by companies.
- From 2013, all PRI signatories will be required to report on how they have implemented their responsible investment commitments.

These activities are starting to bear fruit. For example, there are an increasing number of academic articles that demonstrate the relationship between responsible investment/ESG analysis and long-term investment performance, there are a number of business schools that offer courses and modules on responsible investment, there are guidance documents on the design and implementation of responsible investment, and there are guidance documents and tools on how ESG issues may be integrated into investment processes.

However, relatively little of this has been effectively communicated. There are various reasons: in some cases, it is because the information is known to one stakeholder group but not shared or made available beyond that group; in others, the information is available but is effectively hidden in an obscure website; in others, it is because the networks (whether formal or informal) are not available to enable the distribution of information or knowledge; in others it is simply because the different actors have not communicated their needs and information; in others, it is because the views of some actors are not heard or perceived as important ('the dialogue of the deaf' that characterises many discussions in the responsible investment area). In many cases, what is needed is not more research or more development of tools but simply to ensure that the work and research that has been done is effectively disseminated and is readily available to others who may be interested.

Despite the importance of these contributions, it is essential to recognise that building capacity is a necessary but not a sufficient condition to addressing the issue of short-termism. Ultimately, the contribution that any of the measures can make here will be limited by the context within which the actors function and operate. If investment practice remains fixated on short term issues, it will continue to exhibit the characteristics and problems that have been highlighted in this research. In that context, improved capacity may help but it will not change the essential characteristics of the investment system.

1. INTRODUCTION

11 WHY ARE ESG ISSUES IMPORTANT?

It is widely accepted that investors should consider environmental, social and governance (ESG) issues in their investment processes and decision-making, and in their dialogue (often referred to as engagement or active ownership) with companies. For evidence it is only necessary to look at the Principles for Responsible Investment (PRI), which in early January 2013 had over 1,100 signatories, including 272 asset owners, 696 investment managers and 176 service providers.

There are various reasons for investors to pay attention to ESG issues. From an investment perspective, the analysis of ESG issues is required to make a full assessment of the risks and opportunities associated with particular investments. This should enable investors to make better investment decisions and should facilitate more accurate valuations of businesses by the investment markets. Greater investor focus on ESG issues should also contribute to a higher quality dialogue between companies and their investors on drivers of longterm value creation, should incentivise companies to improve their governance and management of these issues, and should encourage investors to proactively seek out opportunities presented by these issues. These actions should, in turn, result in capital being directed towards better governed and better managed companies, and towards companies that are better positioned to contribute to the goals of a sustainable society.

"The analysis of ESG issues should enable investors to make better investment decisions and should facilitate more accurate valuations of businesses by the investment markets."

"Greater investor focus on ESG issues should incentivise companies to improve their governance and management of these issues, and should encourage investors to proactively seek out opportunities presented by these issues."

But this is not solely a discussion about the relationship between companies and their investors. In this report we take a 'whole system' approach to the investment chain, where we also examine the role played by other investment actors and stakeholders. For example, ESG research providers provide information that investors use to assess company performance on corporate governance and corporate responsibility issues; investment banks (the sell-side) analyse how ESG issues impact on profit and loss accounts and on balance sheets; governments provide the conditions (e.g. reporting requirements) to enable investors to properly analyse company performance on ESG issues and provide the incentives (through regulation and other policy interventions) that determine how companies respond to particular ESG issues; business schools provide graduates with skills to analyse the implications of ESG for business and for

investment performance, and non-governmental organisations (NGOs) provide specialist knowledge on environmental and social issues, and scrutinise and challenge the performance of companies and investors on those issues.

These actors do not function in isolation. Rather there is a dynamic and interactive relationship between them. For example, investors can encourage companies to improve their disclosures on ESG issues, which in turn can contribute to improvements in the quality of research and analysis provided by investment banks and ESG research providers, and can inform the design and implementation of public policy. In turn, either the process of reporting or the conclusions drawn by investment actors about companies' performance on the issues in question, may lead to companies improving their performance or may lead to investors altering their investment decisions. These interactions are hugely important in defining how the investment system functions and, in the specific context of a focus on ESG issues, whether, how and to what extent ESG issues are moved to the centre of investment practice.

1.2 WHY IS CAPACITY IMPORTANT?

Underpinning these discussions around roles and influences is the idea of capacity. A central premise of this report is that the effective functioning of the investment system requires that all relevant actors have the capacity to play their proper roles. In broad terms, capacity comprises the four elements set out in Box 1.

BOX 1: THE FIVE ELEMENTS OF CAPACITY

- Attitudes, values and belief systems, specifically that individuals and organisations recognise the importance of ESG issues to companies and to investors,² and accept that they have a responsibility for (as relevant) company or investor performance and action on these issues.
- Skills, knowledge and expertise, specifically that individuals and organisations have sufficient knowledge and expertise to analyse the ESG information that is available, to make sense of this information in the context of their roles and their organisation's goals, and to make informed decisions about the actions that they should take.
- Resources, specifically that individuals and organisations have sufficient human resources, financial resources and organisational/institutional support to take appropriate action on the ESG issues that are relevant to them.
- Access to information, specifically that individuals and organisations have access to the tools, data and information that they need to deliver on their ESG-related goals.
- An enabling environment, specifically that approaches to investment focus on long-term financial returns and the factors – including ESG –that will deliver them.

Clearly, these are related. Knowledge without resources means that actors are unlikely to be able to effectively deliver on their goals. Resources without knowledge mean that actions are less likely to be effective, or if they are effective, they may well be accompanied by significant inefficiencies or negative (or undesirable) consequences.

1.3 ABOUT THIS PROJECT

At the end of 2011, the PRI, together with the International Corporate Governance Network (ICGN) and The European Federation of Financial Analysts Societies (EFFAS), was commissioned by the European Commission (DG Enterprise and Industry) to help build the capacity of investment actors to analyse and use ESG information.

One element of this project that fell within the PRI's remit, and the subject of this report, was to assess and clarify the capacity needs of key investment actors to analyse and use ESG information. This research divided into two parts. The first, reflecting the importance assigned by the European Commission to encouraging greater attention to be paid by investors to ESG factors (see Box 2), related to the manner in which investors use the ESG information provided by companies (or by intermediaries such as ESG research organisations or investment banks) in their investment research and decision-making, and in their engagement with companies.

The second, reflecting the Commission's thinking in the wake of the global financial crisis, related to the wider interaction and relationship between the key actors (companies, investors, research and ratings providers, non-governmental organisations, policy makers and regulators, business schools, etc.) in the investment system. Specifically, the Commission wished to explore the contribution that capacity-building could make to improving and strengthening the dialogue between these actors about individual ESG issues and about structure and functioning of the investment system as a whole.

BOX 2: SETTING THE CONTEXT FOR THE PROJECT – THE EUROPEAN COMMISSION'S VIEW

In the call for proposals which led to this project, the European Commission set out its thinking on the importance of integrating ESG issues into investment decision-making, offering the following reflections:

The European Union has a strong interest in supporting the further integration of sustainability and corporate social responsibility into enterprise strategies and operations. This will be important to the achievement of the EU's economic, social and environmental objectives. The ability to create social and environmental value will have a growing influence on the financial success of enterprises. The European Commission's 2010 Industrial Policy Communication noted that the financial crisis showed a new approach is needed to the balance between short-term profit maximisation and sustainable value creation in the longer run.

The extent that investment actors take account of environmental, social and governance (ESG) performance of companies is one determinant of the seriousness with which investee companies manage these issues. The more attention that asset owners, investment managers and analysts pay to ESG information, the greater their influence in terms of driving more responsible and sustainable business.

At the same time, it has been suggested that market actors would value companies more accurately if they took better account of ESG and other non-financial information. The socially responsible investment sector (SRI) by definition uses aspects of ESG performance as criteria for investment decisions. A number of leading mainstream funds (non SRI) have developed targets and methodologies for the better integration of ESG information.

In spite of this progress, many mainstream investment actors still fail systematically to integrate ESG information into their valuation of companies. This may be for a number for reasons, including force of culture and habit, lack of widely applicable evidence of the effect of ESG performance on financial performance, lack of appropriate ESG information from investee companies, and lack of the necessary skills and methodologies to integrate such information into valuation models even when it is available.

It is in the public interest, as well in the particular interests of the investment community, to ensure that the market values companies as accurately as possible, including by better integrating relevant ESG information into investment decisions. In the Single Market Act, adopted in October 2010, the European Commission proposed that attention would need to be given to "facilitating more accurate valuation of businesses by the financial markets".

[T]he concept of integrated financial and non-financial reporting is attracting growing attention from enterprises and other stakeholders, driven in particular by the work of the International Integrated Reporting Committee. If there is a trend towards better disclosure of ESG information, and also towards integrated reporting, then it is important that the investment community builds a corresponding capacity to better use ESG information, including a greater capacity for integrated analysis.

1.4 REPORT STRUCTURE

This report presents the findings from the research and, in line with the two elements outlined in Section 1.3 above (i.e. building capacity in relation to ESG information and in relation to wider investment-related issues), offers a series of recommendations on how ESG capacity across the investment system may be strengthened. The report is divided as follows:

- Section 2 describes the research approach, including discussion of the implications of the research approach for the project findings.
- Section 3 presents the key findings, organised into three

^{1.} For a full list of PRI signatories, see http://www.unpri.org/signatories/signatories/ (last viewed 16 January 2013).

^{2.} We are not offering an opinion on whether ESG issues are recognised as important for inherent (i.e. in and of themselves) or instrumental (i.e. because of the impact they can have – for example, on a company's cashflows or investors' returns) reasons. Rather, the point is that, as a prelude to action, organisations (and the individuals within these organisations) need to recognise these issues as important, irrespective of the factors informing this perception. Of course, the specific reasons are important when it comes to defining the actions that are subsequently taken.

areas: (a) the capacity of the various actors to deliver on their formal (e.g. contractual) obligations and on the goals and objectives they have set for themselves, (b) the capacity of the various actors to deliver on the expectations of their stakeholders, and (c) the capacity of the various actors – and of the investment system as a whole – to contribute to the goals of sustainable development.

- Section 4 presents practical proposals on how capacity may be built across the investment system.
- Section 5 offers some wider conclusions, focusing on the roles that different actors may play in taking the proposals forward.

1.5 SOME NOTES ON TERMINOLOGY

A variety of terms are used to describe the reports that companies produce on ESG issues (these include sustainability reports, corporate (social) responsibility (CSR) reports, social and environmental reports) and to describe the issues covered in these reports (these include ESG issues, social and environmental issues, CSR issues). For the purposes of this report, we refer to the issues that are the subject of company reporting as ESG issues, and we refer to the stand-alone reports that many companies produce on these issues as sustainability reports.

Through the report we use the term 'institutional investor' or 'investors' as a generic term to cover the range of organisations – investment management companies, asset owners such as pension funds, foundations, insurance companies, sovereign wealth funds, etc. – that are the subject of this report. If we are discussing a specific investment actor (e.g. investment managers), we specify that we are referring to that actor, not to all investors.

We use the term 'ESG integration' as a generic term referring to the considering of ESG issues in investment research and decision-making, rather than as implying that there is a single 'correct' way to integrate ESG issues into investment practices and process. There are a whole variety of ways in which ESG issues can be considered in investment processes (e.g. inclusion in asset allocation, in cash flow models, in screens). Moreover, investors differ not only in their strategies but in the weight that they assign to these issues relative to other drivers of investment value and even in the specific ESG issues that they consider to be financially relevant. Even within individual investment organisations (and, on occasion, within individual funds) it is not uncommon to find multiple ESG strategies being applied.

2. RESEARCH APPROACH

2.1 OVERVIEW

This project involved a review of the capacity needs of distinct key investment-related actors, namely institutional investors (investment managers, insurance companies, asset owners), the sell-side, ESG research providers, companies, business schools policy makers and NGOs.

Information on the capacity needs of these various actors was gathered over the period August 2012 to January 2013 through a mix of interviews, workshops and desk-based research for each of the groups. For details of the specific approach adopted for each group, see Appendices 1-7. In total, over 80 individuals contributed to this project, as interviewees, workshop participants and/or reviewers.

For each stakeholder group, we focused on the following broad questions (although these were tailored to the role and interests of the specific stakeholder in question):

- How do they currently use ESG information?
- How do they assess their current capacity needs? That is, do they think they have the skills, knowledge and resources needed to effectively deliver on their objectives?
- How do they interact with other stakeholders in the investment system?
- How do they view the responsiveness and the capacity of these other stakeholders?
- How do they think that the investment system might work better? What contribution might improved capacity make?

In December 2012, members of ICGN's Integrated Business Reporting Committee (IBRC), the directors of the PRI and a small group of signatories (for the full list, please see Appendix 7) were provided with the opportunity to review an earlier version of this report and to offer suggestions on possible amendments or changes. It is important to note that while this document has been revised to reflect the comments and suggestions received, this report should not be taken as a formal statement of any of these individuals' views on responsible investment or the capital markets.

2.2 SOME COMMENTS ON THE METHODOLOGY

Appendices 1 to 7 discuss the information-gathering approach and implications for the research findings on a stakeholder by stakeholder basis. This section offers some wider reflections on the methodology and the implications for the findings presented in this report.

First, the research focused primarily on those organisations that are already active on ESG issues. For example, we concentrated on investors that are PRI signatories, on leading companies within the UN Global Compact network, on MBA courses that already include responsible investment, on policy makers that

have engaged with (or been engaged by) institutional investors, and on NGOs that have a track record of engaging with the capital markets. This choice was deliberate, as our aim was to learn how capacity has been developed and the challenges and barriers that have had to be addressed in this process. To ensure that we did not ignore the issues around changing attitudes, values and belief systems (which are often the critical first step in taking action on ESG issues), we explicitly asked the project participants about how we might engage with or develop the capacity of organisations that do not currently pay much attention to ESG issues in their activities.

Second, we recognise that it is frequently difficult for individuals within organisations to provide a properly independent account of the quality of their work or a comprehensive account of the impact their activities have on others (e.g. in interviews, a number of research providers pointed to the challenges they face in knowing exactly how their data and information are used by their clients). We sought to address this issue through asking the different actors about their interaction with other stakeholders in the investment system, and for their views of the capacity and responsiveness of these stakeholders. For example, we asked ESG service providers about how their investment clients used the information provided, we asked companies about how investors use the information that they disclose, we asked NGOs about the nature and quality of their interaction with investors. This approach allowed us to identify areas where the current operation of the investment system could be improved (e.g. areas where incentives are misaligned, areas where there are gaps between the services being offered and what is actually needed), and also provided valuable insights into the functioning of the investment system as a whole. It is important to qualify this by acknowledging that each actor functions with partial rather than complete knowledge of the other actors in the investment system (and, indeed, this is a theme we return to later in this report). We therefore had to verify these views and comments by testing them with other investment actors. This helped us to delineate between subjects that were matters of perception, subjects that arose as a consequence of incomplete or inaccurate information, and subjects that reflected genuine differences in world views.

Third, we engaged primarily with current practitioners within the various key stakeholder groups. This allowed us to identify good and best practices within the investment industry and to identify the practical challenges and dilemmas investors face when trying to integrate ESG issues into their investment practices and processes. One of the key findings from our research is that, with some notable exceptions such as the analysis of the performance of ethical (screened) funds, responsible investment and the impacts of ESG integration remain under-theorised and under-researched from an academic perspective. This has profound implications for practice. It means that that critical, independent analysis of how investors address ESG issues in their investment processes is not happening. This, in turn, means that the feedback and learning processes necessary to inform the development of responsible investment are missing.

"Responsible investment and the impacts of ESG integration remain under-theorised and under-researched."

Fourth, reflecting the scope of the PRI's proposal to the European Commission, we did not cover all the important actors in the investment system. Amongst others, we did not engage with trade unions, politicians, quasi regulatory bodies (e.g. stock exchanges), multi-stakeholder initiatives or standard setting bodies (e.g. accountancy bodies). We also engaged with only one investment (actuarial) consultant. We asked the reviewers of this report to consider the applicability of the findings to these, and other, actors in the investment system. The feedback we received was that the findings are broadly relevant across all actors. However, the reviewers also cautioned that this did not mean that all of the specific issues for these actors had necessarily been identified and recommended that the report findings needed to be qualified accordingly.

Finally, reflecting both the PRI's proposal to the European Commission and the development of practice, most (but not all) of the focus was on ESG and responsible investment in listed equities and private equity, and on developed rather than developing markets. While the report reviewers, again, indicated that the broad conclusions of the research are relevant to other asset classes and to both emerging and developed markets, they suggested that there would be value in a more detailed review of ESG and responsible investment in other asset classes and in emerging markets.

3. KEY FINDINGS

3.1 CURRENT CAPACITY NEEDS

3.1.1 ATTITUDES. VALUES AND BELIEFS

Investors' views on ESG issues

Among institutional investors, we encountered a huge divergence in views. Many individuals recognise the importance of ESG issues to investment performance, and are investing significant time and resources in researching how they can take account of these issues in their investment practices. These efforts are reinforced by the fact that so many investment organisations are signatories to the PRI, which creates an organisational impetus to focus on ESG issues.

Despite these efforts and enthusiasm for ESG-related research, a recurring theme in the interviews conducted for this project was that many organisations have yet to make significant progress on integrating ESG issues into their investment processes. The main obstacles to progress were identified as:

- Many investors continue to believe that ESG issues are simply not financially material³ (or financially relevant) to their investments. This means that discussions between investment managers and their clients tend to focus on financial performance, rather than considering ESG impacts and outcomes.
- The professional training received by many investment analysts currently working in the investment industry paid relatively little attention to ESG issues. While this has changed with the Chartered Financial Analyst qualification, for example, now including some discussion of ESG issues, the consequence is that many investment analysts are not necessarily trained to look on ESG issues as a potential source of investment value.
- Many investment analysts and fund managers believe that it is extremely difficult to add investment value through a focus on ESG issues. There are various reasons, including the potential research costs (time and money) associated with the analysis of ESG issues, the belief that if these issues are material they will already be reflected in share or asset prices, the wide scope of ESG issues (i.e. identifying which issues may be financially significant is, in and of itself, a major task), the long term nature of these issues (i.e. many of the expected financial impacts will occur some years into the future and so outside current investment time horizons) and the lack of understanding about how certain issues, for example human rights, can be integrated into financial models.
- There is still relatively little 'hard' (academically robust) research on the investment value of focusing on ESG issues,

- (e.g. by means of ESG integration and/or active ownership).4
- Many investors have a relatively narrow view of what fiduciary duty means for them. Many hold the view that divesting from companies purely on ESG grounds may be a breach of their fiduciary duties and that engagement (or active ownership) is not part of investors' duties to their clients.⁵

"Many investors continue to believe that ESG issues are simply not material (or financially relevant) to their investments. This means that discussions between investment managers and their clients tend to focus on financial performance, rather than considering ESG impacts and outcomes."

"Many investment analysts and fund managers believe that it is extremely difficult to add investment value through a focus on ESG issues."

Other investment-related organisations' views on ESG issues

We received a somewhat different perspective from the interviews we conducted with the sell-side (although this must be qualified by noting that we focused our attention on sell-side organisations that have made significant progress in integrating ESG issues into their investment processes). These interviews suggested that there is a general recognition of the potential importance of ESG issues to investment performance and an appetite for using ESG-related information in investment research, where this research can contribute to the goal of investment outperformance. However, these interviewees also confirmed that it can be difficult to add investment value through a focus on ESG issues, and they noted that demand from their clients (the investment managers and insurance companies) was necessary for them to allocate resources to this area of research. One sell-side interviewee commented: "Client demand and, importantly, client willingness to pay has seen ESG move from being an occasional research subject to one that is much more systematically researched and analysed".

"Client demand and, importantly, client willingness to pay has seen ESG move from being an occasional research subject [on the sell-side] to one that is much more systematically researched and analysed."

^{3.} See the definition and discussion of materiality in Section 3.3 below.

^{4.} It is, however, important to note that there are now a number of studies that provide robust evidence of the investment value of ESG integration and active ownership. The most significant of these are:

Marco Becht, Julian Franks, Colin Mayer and Stefano Rossi (2009), 'Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Funds'. The Review of Financial Studies. Vol. 22, No. 8, pp. 3093-3129.

Funds', The Review of Financial Studies, Vol. 22, No. 8, pp. 3093-3129.

• Alon Bray, Wei Jiang, Frank Partnoy and Randall Thomas (2008), 'The Returns to Hedge Fund Activism. ECGI Law Working Paper №.098/2008. http://ssrn.com/abstract=1111778

Elroy Dimson, Oguzhan Karakas & Xi Li (2012), 'Activism on Corporate Social Responsibility', http://www.inquire-europe.org/research.html

Robert Eccles, Ioannis Ioannou and George Serafeim (2011), 'The Impact of a Corporate Culture of Sustainability on Corporate Behaviour and Performance', http://accessalpha.com/pdf/2011/HARVARD%20SUSTAINABILITY%20PAPER.pdf

For a comprehensive survey of the literature on the implications of ESG issues for portfolio performance, see Deutsche Bank Climate Change Advisers (2012), Sustainable Investing. Establishing Long Term Value and Performance. June 2012 (DBCCA. New York).

^{5.} There have been a number of major reports that have made the case for a wider interpretation of fiduciary duty. See, in particular, FairPensions (2011), Protecting our Best Interests: Rediscovering Fiduciary Obligation (Fairpensions, London); John Kay (2012), The Kay Review of UK Equity Markets and Long-term Decision Making. Final Report – July 2012 (Department for Business, Innovation and Skills, London); United Nations Environment Programme Finance Initiative [UNEP FI] (2005), A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment (UNEP FI, Nairobi) [commonly referred to as the 'Freshfields Report']; UNEP FI (2009), Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment (UNEP FI, Nairobi).

Among the other organisations (ESG research providers, companies, NGOs, policy makers) we interviewed, there was a consensus that ESG issues are important to companies (and need to be managed as corporate priorities) and that these issues are important influences on investment value over the longer-term. This finding should be treated with some caution as it is primarily a reflection of the organisations interviewed (leading members of the Global Compact network, NGOs. policymakers dealing with ESG issues, providers of ESG research) and, therefore, it would have been surprising to find more than a handful of individuals who did not agree with this consensus position.

While these organisations agreed about the importance of ESG issues, it was striking that this did not necessarily translate into a view that their organisations should engage with investors or contribute to wider debates on the capital markets more generally. For example, many NGOs are often reluctant to commit resources to this area of work because they are not convinced of the benefits (in terms of how this work will support their organisational goals) with a number expressing scepticism about the extent to which investors integrate the research and information that NGOs provide into their investment decisions or into their engagement with companies.

Views on investors and public policy

Public policy engagement is increasingly seen as an integral part of investors' responsible investment commitments.⁶ For example, in 2012, the PRI committed to developing a research and public policy programme focused on accelerating the transition to a sustainable global financial system.⁷

While some investors have already played an active role in public policy, many have yet to do so. There are a number of reasons for this, notably the perception that public policy influencing falls outside what investors see as their 'core business', the frequent lack of understanding of the differences between political lobbying and policymaker engagement, and the lack of understanding regarding the outcomes and business benefits that can result from such activity (in particular when compared to the better defined and, often, more immediate outcomes and benefits that can accrue from company engagement).

Policymakers generally welcome investor input to policy debates. However, a number of those interviewed noted that policymakers may be sceptical about investors' motivations. perceiving that there is a disconnect between investors' proposals and the investment decisions that investors actually take. This, in turn, may make policymakers less willing to respond positively to the proposals made by investors.

3.1.2 SKILLS. KNOWLEDGE AND EXPERTISE

Investment research and decision-making

One of the most striking conclusions from the research is that the majority of the investment organisations, sell-

side organisations and ESG research providers interviewed considered that they had (or could readily easily develop or access) the skills, knowledge and expertise they needed to deliver on their formal obligations. That is not to say that these skills are necessarily immediately available, but most felt that the skills and expertise that they needed could, generally, be filled relatively easily. For example, ESG research providers considered that their needs could be met through hiring good staff (which, at more junior levels, was generally taken as a shorthand for individuals with good degrees or postgraduate degrees, whose attitudes and values aligned with the culture of the hiring organisation), and training (primarily on the job training on the specific tools and methodologies used by the organisation, possibly supplemented by some short courses or conference attendance). On the sell-side, there was a general consensus that the key attributes of sell-side analysts focusing on ESG issues was their understanding of investment decision-making, rather than their specialist knowledge of ESG issues, with one interviewee noting: "For sell-side analysts looking at ESG issues, knowledge of the drivers of investment value – for example how companies make money, how they compete, business fundamentals, industry positioning – and equity market knowledge are more important than knowledge of the specific ESG issues".

It was generally felt that an appropriate level of knowledge of ESG issues could be built reasonably guickly. On interviewee, expressing a commonly held view, commented: "It is easier to teach ESG to a good analyst than to teach an ESG specialist to be a good equity analyst"

"For sell-side analysts looking at ESG issues, knowledge of the drivers of investment value and equity market knowledge are more important than knowledge of the specific ESG issues".

A surprising finding was that, despite the amount of training being provided by ESG research providers (in particular to more junior staff), there does not appear to be a significant demand for already trained individuals. The ESG research providers generally looked for individuals with generic research skills and some knowledge of ESG issues; relatively little importance was assigned to the individual's understanding of financial issues (see further Appendix 2). When we asked about this, a number of those interviewed explained that much of the training they provided related to their specific systems and processes, and that much of this training would need to be provided irrespective of the individual involved.

"Despite the amount of training being provided by ESG research providers (in particular to more junior staff), there does not appear to be a significant demand for already trained individuals."

A number of those interviewed noted that, in the event that specific technical or investment knowledge was not available in-house, this could be obtained from consultants,8 from discussions with other stakeholders (e.g. some pointed to NGO engagement as an important input to their research processes) and from their industry peers (in particular through training and professional development courses offered by industry bodies such as the social investment forums).

In the course of the interviews, two distinct areas where skills. knowledge and expertise need to be developed were identified. For institutional investors, the integration of ESG issues into their investment practices and processes is still seen by many as a work in progress. Even those that have made good progress on integrating ESG issues into their listed equities processes pointed to the significant challenges they face in integrating these issues into other asset classes (e.g. fixed income, infrastructure) and into emerging market investments. Interviewees noted that there is a general lack of expertise in the investment industry, with the possible exception of the sellside, on how to integrate ESG issues into investment processes, compounded by a lack of guidance on how investors might approach this integration.

"For investors, the integration of ESG issues into their investment practices and processes is still seen by many as a work in progress."

The second area related to ESG research providers, with a number of investors criticising the ability of ESG research service providers to provide investment-relevant information (or, more precisely, to provide information and data that was relevant to the investor's investment needs and interests). The ESG research providers commented that this reflected the commercial relationship between the two, with investors paying ESG research service providers for specific types of information (e.g. inclusion/exclusion, rankings) but not for investment (or financial) analysis or similar insights (which investors generally source from the sell-side). The consequence is that there is, at present, limited commercial incentive for ESG research providers to develop their capacity in relation to investment decision-making.

"There is, at present, limited commercial incentive for ESG research providers to develop their capacity in relation to investment decision-making."

Public policymakers

While policymakers in finance and similar departments generally have a good understanding of the structure and operation of the capital markets, officials in other departments tend to have a relatively limited understanding of capital markets. Even within finance departments, while many will have some familiarity with investors' role on corporate governance relatively few will have much understanding of responsible investment or of investors'

wider interest in environmental and social issues. A number of the investors interviewed noted that building policymaker knowledge (on what responsible investment is, on how the investment markets work, etc.) is an integral part of their public policy engagement processes.

"A number of the investors interviewed noted that building policymaker knowledge (on what responsible investment is, on how the investment markets work, etc.) is an integral part of their public policy engagement processes."

Public policy engagement is relatively novel for many investors, and is also highly resource intensive. The consequence has been that that, rather than seeking to develop in-house capacity, many investors delegate this responsibility to collaborative initiatives or industry associations, with these organisations then hiring individuals with experience of the public policy process.

NGOs

The NGOs engaged with for this project acknowledged that they do not have all of the knowledge that they need in order to engage effectively with investors.

In part, this is an issue of resources where individuals (or small teams in some of the larger NGOs) are required to cover multiple asset classes and multiple issues. It also reflects the lack of understanding within NGOs' management teams regarding the complexity of the investment/finance sector which means that these individuals are often required to cover a whole series of issues that fall well outside their core expertise. These issues are compounded by the relative novelty of capital market-related work for many NGOs, which means that they are often reluctant to commit resources to this area.

NGOs also noted that while many NGOs interested in the capital markets have yet to develop all of the skills, knowledge and expertise that they need, there is a collective body of expertise (in terms of understanding of the investment industry and of the relative effectiveness of different campaigning strategies) within the NGO community. It was therefore felt that many of the capacity needs could be addressed through NGOs working more closely together, to build collective capacity, to develop knowledge of successful campaigning approaches, and to generally leverage their collective resources.

3.1.3 RESOURCES

Investors

Overall, institutional investors, ESG research providers and the sell-side consider that they have a reasonable level of resources available to deliver on their responsible investment

^{6.} Roger Urwin (2011), 'Pension Funds as Universal Owners: Opportunity Beckons and Leadership Calls', Rotman International Journal of Pension Management, Vol. 4, No. 1, pp. 26-33.

^{7.} Principles for Responsible Investment (PRI) (2012), Annual Report 2012 (PRI, London), pp. 6-7.

^{8.} A number of interviewees noted that while consultants could address specific technical gaps and need, relatively few consultants could deliver the entire range of advice that was required. For example, some investors pointed to consultants who were very knowledgeable about ESG issues but had limited knowledge or understanding of the implications of these issues for investment decision-making, and participants in the NGO workshop (see Appendix 5) noted that consultants with knowledge of the capital markets were rarely able (or willing) to advise on how NGOs may best seek to influence institutional investors

commitments,⁹ although a number of those interviewed highlighted that these resources are stretched by the number of 'non-core' activities they are also required to carry out (e.g. administration, client reporting, external reporting, responding to queries).¹⁰ A number also argued that the increasing emphasis on ESG integration has led to some resources being diverted away from engagement with companies, although they also acknowledged that this integration also meant that more individuals within their organisation were looking at ESG issues.

Asset owners, however, face significant capacity constraints. While many asset owners look for ESG capacity when searching for external investment managers, and include ESG criteria in management contracts, just one quarter of the asset owners that have detailed agreements in place with managers to address ESG issues, consider that they monitor their external managers' performance closely."

"Just one quarter of the asset owners that have detailed agreements in place with managers to address ESG issues, consider that they monitor their external managers' performance closely."

It is relevant to note that many investors (investment managers, asset owners, insurance companies, etc.) collaborate with others; indeed this is one of the defining characteristics of the responsible investment industry at present. For example, investors frequently collaborate when they are engaging with companies (e.g. the PRI's Clearinghouse¹² is a global platform that allows PRI signatories to pool resources, share information and engage collaboratively with companies, policymakers and other actors), most of investors' public policy work is delivered collaboratively (e.g. through the PRI's Clearinghouse, through the international climate change networks,¹³ through smaller groups led by one or two investors), and investors have worked together on a whole series of other responsible investment-related issues (e.g. disclosure requirements for ethical funds, encouraging improved ESG research from the sell-side).

Companies

While the companies interviewed did not indicate that they had significant resource constraints for ESG reporting, a number commented that they were facing increasing demands on these resources in two areas. The first is that reporting is getting more complex, requiring reporting on a wider range of ESG issues and associated performance indicators. The second is that investors and other stakeholders are increasingly requesting bespoke or tailored information.

ESG research providers

While the ESG research providers were, broadly, satisfied that they had sufficient resources to deliver their core products and services, they are increasingly expected to provide clients with advice on the investment implications of particular ESG issues. They noted that, despite these additional demands, their investment clients are generally unwilling to pay more for this advice and support. They also commented that while they recognise that the services they provide need to evolve to meet clients' demands, their clients are reluctant to see significant changes in their research methods as many have built their investment processes (in particular for screened funds) specifically around the data and information produced by the research provider.

NGOs

The NGOs that contributed to this project were very clear that their resources are significantly constrained. These constraints were seen as being in both absolute terms (i.e. relative to the goals that they set themselves) and relative terms (i.e. relative to the resources available to investors, which in turn are significantly less than the resources allocated by companies to investor and civil society engagement and, more generally, to brand and public relations).

3.1.4 ACCESS TO INFORMATION

The availability of information and the quality of that information were highlighted as issues by most of the organisations and individuals that contributed to this research.

Company disclosures on ESG issues

Company reporting on ESG issues – both in terms of breadth and quality - has improved significantly over the past decade. However, this reporting still falls short of the quality required. At the individual level, some leading companies provide a robust account of their performance on ESG issues, where robust means that users of the data can understand: the company's position on the issues in question, the company's historic (trend) and expected future performance on these issues, the significance of these issues to the business, and the relationship between these issues and corporate strategy, short and long term value creation and risk management. However, most companies' disclosures were seen by interviewees across the investment system as falling far short of one or more of these requirements. For example, in relation to ESG performance data, the information provided by companies is generally not comparable; calculation methodologies are applied inconsistently and companies generally provide little information on the scope of reporting or even the meaning of the indicators being reported (e.g. when companies report employee turnover it is often not clear whether they are including or excluding redundancies, when they report the proportion of women in senior management, when companies report employee costs they are rarely clear about whether these numbers include or exclude elements such as employer pensions contributions and national insurance). The consequence is that, from an ESG performance perspective, it is difficult to make standardised comparisons between companies (e.g. in benchmarks).

"It is difficult to make standardised comparisons between companies (e.g. in benchmarks)."

The characteristics of ESG reporting also make it difficult for ESG-related information to be integrated into investment decision-making. Companies usually do not put their ESG information into a business context (e.g. by commenting on the financial significance of the risks and/or opportunities presented by these issues), and are rarely clear about which, if any, ESG issues are important value drivers for their business. Moreover, the majority of ESG-related information only reported once a year and is generally backward looking. This contrasts with other investment-relevant parameters (e.g. oil prices, share prices) which are updated much more frequently, and with financial information which tends to be much more forward-looking. As noted by one interviewee: "You can't have an integrated approach with backward looking data."

"You can't have an integrated approach with backward looking data."

The companies we interviewed acknowledged these issues but argued that reporting is complicated by the lack of clarity from investors on the specific information that they require from (or expect of) companies. They also noted that it is difficult to balance the pressures for integrated reporting, the pressure to report in line with reporting frameworks such as the Global Reporting Initiative and the demands from stakeholders and investors for reporting on specific issues, with business needs such as providing a coherent account of their overall approach to corporate responsibility. Companies also commented that many ESG issues (e.g. controversial projects) are difficult to cover adequately in formal reports, and so they see investor or stakeholder meetings as an important complement to their formal written reports.

While the limitations in disclosure are a well-recognised problem, it is also relevant to note that researchers and analysts across the various stakeholder groups we interviewed have developed strategies for coping with this (e.g. they have developed tools that enable them to estimate missing data points, they have adopted rules of thumb/heuristics that guide their decision making).¹⁴

Investor disclosures

Disclosure by investors is important to enable market participants and other stakeholders to differentiate between those organisations (asset owners and investment managers) who do a good job on responsible investment and those that do not. It also has important implications for the integration of ESG issues into investment processes, as it means that ESG research providers and companies do not have a clear sense of how the data and information they provide is actually used, which in turn limits their ability to provide information that is useful to investors. Some of those interviewed believed that the disclosures currently provided by investors are insufficient in this respect. There are a number of different aspects to highlight. The first is that many investors do not report on their approaches to responsible investment with, for example, less than half of the respondents to the PRI's 2011 survey making their responses publicly available through the PRI's website. 15 The second is that while many provide at least some information on their websites on how they integrate ESG issues into their investment processes or on how they implement responsible investment more generally. relatively few provide a coherent, overarching account of their approach to responsible investment. The third is that there are significant gaps in the information being disclosed (e.g. in relation to the importance assigned to ESG issues in their investment processes, the specific ESG issues considered, the scope of their responsible investment commitments. the resources allocated to responsible investment).

Investors identified a number of practical reasons why their reporting fell short of the demands of stakeholders, pointing to the tensions between public reporting and the need to keep proprietary information private (in particular, investment managers cannot disclose information on issues such as their clients' voting policies without explicit permission from their clients) the lack of demand from clients (with many investors questioning whether performance on responsible investment was actually a material factor in appointment/re-appointment processes) and a lack of consensus on the data/indicators that should be provided in such reporting. In relation to this latter point, the PRI's revised reporting framework (which will be introduced in 2013) will play an important role in specifying the types of information that investors should be providing in their public reporting.

3.2 MEETING STAKEHOLDERS' EXPECTATIONS

3.2.1 THE DIVERGENCE OF VALUES AND EXPECTATIONS

While the main conclusion from each actor's own selfevaluation is that, in the round, they do a reasonable job of delivering on their own obligations and commitments, a quite

^{9.} The NGOs that participated in this project challenged this assessment, arguing that the resources allocated by investors to responsible investment seemed inadequate to the scale of their responsible investment commitments. For example, they pointed the fact that most investors have just one or two responsible investment analysts but that these often claim to be covering a global universe of companies (3000-5000 companies).

^{10.} It should be acknowledged that, to the extent that these additional activities relate to growing interest in responsible investment from clients and others, they can be interpreted as an indication of an increase in the attention given to ESG issues within the investment chain.

^{11.} See further Appendix 1 to this report and PRI (2011) 2011 Report on Progress (PRI, London).

^{12.} http://www.unpri.org/areas-of-work/collaborations/

^{13.} Specifically, the European Institutional Investors Group on Climate Change (IIGCC), the US Investor Network on Climate Risk (INCR), the Investor Group on Climate Change Australia/New Zealand (IGCC) and the Asia Investor Group on Climate Change (AIGCC).

^{14.} For example a number of the ESG researchers we interviewed noted that they often assume that a lack of reporting on a particular issue means that the issue is not being explicitly managed by the company and, therefore, that this lack of reporting may indicate weaknesses in the company's quality of management.

^{15.} It is important to acknowledge that this will change with the PRI's introduction of mandatory reporting for signatories in 2013. For further information, see http://www.unpri.org/areas-of-work/reporting-and-assessment/ (last viewed 16 January 2013).

different picture emerges when we look at the views and perceptions of other stakeholders. A common theme was that 'they are good at what they do' or 'they are obviously very well qualified' but 'they lacked the capacity to effectively engage with other stakeholders that are relevant to them'. In fact, many investment industry stakeholders expressed

dissatisfaction with – and sometimes, explicit criticism of – other organisations in the investment industry. Table 3.1, albeit in a slightly polarised and somewhat simplified manner, sets out some of the areas where stakeholders' expectations are not matched by what is actually being provided.

Table 3.1: The Expectation/Delivery Gap

Expectations The Reality Investors, sell-side analysts. ESG Many companies do not report on their environmental or social performance, and the research providers and NGOs expect ESG-related disclosures provided by many of those that do report (whether in their companies to provide disclosures that annual reports or in their CSR/sustainability reporting) do not meet the demands of are comprehensive, comparable with investors, NGOs or ESG research providers. other companies, and that clearly explain how ESG issues are relevant to the Companies face practical challenges in gathering, processing and presenting data and business over the short, medium and information in a manner that meets their internal objectives (e.g. to provide a coherent long-term. account of their approach to corporate responsibility) while also meeting the demands of their stakeholders. This is compounded by the variety of information demands from stakeholders and the lack of clarity from investors around which, if any, data points they actually use in their investment decision-making. Investors rarely link (or integrate) questions about financial and extra-financial **Companies** expect **investors** to engage information (e.g. how sustainability issues relate to business issues such as efficiency, with them on the strategic implications of ESG issues, and to build these issues costs or competitive advantage), and tend to focus on short-term (generally less than one year) drivers of company value. This signals to company management that into their discussions with company management. ESG issues are of relatively little interest or of peripheral importance to investors. **Investors** expect **ESG** research ESG research providers struggle to provide the types of investment insights that their investor clients are demanding. There are various reasons: the timeframes over providers to provide them with investment-relevant research. which ESG issues are financially relevant are generally much longer than investment time horizons; ESG research providers often do not have the investment expertise required to provide these sorts of insights; investment clients generally do not pay

Investors expect NGOs to have a detailed understanding of the investment industry, to acknowledge the practical challenges faced by investors, and to be prepared to work with investors and companies to find solutions to the issues identified.

NGOs have significant resource constraints which mean that they cannot support an extensive dialogue process with companies and investors.

their ESG research providers for this sort of research; investors are generally poor at

NGOs generally do not see themselves as 'solutions providers'.

explaining what sort of insights or data would be most useful to them.

NGOs expect investors and sell-side analysts to encourage changes in companies' disclosures, practices and processes, and performance, to invest in companies with better ESG performance, to invest in companies that make a positive contribution to the goals of sustainable development, and to avoid or divest from companies whose performance falls below norms of good practice or whose activities do not make a positive contribution to sustainable development.

Investors have contributed to improvements in corporate disclosures (e.g. on greenhouse gas emissions) and in corporate policies, practices and processes on corporate social responsibility (CSR). However, investors have struggled to deliver changes in situations where there is a less clear-cut business case for action.

NGOs feel that it is difficult to get investors to take action or support NGO campaigns (even if NGOs believe there is a compelling business case for action), that investors are often very slow to take any action, and that investors tend to give companies the benefit of the doubt.

While NGOs acknowledge the importance of engagement as a responsible investment strategy, they question investors' commitment to responsible investment, arguing that very few investors are willing to consider divestment in the event that engagement proves incapable of delivering the types of changes sought.

A close reading of Table 3.1 and of Appendices 1-7 to this report suggests that there are two distinct issues at play. The first relates to the roles and responsibilities of different actors within the investment system. The second relates to the capacity of these actors (discussed in Sections 3.2.2 below).

In relation to the former point, the divergence in expectations relates in part to the difference between the 'formal' obligations that each actor has (e.g. investors' obligations to their clients or beneficiaries, ESG research providers' obligations to their investor clients, NGOs' obligations to their funders and members, policymakers' obligations to governments and to wider society, companies' obligations to their shareholders and stakeholders), and the expectations of other stakeholders in the investment system. To take one example, while many NGOs think that investors should be prepared to divest from companies that perform poorly or that do not respond to engagement on issues of concern, investors face a series of practical constraints, including the mandates awarded by their clients (which may require them to invest in a particular universe of stocks, e.g. in tracker funds), concerns about the implications of divestment for investment performance, and the concern that divestment may limit their ability to exert influence through engagement.

3.2.2 CAPACITY ISSUES

The capacity issues that are relevant to this divergence of expectations broadly mirror those presented in Section 3.1 above. Attitudes, perceptions, skills, resources and information asymmetries were all cited by the project participants as factors that need to be taken into account. There are, however, a number of additional capacity issues that were identified as important if the expectation/delivery gap was to be narrowed.

Lack of demonstrated understanding of the roles and responsibilities of other actors

In the course of this research, many of those interviewed were critical of the lack of understanding shown by other actors. For example, NGOs were criticised for not understanding investment, investors were criticised for not understanding the constraints faced by policy makers, ESG research providers were criticised for not understanding how their research could be used in investment decision-making, policymakers were criticised for not understanding the role that investors could play in the policy process, and companies were criticised for not understanding the information needs of investors, the sell-side, ESG research providers and NGOs.

The project participants stressed the importance of each actor developing a proper understanding of the formal obligations that each actor has (to clients, to beneficiaries, to members, etc) and the constraints (in particular in relation to resources) that each faces. The project participants commented that this understanding needed to be accompanied by a willingness to, at least, acknowledge these obligations and constraints in their dialogue with other actors, as an essential part of developing better relationships and enabling them to be more effective in their interaction (e.g. through establishing credibility, through establishing a common understanding of potential solutions).

Lack of resources

Many of the issues identified in Table 3.1 stemmed from the limited resources available to the different actors. One of the consequences has been that the various actors have tended to concentrate much of their time on engaging with their internal colleagues and their peers (e.g. companies tend to talk to other companies, NGOs tend to talk with other NGOs), rather than engaging more widely with actors in the investment system (with this engagement frequently seen as being of secondary importance). The consequence has been that these actors have not had the breadth of networks that they need to do their jobs effectively (e.g. NGOs and policymakers have relatively few contacts in the investment community beyond the 'usual SRI suspects', investors often do not know the key policymakers focusing on their areas of interest).

Access to information

Many of the criticisms about how different stakeholders act reflect the systematic lack of information flow within the investment industry. For example, ESG research providers and companies complained that they receive relatively little feedback from investors on how they use ESG-related information in their investment processes, NGOs complained that they rarely receive feedback from investors on the actions taken in response to NGO research or campaigns, companies complained that NGOs are unwilling to contribute resources to 'solutions oriented' processes. Clearly, practical constraints such as time availability, the perceived importance or value of providing this feedback, and commerciality constraints (specifically relating to investment decisions) all play a role. It is, however, clear that this general lack of communication and feedback is inhibiting the development of responsible investment. A number of those interviewed argued that simply addressing this lack of information would help address many of the criticisms that have been made of the investment system and, importantly, help address the frustration that the various actors have with other actors in the investment system.

"Many of the criticisms about how different stakeholders act reflect the systematic lack of information flow within the investment industry."

"It is clear that this general lack of communication and feedback is inhibiting the development of responsible investment."

3.3 WIDER STRUCTURAL ISSUES

There was a general consensus among the project contributors that many of the issues around the current functioning of the investment system could be resolved, or at least significantly improved, through education, capacity-building, the deployment of additional resources, and better information flows between stakeholders. However, there was also a clear sense that, even if these issues were resolved, the lack of demand from asset owners for responsible investment,

short-termism and investor definitions of materiality – each of which are discussed further below – will continue to limit the potential of responsible investment to contribute to the goals of sustainable development. 16. That is, while capacity building does have an important role to play, it is a necessary but not sufficient condition to enable progress to be made towards a more sustainable investment system.

Asset owner demand

A common view amongst those interviewed for this project (in particular, interviewees from investment management companies) was that there is a systemic lack of demand from asset owners (e.g. pension funds, foundations), insurance companies, and individual investors (retail investors, highnet worth investors) for responsible investment.¹⁷ Many of the investment manager representatives interviewed for this project expressed frustration that their efforts on responsible investment did not seem to be a factor in the decisions made by clients in their fund manager appointment or reappointment processes. A number also highlighted the almost complete absence of oversight or monitoring (see Section 3.1. above and Appendix 1) of how investment managers actually implement their clients' responsible investment commitments and policies. 18 This lack of demand. in turn, weakens the case for investors to commit resources to responsible investment and to do high quality work in this area.

"There is a systemic lack of demand from asset owners (e.g. pension funds, foundations), insurance companies, and individual investors (retail investors, high-net worth investors) for responsible investment."

Many of the investment manager representatives interviewed for this project expressed frustration that their efforts on responsible investment did not seem to be a factor in the decisions made by clients in their fund manager appointment or reappointment processes.

These comments – on the lack of client demand and oversight - may seem surprising given that the PRI currently has over 250 asset owner signatories. Participants identified several reasons why asset owners are not paying particular attention to responsible investment issues in general. The most common reason identified was the overwhelming focus on short-term

investment performance (discussed further below), resulting in a failure to explore the extent to which ESG factors are incorporated into investment processes. Other factors that were identified included a general scepticism about the investment benefits - in particular over the short term - of responsible investment, a general lack of understanding of how and why ESG issues could be relevant to investment, a lack of understanding of how to integrate ESG factors into investment processes, a lack of consensus around what asset owners should expect their investment managers to be doing, a lack of pressure from clients, stakeholders or industry peers to take action on these issues, an unwillingness to take a leadership position, and a perception that focusing on these issues would entail incurring additional costs or risk damaging investment performance.

While investment managers were critical of the lack of explicit demand from their clients for responsible investment, it is clear that investment managers are starting to pay greater attention to ESG issues in their investment processes and to encourage their research providers to support them in this endeavour. The sell-side interviewees reported that their investor clients (investment managers and insurance companies) are paying much more attention to how ESG factors are being included in investment research and are demanding more research on these issues. A similar message came from the ESG research providers who noted that their clients are increasingly interested in exploring how ESG information can be used in investment decision-making and in how ESG issues are likely to affect investment performance. Interestingly, both ESG research providers and the sellside pointed to the growth in the number of asset owner signatories to the Principles for Responsible Investment as a key driver for change, noting that this has created pressure for investment managers to sign up to the principles and, critically, to demonstrate that they are paying due attention to the ESG issues in their investment practices and research.

Short-termism¹⁹

In relation to timeframes, project participants highlighted the short-term focus of most investment contracts (or mandates).20 The stereotype is that investment mandates are typically for a three-year period, with one-year performance targets and quarterly reviews. Inevitably, this drives a focus on short-term financial performance, with investment decisions based on likely short-term movements in asset prices rather than on a view of the companies' longer-term strategy and prospects. It also leads to an overwhelming focus on short term factors (e.g. this quarter and next quarter's numbers) in the discussions that investors and the sell-side have with companies.

"The stereotype is that investment mandates are typically for a three-year period, with one-year performance targets and quarterly reviews."

This has a series of perverse consequences. First, it incentivises companies to focus on activities that yield returns in the short term.21 rather than on activities that will lead to success over 10 or 20 years, or even 3-5 years (such as investing in greenhouse gas abatement, workforce training, or strategies to create business opportunities and maximise their development impact in emerging markets). Second, it reduces the incentives for investors to engage with the companies in which they invest on issues that may provide longer-term benefits to the company. As shares are likely to be sold long before these benefits emerge, investment managers are unlikely to see this engagement as being of benefit to them or their clients. Third, it perpetuates short-term thinking among other investment actors. For example, in the course of this project, ESG research providers and the sell-side noted that there is limited market demand for longer-term thematic research and NGOs noted that they often have to try and make relatively short-term business cases to justify why investors should focus on particular ESG issues.

"[Short-termism in investment markets] incentivises companies to focus on activities that yield returns in the short-term (i.e. boosting their quarterly financial results), rather than on activities that will lead to success over 10 or 20 years."

Materiality

Materiality is one of the most important concepts in investment practice. The term 'materiality' (or, more specifically financial materiality) is widely used to describe the financial significance of a particular issue. In accounting terms, information is defined as material if its omission, mis-statement or non-disclosure has the potential to adversely affect decisions about the allocation of scarce resources made by the users of the financial report or the discharge of accountability by the management or governing body of the entity.²² There is no consensus on the precise threshold or quantitative level at which an issue becomes 'material'. However, a general rule of thumb used by most investors is that events that lead to impacts of greater than ten per cent on a key financial performance indicator (such as profit, turnover or revenues) are considered material, whereas impacts of less than five per cent are generally not considered material.²³ Moreover, for most investors, the timeframe of interest is relatively short-term with most attention being paid to how the company and its share price will perform over the next year or two years at most. Issues that may impact on the business beyond that time (e.g. regulation that takes effect a number of years in the future) are unlikely to receive much attention. The consequence is that, in conventional investment analysis, the vast majority of environmental and social issues are not considered financially material.

21. John Graham, Campbell Harvey, and Shiva Rajgopal (2006), 'Value Destruction and Financial Reporting Decisions', Financial Analysts Journal, Vol. 62, No. 6, pp. 27-39.

22. Rory Sullivan (2011), Valuing Corporate Responsibility: How Do Investors Really Use Corporate Responsibility Information? (Greenleaf, Sheffield), p.123.

"The consequence is that, in conventional investment analysis, the vast majority of environmental and social issues are not considered financially material."

"For most investors, the timeframe of interest is relatively short-term with most attention being paid to how the company and its share price will perform over the next year or two years at most. Issues that may impact on the business beyond that time are unlikely to receive much attention."

Client demand, timeframes and materiality are all related

The issues of client demand, timeframes and materiality are all related and reinforce one another. The lack of incentive to take a longer-term view not only drives short-term thinking within investment decision-making but it forces short-term thinking through the entire investment system. For example, in the course of this research, the sell-side and ESG research providers noted that their investment clients are primarily interested in research that could provide insights into short-term financial performance, companies complained about the almost obsessive focus of investors on near-term financial performance rather than longer-term value creation, and even NGOs feel compelled to try and make short-term investment cases rather than focusing on the longer-term benefits of a focus on ESG issues.

"The lack of incentive to take a longer-term view not only drives short-term thinking within investment decision-making but it forces short-term thinking through the entire investment system."

These trends persist despite the growing body of evidence that short-term investment approaches may depress long-term company performance and investment returns and contribute to asset mispricing and market bubbles.²⁴ There is evidence, however, that it may be possible for investment managers' clients (in particular, pension funds) to change the manner in which investment managers define materiality. A number of those interviewed noted that if clients ask guestions about how ESG issues such as climate change are being assessed and integrated into investment decisions and if the manner in which these issues are integrated is an important consideration in manager appointment/reappointment decisions, this will create pressure for investment managers to take a longer-term view, to pay more attention to these issues in their investment processes and investment decisions, and to allocate more resources to responsible investment more generally.

^{16.} These issues are very familiar to those involved in responsible investment debates, and are widely cited as critical obstacles to a more sustainable investment system. See, for example, the analysis of UK equity markets presented in Kay (2012) (Note 5) and the Oxfam analysis of the obstacles to the greater consideration of poverty and development issues presented in Helena Viñes Fiestas, Rory Sullivan and Rachel Crossley (2010), Better Returns in a Better World. Responsible Investment: Overcoming the Barriers and Seeing the Returns (Oxfam, UK).

^{17.} This is despite the fact that over three-quarters of the asset owner respondents to the PRI's 2011 signatory survey stated that they looked for ESG capacity when searching for external investment managers, and that two-thirds stated that they included ESG criteria in management contracts (PRI (2011), 2011 Report on Progress (PRI, London). http://www. unpri.org/publications/2011_report_on_progress.pdf).

^{18.} For example, only one in four of the PRI signatories that indicated that they had detailed agreements in place with managers to address ESG issues (see Note 15), considered that they closely monitored their external managers' performance, and 9% reported that that they do not monitor their external managers at all (PRI (2011) (Note 15)).

^{19.} For a discussion of the scale of this issue, see IRRC Institute and Mercer (2010, Investment Horizons: Do Managers Do What they Say? (IIRC Institute, New York). 23. Ibid., pp. 122-133. 24. Graham et al. (2006) (Note 21); Kay (2012); Dimitri Vayanos and Paul Woolley (2012), An Institutional Theory of Momentum and Reversal (Paul Woolley Centre for the Study of 20. For a discussion of the importance of pension funds and sovereign-wealth funds taking a longer-term approach to their investments and the obstacles to this, see Alexander Cappelen and Runa Urheim (2012), Pension Funds, Sovereign-wealth Funds and Intergenerational Justice (Norwegian School of Economics, Bergen). Capital Market Dysfunctionality, London School of Economics, London)

4. MAKING PROGRESS

The material presented in Section 3 points to a series of areas where progress or action is required. It is, however, important to acknowledge that there is also a huge amount of time and effort being invested in capacitybuilding across the investment industry, by a whole range of actors including investor collaborations such as the PRI, professional bodies, research providers, consultants, universities and NGOs, as well as individual companies and investors. Despite these efforts, many of these initiatives have yet to be widely communicated or widely recognised.

Therefore, the approach taken in this section is, building on Section 3, to set out the areas where further action is required – with a particular focus on those actions that can be taken forward over the next 2-3 years – and then to identify some of the areas where work is already in hand to address the issues identified. It is important to emphasise that there is significant overlap and interdependency between the issues. For example, investors are more likely to commit resources to responsible investment if they believe that ESG issues are important drivers of investment value and if their clients or beneficiaries press them to integrate consideration of these issues into their investment processes.

Investors are more likely to commit resources to responsible investment if they believe that ESG issues are important drivers of investment value and if their clients or beneficiaries press them to integrate consideration of these issues into their investment processes.

4.1 CHANGING ATTITUDES. VALUES AND BELIEFS

A significant number of investors do not believe that ESG issues are relevant to them and, even if they do believe that these issues are relevant, they are not convinced that there is likely to be significant value to them in focusing on these issues in their investment practices. Changing these attitudes will require:

- Robust academic and practitioner evidence that ESG issues are financially material at the individual company level and at the investment portfolio level.
- The systematic integration of ESG issues into training requirements (both professional training and on-the-job training) and into training programmes.
- Practical guidance and examples of how a focus on ESG issues can add investment value and the development of a stronger evidence base for responsible investment (e.g. the investment benefits of different approaches, the engagement outcomes that can be achieved, the public policy outcomes).

- Evidence that focusing on ESG issues does not necessarily entail significant added costs for asset owners or investment managers. This is not to suggest that the costs are insignificant or that there are no costs associated with ESG integration. Rather it is about demonstrating that the costs are outweighed by the financial benefits and/or that the costs to the client are modest.
- A broadening of the interpretation of fiduciary duty, requiring investors to take account of ESG issues in their investment practices (both investment decision-making and active ownership).25

RELEVANT INITIATIVES: SOME EXAMPLES

- As part of the same EC-funded project as this research, the PRI has issued a report, Integrated Analysis: How investors are addressing environmental, social and governance factors in fundamental equity valuations - A Report from the PRI ESG Integration Working Group (PRI, London), that provides a systematic guide to the integration of ESG issues into fundamental equity valuations.26
- UNEP FI's Property Working Group (PWG) has published a series of reports setting out the case for property investors to take account of social and environmental issues in property investment.²⁷
- A number of research articles and synthesis papers have been published that provide robust evidence in support of the argument that investors should take account of ESG issues in their investment practices and processes.²⁸

One of the specific areas where investors' attitudes, values and beliefs are of particular importance is in relation to public policy; even among investors that are signatories to PRI, relatively few play an active role in public policy, notwithstanding the critical role that public policy plays in facilitating and encouraging ESG integration and responsible investment more generally. Changing investors' views on the importance of public policy engagement as part of their wider responsible investment-related activities will require that there is a clear case for investors to engage with policymakers (i.e. evidence that well designed public policy can provide real benefits to investors), that there is robust evidence that public policy engagement can be effective (i.e. investor engagement can lead to changes in public policy frameworks) and evidence that such engagement does not create reputational or other business risks for investors.

25. One point of feedback we received on this proposal was that if the evidence is sufficiently compelling, then the perceived obstacle to ESG integration presented by fiduciary duty will cease to be an issue. Over the long-term, this may be true but it presupposes that the evidence is sufficiently robust and that the argument that investors should take account of ESG issues in their investment practices is widely accepted.

RELEVANT INITIATIVES: SOME EXAMPLES

- The PRI has committed to developing a research and public policy programme focused on accelerating the transition to a sustainable global financial system.
- Many investor collaborations (e.g. the international investor climate change networks)²⁹ already have extensive experience of public policy engagement, and share this experience (outcomes, lessons learned) with their members.

4.2 DEVELOPING SKILLS, KNOWLEDGE **AND EXPERTISE**

The priority areas for developing skills, knowledge and expertise include:

- (for investors) How to integrate ESG issues into their investment processes, across asset classes, investment strategies and geographic markets.
- (for ESG research providers) How to present their information in a way that is relevant to their investment clients' investment needs and interests).
- (for companies, NGOs, investors, policymakers, ESG research providers) How ESG issues affect investment performance, how investors analyse and use ESG information, what responsible investment is (specifically, the different responsible investment strategies such as screening, engagement, investment integration, etc.).
- (for policymakers, in particular those that do not work in finance or similar departments but that interact with investors) How the capital markets work and what role can be played by investors in improving corporate performance on ESG issues and in relation to public policy more generally.
- (for business schools) Course/training materials on responsible investment.
- (for NGOs) How to engage effectively with the capital markets and with individual investment organisations. This includes both general capacity building around the structure, operation and potential contribution of the investment system itself as well as more specific support on the design and implementation of effective campaigns.

RELEVANT INITIATIVES: SOME EXAMPLES

■ The PRI has issued a report³⁰ that provides a systematic guide to the integration of ESG issues into fundamental equity valuations, and presents a series of case studies on ESG integration.

- The PRI has issued a series of short introductory briefings on key ESG-related issues, including briefings in fiduciary duty, responsible investment strategies and the business and investment case for investors to focus on ESG issues.³¹
- The ICGN ESG Professional Development Programme aims to help investors identify, analyse and integrate ESG into their investment processes.³²
- UNEP FI offers online training courses on a range of ESGrelated issues, including climate change and finance, and environmental and social issues risk analysis.33
- The Responsible Investment Academy's foundation course, Responsible Investment Essentials, has been approved by the CFA, allowing financial professionals who are members of CFA Institute the opportunity to be rewarded for their training in responsible investment.³⁴
- NGOs have discussed how they may work better together to build their capacity, share experience and campaigning materials. For example, in the UK, FairPensions provides support and advice to NGOs seeking to engage with the investment community.

4.3 STRENGTHENING MARKET DEMAND FOR RESPONSIBLE INVESTMENT

One of the key findings from the research is that the lack of demand from asset owners (e.g. pension funds, foundations), insurance companies, and individual investors (retail investors, high-net worth investors) for responsible investment is a major obstacle to organisations (investment managers, ESG research organisations) committing resources to responsible investment or to research on ESG issues.

Stronger market demand will depend crucially on a recognition and understanding by asset owners of the financial and other benefits to them of devoting increased attention to ESG. As we have noted elsewhere in this report, the investment value of ESG needs to become more firmly embedded in asset owners' attitudes, values and belief systems.

This stronger understanding then needs to be reflected in asset owners' governance frameworks and operating procedures, and in the way they deal with other participants in the investment chain.

From the interviews conducted in the course of this research and from other PRI projects (in particular the feedback from the consultation on PRI's reporting framework), asset owners and other organisations need to:

^{26.} Principles for Responsible Investment [PRI] (2013), Integrated Analysis: How investors are addressing environmental, social and governance factors in fundamental equity valuations - A Report from the PRI ESG Integration Working Group (PRI, London).

^{27.} http://www.unepfi.org/work_streams/property

^{29.} See Note 13.

^{30.} PRI (2013) (Note 26).

^{31.} http://www.unpri.org/about-ri/introducing-responsible-investment/

^{32.} https://www.icgn.org/esg-education

^{33.} http://www.unepfi.org/training/index.html

^{34.} http://hosted.verticalresponse.com/988489/9ec9e2c876/1739585061/2d9e58cbea/

- Provide a clear statement (e.g. a policy statement or a statement of investment principles) on the importance of ESG issues to the organisation, and on the goals that they have set for themselves in this regard.
- Provide training to their trustees and to key individuals within the organisation on ESG issues, focusing on the importance of these to investment performance and on how effectively managing these issues is an integral part of their fiduciary duty.
- Explain to beneficiaries (e.g. through the provision of materials on the website, through training) the importance of responsible investment to the organisation.
- Build responsible investment into investment manager appointment and reappointment processes, making the investment managers' commitment to, and track record on, responsible investment a critical factor in these decisions. When evaluating investment managers, attention should be paid to factors such as their resources for responsible investment, their approach to ESG integration (including the evidence that these factors have affected investment decisions), their commitment to engagement and voting, the outcomes achieved from their engagement and voting activities, their commitment to collaboration, and their commitment to public policy engagement.
- Build responsible investment into performance management and monitoring processes, through making compliance with the pension fund's policies and goals an explicit contractual requirement, and through regularly reviewing the investment manager's implementation of responsible investment.

CURRENT INITIATIVES

- The PRI has released a responsible investment tool for asset owners, "Aligning ESG Expectations: Guidance for asset owners on incorporating ESG factors into manager selection, appointment and monitoring", that provides guidance on how implementing manager selection, appointment monitoring policies and processes that take of investment manager's approaches to responsible investment.³⁵
- The ICGN Draft Model Mandate provides guidance to asset owners on the expectations that they can have of their fund managers and on how they can formulate their contracts (mandates) with those managers such that they deliver on these expectations.³⁶
- The PRI signatory reporting framework will require asset owner signatories to describe how they have integrated ESG/responsible investment into manager appointment/reappointment processes, to describe how they monitor and evaluate investment managers, and to describe the reporting they provide to beneficiaries and other stakeholders.³⁷

Report to beneficiaries and clients on how they have implemented their responsible investment commitments. This should include explicit discussion of the weight assigned to responsible investment-related factors in investment manager appointment processes, and of how responsible investment-related factors influenced appointment/reappointment decisions.

4.4 INCREASING THE RESOURCES FOR RESPONSIBLE INVESTMENT

The resources allocated to responsible investment/ESG-related research are limited across all of the actors reviewed in this research. It is also clear that these resources are being spread increasingly thinly as investors face increased demand from their clients for reporting on their responsible investment activities, as companies broaden and deepen their reporting, and as ESG research providers are being pressed to broaden the coverage of their research by providing information on the financial implications of ESG issues.

While the obvious answer would be to call for more resources, the reality is that this is unlikely to happen without stronger market signals through the investment system. That is, asset owners need to increase the demand for investors to focus on ESG issues (and this is probably the key change that is required), and investors need to incentivise the sell-side and ESG research providers to develop their capacity in this area. Even if signals are strengthened, it is not clear that there is a willingness among any institutional investors or their clients to pay more for work in this area; low returns, pressure to reduce fees, increased scrutiny of outgoings are recurring themes across the investment industry.

While this is not a hugely encouraging message, a much more interesting picture emerges when we look at the work that is being done in practice. A number of the investment managers we interviewed for this research noted that while the headline number of employees focused explicitly on responsible investment ('the responsible investment team') had remained relatively unchanged, mainstream analysts and fund managers were starting to pay more attention to the potential for ESGrelated research to add investment value and were working with ESG specialists to explore how this might be achieved. The interviewees from the sell-side pointed to increased demand from the investment manager clients for research on ESG issues and a willingness on the part of the clients to direct broker research commission towards those that provide high quality research in this area. This is encouraging in two ways. First, it signals that more resource is being directed towards ESGrelated research, with likely knock on implications for the sellside and ESG research providers who may see more demand for data and research on ESG issues (although this may, again, not result in overall revenue increasing but, rather, see a diversion of some research budgets towards work in this area).38 Second, it is likely to contribute to the development of skills and knowledge across the investment industry; the more people that focus on

ESG-related issues, the greater the likelihood that the necessary core expertise will be developed across the investment industry.

NGOs face somewhat different challenges, as they rely on other sources of funding. From the NGOs that we engaged with, the key message was that there is a need to develop the evidence base that demonstrates the value that NGO work (campaigning, information-sharing, etc.) on the capital markets can contribute to their organisational goals and objectives. This is critical to building the internal case for NGOs to commit more resources to this area. It is also critical to convince donors and funders to provide financial support for NGOs to do work in this area.

4.5 IMPROVING ACCESS TO INFORMATION: COMPANY DISCLOSURES

REPORTING ON ESG ISSUES

In relation to specific ESG issues, there was a broad consensus from the interviews conducted for this research that companies should provide:

- Information on the company itself to the extent that such information is necessary to put its ESG performance into context.
- A list of major ESG-related risks and impacts.
- A clear statement on the financial implications of ESG issues for the business, including the timeframes over which these implications have been assessed.
- Details of their policies on the ESG issue(s) in question.
- Details of their strategies and plans for managing the ESG issue(s) in question.
- Their targets and key performance indicators for these ESG issue(s).
- An assessment of their progress towards meeting their objectives, including performance against targets and key performance indicators. This should include discussion of the factors that have affected their performance.
- An assessment of performance against the company's own policies and against other commitments (e.g. codes of conduct) that have been made by the company.
- Forward-looking information on how the company expects its ESG performance to evolve over time and the key factors (changes in the business environment, public policy and regulation, consumer trends, stakeholder pressures, etc.) that will affect performance.

Within this broad framework, there are two additional points that need to be made. The first is that there is limited consensus on the performance data that should be reported. This relates not only to the headline performance measures (e.g.

RELEVANT INITIATIVES: SOME EXAMPLES

- The PRI Clearinghouse convenes monthly webinars where companies discuss their approach to ESG and investors ask questions and provide feedback to the company on the information provided.³⁹
- The Global Reporting Initiative is revising its Sustainability Reporting Guidelines to reflect changes in the reporting field and the needs of key stakeholder groups.⁴⁰
- The Greenhouse Gas Protocol is partnering with UNEP Finance Initiative to develop guidance for the financial sector to account for greenhouse gas (GHG) emissions associated with lending and investments.⁴¹

total greenhouse gas emissions) but also the supplementary information and data required to put this type of number into context (see, further the discussion in Section 3.1.4 above). The

second is that this reporting needs to be useful to investors. The companies interviewed for this research expressed frustration about their dialogue with investors on their ESG reporting, specifically that there is a huge variation in the information and data that different investors seek, and that investors do not explain how they actually use the information provided by companies in their investment decision-making.

INTEGRATED REPORTING

In addition to reporting on specific ESG issues, there was also agreement that companies need to significantly strengthen the quality of their discussion and analysis of the implications of ESG issues for corporate strategy, short and long term value creation and risk management, and that this should form an integral part of their annual report (i.e. their formal communication with their investors).

RELEVANT INITIATIVES: SOME EXAMPLES

- The International Integrated Reporting Council (IIRC)

 a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs
 is leading the development of a global framework for integrated reporting.⁴²
- The investor participants in the IIRC have established an 'Investor Testing Group' to test the IIRC's proposals with analysts and fund managers, to ensure that the proposals are relevant to investors' needs.

^{35.} http://www.unpri.org/wp-content/uploads/Aligning_Expectations_2013.pdf

^{36.} http://www.icgn.org/files/icgn_main/pdfs/agm_reports/2011/item_9.2_icgn_model_mandate_initiative.pdf

^{37.} http://www.unpri.org/areas-of-work/reporting-and-assessment/

^{38.} This conclusion is somewhat speculative as there are no robust estimates of asset manager demand for ESG-related research. The ESG research market has never been accurately sized and is changing shape rapidly as a consequence of trends such as consolidation, specialisation, the closer interface between the sell-side and ESG research organisations, and the regular shifts between in-house and external resourcing of research. The lack of certainty around the future demand for ESG research limits the willingness of ESG research providers and the sell-side to commit significant resources to this area of work.

^{39.} http://www.unpri.org/areas-of-work/collaborations/priority-collaborative-engagements/

^{40.} https://www.globalreporting.org/reporting/latest-guidelines/g4-developments/Pages/default.aspx

^{41.} http://www.ghgprotocol.org/feature/financial-sector-guidance-corporate-value-chain-scope-3-accounting-and-reporting 42. http://www.theiirc.org/

INTEGRATED REPORTING AND ESG REPORTING ARE BOTH IMPORTANT

A number of the organisations that participated in this research stressed the importance of both ESG reporting and integrated reporting, and that companies should not see the debate as being about one or the other. Stakeholders are interested in both strategic and performance-related issues (i.e. they expect companies to provide both a coherent account of how ESG issues are relevant to their business and provide the specific data to enable their performance on specific ESG issues to be properly assessed). There was a general consensus across the interviews that we conducted that it is unlikely that a single document (e.g. an 'integrated report' or a stand-alone sustainability report) could deliver both the breadth and depth of information required.

4.6 IMPROVING ACCESS TO INFORMATION: INVESTOR DISCLOSURES

There was broad agreement that all investors should report on their approach to responsible investment and that there is a need to significantly improve the breadth and depth of the information that is being reported. Investor reporting is relatively novel and there is, as yet, little consensus on the information that investors should disclose. From the research, and mirroring the reporting expectations of companies as set out above, participants suggested that all investors should produce an annual responsible investment report that describes their approach to responsible investment. More specifically, it was suggested that such reports should provide⁴³:

- A general description of the organisation and its activities, including information such as assets under management, the main asset classes managed, the main investment strategies used.
- A statement of the organisation's views on responsible investment and ESG issues, including discussion of the financial/business implications of these issues for the organisation.
- A description of the company's governance and management arrangements for responsible investment, including details of responsibilities, accountabilities and resources for responsible investment.
- Details of their responsible investment policies.
- A description of the strategies (e.g. the integration of ESG issues into investment research and decision-making processes, engagement, participation in collaborative initiatives, voting) they use to implement these policies.
- Their targets and key performance indicators for responsible investment, and an assessment of their performance against these targets and key performance indicators.
- A description of how ESG issues are taken into account in their investment processes, including details of the key areas (topics) that have been researched and how

- this research has influenced investment decisions (at the stock and asset allocation level). This should also include discussion/analysis of the investment value that has been added through a focus on ESG issues.
- A description of their engagement activities, including: (a) a description of engagement process and strategies used; (b) details of engagement topics and the objectives of the engagement; (c) quantitative and qualitative information on engagement, including the number of companies engaged with, the forms of engagement (letter, face-to face meeting, group meeting), the outcomes sought and the changes achieved.
- A description of their voting activities, including details of the total number of votes cast, the number of votes for, abstained and against management, the reasons for abstentions and votes against management, and the influence the voting decision had on company practice.
- Details of the collaborative initiatives they participated in and the outcomes achieved from these initiatives.
- Details of their engagement with policymakers.
- (For organisations that outsource some or all of their investment management or related activities) Details of how responsible investment and ESG issues are considered in manager appointment/reappointment, monitoring and reward processes, and the manner in which these issues influence appointments and rewards.

RELEVANT INITIATIVES: SOME EXAMPLES

- The PRI is currently (as at February 2013) revising its reporting requirements for PRI signatories. All PRI signatories will be required to report against this framework from 2013.⁴⁴ A portion of the reports will be made publically available from 2014.
- The PRI has developed a responsible investment tool for asset owners, "Aligning ESG Expectations: Guidance for incorporating ESG factors into manager selection, appointment and monitoring", that provides guidance to asset owners on how they can implement manager selection, appointment monitoring policies and processes that take of investment manager's approaches to responsible investment.⁴⁵

It is important to recognise that formal reporting requirements such as the PRI's reporting framework will not necessarily meet all of the demands for investor transparency. For example, ESG research providers are likely to need a more detailed account of how ESG data and information is, or might be, used in investment research and decision-making, and NGOs will look for a more comprehensive account of how the issues that they have raised have actually been addressed. Therefore, investors may need to be more open with certain stakeholders about how they implement their responsible investment commitments, e.g. which ESG

information do they use, how do they use this information, what influence has this information had on their decisions and actions, what outcomes (e.g. changes to investment portfolios, changes in corporate practices and performance) have resulted from the actions that they have taken.

One of the recurring themes in this report is the relative lack of robust academic research on the investment benefits of a focus on ESG issues. One of the key reasons is that most of the evidence required for this research is not readily available to researchers. To increase the quality of the academic research in this area, investors need to provide academics/researchers with access to information on, for example, the investment returns from different approaches to ESG integration or the outcomes that result from their engagement.⁴⁶

4.7 ENCOURAGING LONGER-TERM APPROACHES TO INVESTMENT

The prevailing focus of most investors on short-term drivers of investment value was identified by many of the project participants as the most significant challenge to a more sustainable investment system. Much of the dissatisfaction with the current operation of the investment system could also be directly attributed to the mismatch of timeframes (i.e. the short timeframes that characterise much investment decision-making, and the longer timeframes over which companies need to implement their strategies and that NGOs and other stakeholders see as relevant to sustainability issues such as climate change) that characterise the investment system.

While addressing this issue goes far beyond the scope of this project, the proposals set out in Sections 4.1-4.6 should help address some of the underlying causes, through making a clear financial case for investors to take a longer-term view, through creating at least some market pressures for investors to strengthen their approaches to responsible investment,

and through strengthening investors' relationship with wider society. The proposals should also help (through building capacity, through framing the debate) create the space for a more structured and informed dialogue between companies, investors and stakeholders about the purpose of the investment system and the actions to be taken to maximise the contribution of investors to the goals of sustainable development.

Despite the importance of these contributions, it is essential to recognise that building capacity is a necessary but not a sufficient condition to addressing the issue of short-termism. Ultimately, the contribution that any of the measures can make here will be limited by the context within which the actors function and operate. If investment practice remains fixated on short term issues, it will continue to exhibit the characteristics and problems that have been highlighted in this research. In that context, improved capacity may help but it will not change the essential characteristics of the investment system.

CURRENT INITIATIVES

There is a huge amount of work – research projects, working groups – being conducted into the issue of short-termism in investment markets, and how this may be addressed. Examples include:

- The Kay Review of UK Equity Markets and Long-term Decision Making.⁴⁷
- The Eumedion study of the shareholding periods of Dutch Investors.⁴⁸
- The OECD's Institutional Investors and Long-term Investment project.⁴⁹
- The Long-Term Investors Club.50

^{43.} It should be noted that this list of issues mirrors the topics that are likely to be included in the reporting framework that all PRI signatories will be required to report against from 2013. See further http://www.unpri.org/areas-of-work/reporting-and-assessment/

^{44.} http://www.unpri.org/areas-of-work/reporting-and-assessment/

^{45.} http://www.unpri.org/wp-content/uploads/Aligning_Expectations_2013.pdf

^{46.} There are, of course, confidentiality issues with allowing third parties access to such data but investors generally address this through requiring researchers to sign confidentiality agreements and, as required, imposing some conditions on the information that is put into the public domain.

^{47.} Kay (2012) (Note 5).
48. Frans de Roon and Alfred Slager (2012), Duration and Turnover of Dutch Equity Ownership: A Case Study of Dutch Institutional Investors (Tilburg University, Tilburg, The Netherlands)

^{49.} http://www.oecd.org/fr/assurance/pensionsprivees/institutionalinvestorsandlong-terminvestment.htm 50. www.ltic.org

5. CONCLUDING COMMENTS

Building capacity is both a multi-stakeholder process (where multiple stakeholders contribute), but it is also specific to each stakeholder. The decision on whether capacity building is an individual or collective activity will need to be decided on a case-by-case basis, rather than simply arguing that a capacity need must be addressed by an individual stakeholder group or by all stakeholders acting together. In practice, both are likely to be required.

As indicated in the examples throughout this report and appendices, there is actually a significant body of information (data, tools, experience) already available. For example, there are an increasing number of academic articles that demonstrate the relationship between responsible investment/ESG analysis and long-term investment performance, there are a number of business schools that offer courses and modules on responsible investment, there are guidance documents on the design and implementation of responsible investment, and there are guidance documents and tools on how ESG issues may be integrated into investment processes.

However, relatively little of this has been effectively communicated. There are various reasons: in some cases, it is because the information is known to one stakeholder group but not shared or made available beyond that group; in others, the information is available but is effectively hidden in an obscure website; in others, it is because the networks (whether formal or informal) are not available to enable the distribution of information or knowledge; in others it is simply because the different actors have not communicated their needs and information; in others, it is because the views of some actors are not heard or perceived as important ('the dialogue of the deaf' that characterises many discussions in the responsible investment area).

In many cases, what is needed is not more research or more development of tools but simply to ensure that the work and research that has been done is effectively disseminated and is readily available to others who may be interested.

"In many cases, what is needed is not more research or more development of tools but simply to ensure that the work and research that has been done is effectively disseminated and is readily available to others who may be interested."

There is a related point which is that many of the stakeholders we interviewed are relatively isolated, with most of their interaction with their peers rather than more systematically developing communities of practice where stakeholders from different areas engage, share knowledge and experiences, share views and perceptions, and identify areas of common interest and areas of divergent interest.

At the same time as all the above, and as highlighted elsewhere in this report, there is a critical need for research and evidence that that demonstrates the investment value that can be derived through a focus on ESG factors, and in particular research that demonstrates the longer-term benefits of this approach in both financial and wider social and environmental terms.

"There is a critical need for research and evidence that that demonstrates the investment value that can be derived through a focus on ESG factors, and in particular research that demonstrates the longer-term benefits of this approach in both financial and wider social and environmental terms."

APPENDIX 1: INVESTORS

INTRODUCTION

Investors influence company performance on environmental, social and governance (ESG) issues in a variety of ways, including through the price/market signals resulting from their investment activities, through the manner in which they cast their votes and use the other formal rights granted to them as investors, through their dialogue with companies, through their ability to impact on companies' brand/reputation, and through their influence on public policy. There is a growing body of evidence that investors, through a combination of active ownership and the integration of ESG issues into their investment research and decision-making activities, can make a significant difference to ESG performance, outcomes and reporting by investee companies, and that, in turn, these activities can make a significant contribution to improved investment performance.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of ESG issues and of the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems. It is driven by the growing recognition in the financial community that effective research, analysis and evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term, and that this analysis should inform asset allocation, stock selection, portfolio construction, shareholder engagement and voting.

"Effective research, analysis and evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term."

While the potential contribution of responsible investment is enormous, it is also the case that responsible investment remains a relatively novel activity for many investment organisations, and, at least to date, issues such as the capacity needs of the industry have received relatively little academic/research attention.

METHODOLOGY

PRI's signatories cover a wide variety of asset classes, organisational sizes, and geographies. Moreover, PRI signatories are at very different stages of implementing their commitments to PRI, ranging from those that have only just started the process of integrating ESG issues into their practices and processes, through to those who have well established responsible investment processes.

To assess the current state of play in the responsible investment industry, we used the most recent (2011) comprehensive survey that PRI conducted of its members as the basis for our analysis. In 2011, 539 signatories participated in the survey, with investment managers representing 64% of total responses and asset owners 36%, a distribution which is broadly representative of the PRI Initiative's signatory base as a whole. The majority of responses came from Australia, France, Netherlands, the United Kingdom and the United States, a distribution which is, again, broadly reflective of the signatory base as a whole.

We used the PRI's 2011 Report on Progress² (which was based on the PRI's survey) to provide a high level indication of investors' capacity to analyse and use environmental, social and governance information.

One of the limitations of the report is that it primarily provides an overview of investor practices in the round, rather than focusing on issues such as the actual capacity needs of investors including the current and future challenges that they face in implementing their responsible investment commitments. We, therefore, supplemented the high level data from the report with a review of the responses provided by 20 asset owners and 20 asset managers³ to the following open-ended questions in the PRI survey:

- Question 78: Please describe the main benefits your organisation has enjoyed as a result of adopting the PRI.
- Question 79: What has your organisation changed as a direct result of becoming a PRI signatory?
- Question 80: What are the top three activities the PRI Secretariat could undertake to support and encourage further implementation of the Principles by current and prospective signatories?
- Question 81: What are your top three PRI related goals/ priorities for 2011?
- Question 82: What were the most significant achievements in 2010 in terms of your implementation of the Principles?
- Question 83: What were the biggest barriers in 2010 in terms to your implementation of the Principles?.
- Question 84: Please indicate which Principle you find most difficult to implement, and which Principle you find least difficult to implement.

A draft of this Appendix was reviewed by two PRI representatives and by two representatives of PRI signatories (see Table 1A). While the findings presented here reflect the feedback received, they should not be taken as formal statements of any of these individuals' views on responsible investment or the capital markets.

See, for example, Macro Becht, Julian Franks, Colin Mayer and Stefano Rossi (2009), 'Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Funds', The Review of Financial Studies, Vol. 22, No. 8, pp. 3093-3129; Alon Brav, Wei Jiang, Frank Partnoy and Randall Thomas (2008), 'The Returns to Hedge Fund Activism. ECGI Law Working Paper N°.098/2008 (http://ssrn.com/abstract=1111778); Elroy Dimson, Oguzhan Karakas & Xi Li (2012), 'Activism on Corporate Social Responsibility' (http://www.inquire-europe.org/research.html); Deutsche Bank Climate Change Advisers (2012), Sustainable Investing. Establishing Long Term Value and Performance. June 2012 (DBCCA, New York).

^{2.} http://www.unpri.org/publications/2011_report_on_progress.pdf

^{3.} The forty signatories were selected at random from those who had given comprehensive answers to questions 78-83, which were voluntary in the 2011 reporting survey. The selection represents, as far as possible, the PRI signatory base as a whole in terms of geographic region and size.

FINDINGS

1. ESG INTEGRATION: THE STATE OF PLAY

The responses to the 2011 survey suggest that the majority of PRI's signatories have started to integrate consideration of ESG issues into at least some of their investments. To date, most progress has been made in relation to listed equities in developed markets (reflecting the general better quality of information that is available from companies in these markets), although there has also been significant progress in private equity, infrastructure and fixed income, and growing attention on ESG issues in emerging markets.

While investors are paying increased attention to ESG issues, many acknowledged that the integration of these issues into investment decision-making remains a major challenge. A number of respondents pointed to the need for better data on ESG issues and for better tools and methodologies for the integration of ESG issues into investment research and decision-making processes.

More generally, a number of respondents noted that while there is a general acknowledgement that ESG issues can be financially material, the reality is that most ESG issues are either intangible or long-term and it is, therefore, difficult to reflect them in current valuations given that the market tends to discount or even ignore longer-term impacts. In this regard, one investment management signatory commented that: 'Although a fund manager may accept a prima facie case for the unsustainability of certain activities, he or she will find it hard to justify a material modification to their share price expectations if they believe the market will not recognise this issue within a 2-year timeframe'. A related issue is that, given the technical difficulties in integrating ESG issues into conventional investment processes, the transaction costs (research costs, human resources) may outweigh any benefits that may accrue from this integration.

"The reality is that most ESG issues are either intangible or long-term and it is, therefore, difficult to reflect them in current valuations given that the market tends to discount or even ignore longer-term impacts."

Asset owners raised similar issues about materiality and the value of integrating ESG issues into their investment processes, with a number highlighting a lack of clear evidence on the materiality of ESG to investment performance. Asset owners stressed the importance of developing this evidence base as they want to be able to demonstrate the impact or relevance of ESG factors to portfolio performance over the long term to counter the resistance by internal and external investment managers to integrating consideration of ESG issues into their investment research and decision-making processes. One asset owner respondent commented: 'The most significant barrier to implementing Principle 1 is the perception amongst investment stakeholders that sustainability is an 'add on' rather than a mainstream concept...We find that we often have to educate our stakeholders on what sustainability is, what it means for a superannuation fund, why it is our central operating principle, how we do it, and how it contributes to better long term shareholder value over the long term.'

"The most significant barrier to implementing Principle 1 [the incorporation of ESG issues into investment decision-making] is the perception amongst investment stakeholders that sustainability is an 'add on' rather than a mainstream concept."

2.ENCOURAGING IMPROVED CORPORATE DISCLOSURES IS A KEY FOCUS FOR INVESTORS

In their answers to the open-ended questions in the PRI survey, many of the respondents noted that common barriers to the integration of ESG issues into investment decisions are the general lack of consistent and comparable data on companies' ESG performance, and the lack of information on how ESG-related issues impact on or relate to company strategy. These issues are particularly relevant for smaller companies (probably reflecting the more limited resources they have available for this sort of reporting) and for asset classes outside listed equities.

"Common barriers to the integration of ESG issues into investment decisions are the general lack of consistent and comparable data on companies' ESG performance, and the lack of information on how ESG-related issues impact on or relate to company strategy."

The PRI's 2011 Report on Progress indicated that many signatories were seeking ESG disclosure from investee companies and were encouraging standardised reporting. For example, 71% of signatories had asked companies to integrate ESG information into their financial reporting, and almost 45% had asked companies to use the Global Reporting Initiative (GRI) as a reporting framework. It is relevant to note that the focus of these efforts has extended beyond listed equities, with signatories reporting that they were also pressing companies in other asset classes (notably infrastructure, private equity, corporate fixed income and non-listed real estate) to improve their disclosures.

One of the striking features was the role being played by asset owners in this process, with over 60% of asset owners reporting that they had asked their investment managers to collect ESG-related information from the companies in which they were invested.

While investors have played an important role in encouraging improved corporate reporting, a number of interesting messages emerged from the analysis of detailed responses:

There is no 'one-size-fits-all' approach to how investors are incorporating ESG issues into their investment decisions. While investors have been supportive of improved reporting (in terms of the breadth, the depth and the quality of reporting), many are yet to use more than a small proportion of the reported data in their investment processes. A number of investment managers acknowledged that companies receive mixed messages from investors on their ESG information requirements, and that companies have complained that they don't know what ESG information investors expect them to provide.⁴

- There is a multiplicity of ESG ratings and ESG research providers. This makes it difficult for investors to understand which ratings are more or less reliable indicators of corporate responsibility and corporate governance performance. This is compounded by the fact that ESG research providers generally do not provide an assessment of the financial implications of the issues that they are researched (see, further, Appendix 2). This has led to some investors developing their own tools and their own information requests, further increasing the reporting burden on companies.
- Investors are not the only stakeholder with an interest in ESG information, and companies need to balance the needs of investors with the needs of other stakeholders. The consequence is that it is often difficult for investors to find the information that they consider relevant to their particular interests.
- Investors expect companies to provide both integrated reporting (where companies explain how ESG issues are relevant to their wider business strategy, over the short and long term) and data on their performance on specific ESG issues. That is, the demand for integrated reporting should not be seen as a suggestion that companies do not also provide the granular information that investors, and other stakeholders, are also interested in.
- Investors do not confine themselves to the information provided by companies in their annual and CSR/ sustainability reports. Investors also look at the information provided by companies to initiatives such as the Carbon Disclosure Project, and will supplement the information published by companies with one-to-one meetings and information requests on specific issues. For example, almost a third of the respondents to the PRI's survey indicated that they also use surveys or other tools to obtain company-specific information on ESG issues.

"Investors expect companies to provide both integrated reporting (where companies explain how ESG issues are relevant to their wider business strategy, over the short and long term) and data on their performance on specific ESG issues."

3. ASSET OWNERS ARE A KEY INFLUENCE

Most of the investment manager signatories to the PRI acknowledge that the demands of their clients (in particular, asset owners) are a key influence on the decisions they have taken in relation to responsible investment, including decisions on whether or not to sign the PRI, what level of resources to commit to responsible investment, and what responsible investment activities they should undertake.

The PRI's survey suggests that many asset owners are paying attention to their investment managers' approach to responsible investment. For example, over three-quarters of the asset owner respondents stated that they look for ESG capacity when searching for external investment managers, and two-third include ESG criteria in management contracts.

Moreover, three quarters of asset owners and investment managers reported that they include criteria on ESG issues when buying research.

4. INVESTORS ARE STARTING TO BE MORE TRANSPARENT ABOUT THEIR APPROACHES TO RESPONSIBLE INVESTMENT

The investment community's transparency on its approach to responsible investment has increased, with 44% of the respondents to the PRI's survey making their responses publicly available through the PRI's website, compared to 40% in 2010 and 25% in 2009. This trend towards transparency has occurred in many regions of the world; for example, 48% of South African signatories and 56% of Brazilian signatories made their responses publicly available. It is relevant to note, however, that the corresponding rates for Asia were just 13% in 2010 and 16% in 2011.

Beyond their responses to the PRI's survey, a growing number of PRI signatories now provide information on their approaches to responsible investment. For example, the 2011 PRI survey found that 93% of respondents provide at least some information on how they integrate ESG issues into their investment processes, 59% publicly disclose their voting policy on listed equities, and 45% publicly disclose their active ownership policies.

However, views on the merits of increased disclosure were mixed, with a number of investment managers pointing to the tensions between public reporting (and generally being transparent) and the need to keep proprietary information private. In addition, a number queried whether their performance on responsible investment was actually a material factor in client decision-making (e.g. in appointment/ re-appointment processes) with one respondent noting 'Only rarely do we get further questions [from our clients] on the information provided in these surveys', and another commenting 'ESG issues have not yet become a key talking point for investors'. There are some signs of change, with a number of asset owners reporting that they were in active dialogue with their external investment managers in relation to ESG related risks and how they integrate these risks into their investment decision-making processes. Several reported that one of their aims was to strengthen the emphasis on responsible investment/ESG issues in their manager selection processes.

A number of asset owners were critical of the disclosures being provided by investment managers, noting that the gaps in the information (e.g. in relation to the importance assigned to ESG issues in their investment processes, the specific ESG issues considered, the scope of their responsible investment

4. See also Appendix 3 (Companies) where similar issues were raised by companies.

APPENDIX 2: ESG RESEARCH PROVIDERS

commitments, the resources allocated to responsible investment) provided meant that it was very difficult to differentiate between those investment managers who did a good job on responsible investment and those that did not. One asset owner respondent noted that there is '...work to be done to improve contracting with fund managers, particularly in asset classes or portfolios which are managed externally; the goal should be to improve disclosure around ESG'. One of the challenges that investment managers face is how best to respond to diversity of issues raised by those asset owner clients that are interested in ESG issues, while simultaneously delivering on the investment goals of the 'silent majority'.

A number of the asset owner respondents noted that they had improved their reporting of ESG issues, both internally (e.g. to their boards on the incorporation of ESG into investment decision-making) and externally (to members, clients and other stakeholders through specific ESG publications, annual reports and the provision of policy and other information on their websites). Despite this progress, the PRI Report on Progress indicated that only 8% of asset owner signatories report on their approach to responsible investment to their beneficiaries.

5. CAPACITY ISSUES

Both asset owner and asset manager respondents noted that they faced significant capacity constraints in implementing their responsible investment commitments. These related both to the resources available for responsible investment and the skills, knowledge and expertise available.

In relation to resources, the major complaint related to the amount of time consumed by activities that were seen as less relevant to their core responsible investment commitments. The burden of reporting was one area. Another, and probably more significant, was the amount of time required to simply gather basic information. For example, in relation to companies, a number of respondents noted that the enormous gaps in the ESG data available mean that a significant amount of time is required simply to gather information on companies' ESG policies, performance and programmes. Commenting on this issue, one asset owner signatory noted: 'The quality of ESG data needs to improve, and investors must insist on key performance indicators which can be integrated into financial statements and suitably verified'.

The enormous gaps in the ESG data available mean that a significant amount of time is required simply to gather information on companies' ESG policies, performance and programmes

While the issue of resources, in part, reflects the question of the tasks individuals are charged with carrying out, it is also important to recognise that the resources being allocated to responsible investment seem to be insufficient relative to the scale of the work that is needed. As an illustration, in relation to the monitoring of investment managers, the PRI Report on Progress indicated that only one in four of those signatories that have detailed agreements in place with

managers to address ESG issues, consider that they closely monitor their external managers' performance, and that 9% do not monitor at all. In relation to the issue of resources more generally, one asset owner respondent wrote: 'Across all Principles [of the PRI], the biggest barrier faced is lack of time and resources. We believe that we are quite effective in our implementation given our circumstances, but we could do much more if additional resources could be justified.'

In relation to skills, knowledge and expertise, the main issues related to the challenges around ESG integration. There were a number of aspects to this. The first is that, until very recently, traditional training for financial analysts did not include content on ESG issues; this lack of ESG content meant that many analysts had limited interest in ESG issues and that a significant amount of work was needed simply to build their awareness of the wide scope and materiality of ESG issues. The second is that ESG integration is relatively novel and so there is relatively limited information (e.g. tools, case-studies) on how investors might approach the integration of ESG issues into their investment processes and decision-making. This is compounded by the emphasis of investment managers on the 'uniqueness' and proprietary nature of their investment processes, which has meant that there has been a general reluctance to share experiences and learn from the experiences of others, causing a relative lack of cross-fertilisation (i.e. of ESG analysts moving between investment managers).

"ESG integration is relatively novel and so there is relatively limited information (e.g. tools, case-studies) on how investors might approach the integration of ESG issues into their investment processes and decision-making."

Investment managers have taken a variety of actions to address these capacity gaps. Examples of the actions taken include: convening regular meetings with fund managers to discuss material ESG issues on a sector-by-sector basis, providing awareness training on responsible investment and ESG-related issues, enrolling key individuals on training courses, bringing ESG analysts and 'mainstream' analysts into the one research team, joining investor networks that focus on ESG issues. Asset owners reported that they had taken similar actions, including introducing ESG training for investment staff on ESG topics/ themes and providing asset class specific training on ESG issues.

TABLE 1A: REVIEWERS

Name	Organisation
Helen Charrier	Caisse des Dépôts
Titia Sjenitzer	PRI
Christopher Sperling	PRI
Rick Stathers	Schroder Investment Management

INTRODUCTION: ABOUT ESG RESEARCH PROVIDERS

ESG research providers provide a range of ESG-related tools and information to the investment industry. These include ratings of company ESG practices and performance, assessments of whether companies meet specific product, activity or performance-related criteria, and assessments of countries on issues such as corruption, human rights and environmental protection. These ratings and assessments are then used by their investor clients to construct investment portfolios in line with the clients¹ ESG policies; for example, they may be used to exclude companies from negatively screened (or 'ethical') funds or to inform decisions on the over- or underweighting of particular stocks. More recently, investors have started to explore whether these ratings and assessments can be used to support their engagement (e.g. to identify leaders and laggards, to identify weaknesses in companies' management systems and processes) and to inform their investment decisions (e.g. to identify country-specific risks).

ESG research providers also produce other research, including bespoke company, sectoral or country research, research on new or emerging issues, and analysis of trends in ESG performance. This research may be produced in response to client demand or it may also be a form of marketing (e.g. a number of research providers publish reports on ESG issues).

One of the important characteristics of the ESG research industry is that most of the research providers do not do financial appraisals. Rather they primarily produce research and information on ESG issues.

METHODOLOGY

We interviewed ten of the leading ESG research providers (see Table 2A) in the period August-October 2012. These organisations were chosen because they cover the broad spectrum of ESG research products, because they have diverse client bases (in terms of geographies, asset classes, approaches to responsible investment), and because of their representativeness (in terms of the commercial and other pressures that they face) of the ESG research industry as a whole.

We conducted a one hour structured interview with each organisation focusing on the following issues:

- Research methodology, including the ESG information used in research. the primary focus was on company-related ESG research, and the products and services offered based on this research
- Organisational capacity and resources, with a particular focus on the research/analytical skills and competences required of their staff.
- How their investor clients use the ESG information provided to them.

 How they see the ESG research market changing over time, and the implications for their organisation.

Following the interviews, a draft of this Appendix was circulated to the individuals interviewed for review and comment.

Note: While the views and findings presented here are based on the interviews and the subsequent feedback received, they should not be taken as formal statements of any individual ESG research provider's position on responsible investment or the capital markets.

KEY FINDINGS

1. ESG INFORMATION

All of the research providers rely heavily on publicly available company-reported information (annual reports, CSR/ sustainability reports, website content) for their ratings and assessments. The interviewees made a number of general comments about this information:

- The data provided by companies varies widely in terms of its breadth, its quality, its accessibility and, ultimately, its usefulness. Some companies provide very high quality information (in terms of breadth and rigour), others fail to report on ESG issues at all, and some skirt around indicators and data even when they claim to be adhering to or following common standards such as the Greenhouse Gas Protocol or the Global Reporting Initiative. A number of interviewees noted that reporting varies by region, with emerging market company disclosures seen as being of particularly poor quality.
- Company reporting is often static, with relatively little change in the information and text provided from year to year. This makes it difficult to determine what, if any, changes have occurred in performance. This is compounded by companies rarely explicitly identifying areas where things have not changed in the reporting period.
- Most of the research organisations back up this published information by seeking company feedback through emails and phone interviews. Opinions are mixed on the worth of this engagement. Some see it as hugely valuable (and as an integral part of their process) whereas others are sceptical about the value of this information, preferring instead to rely on published (and preferably audited) information. In general, where companies provide information beyond the materials in publicly available reports, research providers ask companies to provide supporting documentation for the information provided.
- The maturity of an issue is a key determinant of the quality of reporting on the issue. Reporting on issues that have been of concern for some time (e.g. climate change) inevitably tends to be much more developed and robust than reporting on issues that are of more recent concern. In situations where reporting is less well developed, research providers have to rely on engagement to gather this information, although it is often the case that the information provided through such engagement can be difficult to verify.

^{1.} The ESG research industry's clients span the investment industry, and include pension funds, investment managers, investment and private banks, insurance companies, charities and foundations.

Companies generally have their Investor Relations and Communications departments as a first point of contact. While the individuals in these departments are often well informed about wider corporate strategy-related issues, they generally do not have the specialist expertise to answer detailed questions. Some of the interviewees argued that companies should provide greater access to the technical people who could answer these more detailed technical questions.

"The data provided by companies varies widely in terms of its breadth, its quality, its accessibility and, ultimately, its usefulness."

"Reporting on issues that have been of concern for some time (e.g. climate change) inevitably tends to be much more developed and robust than reporting on issues that are of more recent concern."

ESG research providers use a range of information sources to supplement the information they receive from companies. These include:

- NGO reports: These are valuable because of NGOs' watchdog role, in particular in emerging markets where it is often difficult to gather robust information on corporate activity. However, all of the research providers stressed that, where NGOs have made allegations against a company, the research providers always seek to obtain information from the company concerned as an integral part of reviewing and verifying the allegation.
- News sources, including press monitoring services.
- Third party data providers such as Thomson Reuters, Bloomberg, Capital Q and Factiva.
- Industry and trade association data and reports.
- Reports from international organisations such as the United Nations.
- Data from regulatory bodies. A number of those interviewed commented that many regulatory bodies have information (e.g. environmental performance information on emissions and other releases, health and safety information such as accident and injury rates, compliance information) that would be very useful if it was made publicly available, as it would enable researchers to focus more closely on performance rather than management processes.

The ESG research providers agreed that while there is no particular hierarchy in terms of the usefulness or robustness of information sources, it is good practice to consider multiple sources to develop a holistic assessment of the company or issue in question.

"While there is no particular hierarchy in terms of the usefulness or robustness of information sources, it is good practice to consider multiple sources to develop a holistic assessment of the company or issue in question."

2. RESEARCH METHODOLOGIES

While each research provider has its own approach to evaluating companies (in terms of the parameters they look at, the information sources they use, the way in which they present their data and information to clients, etc.), all have detailed guidance and methodology documents that they use to specify how their company research is conducted and how they analyse or rate companies. The research providers all have quality assurance systems and processes (data checking, calculation/analysis checks, report reviews, etc.) that they use to ensure that their analysts consistently follow the approaches set out in their guidance and methodology documents.

The research providers also conduct regular reviews of their overall research processes and methodologies. Most of those interviewed commented that their underlying research methodologies have not changed significantly over the past five years, although the coverage (in terms of the number of issues, companies and regions) has grown significantly.

3. SOCIAL ISSUES: A KEY RESEARCH CHALLENGE

While the ESG research providers consider the assessment of environmental and governance issues to be reasonably well developed, many of those interviewed considered that social issues remain particularly difficult to research. This is of particular importance given that investors are starting to pay much greater attention to these issues. There are a number of issues at play:

- Information on social issues can be difficult to obtain.
- Corporate reporting on social issues is generally seen as the weakest part of ESG reporting.
- Social issues are frequently difficult to express/ present in quantitative terms.
- For many social issues there is a lack of consensus around the performance expectations of companies. This makes it difficult for researchers to assess whether or not a company is behaving in an appropriate manner. There are exceptions; interviewees pointed to issues such as labour standards, cluster bombs and controversial weapons where reasonably clear expectations of companies have been defined.

4. SKILLS AND EXPERTISE

For each of the research providers interviewed, most of the company research is carried out by internal staff although certain tasks (e.g. press scanning) are often outsourced. While the following discussion focuses on internal staff, it is relevant to note that the research providers also have access to external expertise; a number have advisory boards (or equivalent structures) and a number noted that they also use external consultants to support them on specific issues or with research in specific markets.

While none of the research providers had highly prescriptive requirements, there was a general consensus around the basic attributes/skills they would look for when recruiting for analyst/research positions (typically those requiring 1-5 years' experience) (see Box 1).

BOX 1: DESIRABLE SKILLS/ATTRIBUTES FOR ANALYST/RESEARCH POSITIONS

- A good undergraduate or, for more senior positions, postgraduate degree (e.g. in business, environmental science and policy, human rights).
- Some research experience (although not necessarily to PhD standard).
- Good knowledge of environmental, social and governance issues (as relevant to the position in question).
- Language skills.
- Basic knowledge of finance and investment.

Most provide thorough on the job training on their research models and processes (this is the primary way that employees are 'brought up to speed'), internal training on project management, report writing and research methods, and occasionally supplement this with some external training such as that offered by the Responsible Investment Academy,² and participation in conferences and seminars.

Most of those interviewed did not see that they faced particular capacity challenges in delivering on their core products and services. There was a general view that the industry is able to attract well qualified individuals, and that any skills/knowledge gaps can be readily addressed through on the job training. The one significant gap identified was that current training does not generally focus on developing finance/investment skills. However, those interviewed suggested that such training and skills development was of less importance given that these analysts/researchers are primarily focused on the delivery of their existing products and services.

For more senior positions, there is a clear view that these individuals increasingly need to have a background in investment/finance. This relates both to their experience and to their professional qualifications, with a number of interviewees noting that qualifications such as the CFA are likely to become more common in the ESG research industry. As discussed further below, as clients have started to pay greater attention to the investment implications of ESG issues, ESG research providers are increasingly expected to link their research to drivers of investment value.

"ESG research providers are increasingly expected to link their research to drivers of investment value."

5. HOW DO INVESTORS USE ESG INFORMATION?

Clients use the information provided by their ESG research providers in a number of ways – to select companies for inclusion in or exclusion from specific funds, to inform decisions on the over- or under-weighting of particular stocks, to support

engagement and to inform investment decisions (e.g. to identify country-specific risks). From interviews with ESG research providers a number of common themes emerge:

- The level of engagement between the ESG research providers and their investment clients differs significantly, with many reporting that they receive relatively little routine feedback from these clients. This has been exacerbated by the investment that many have made in developing online research portals/platforms that allow clients direct access to data and information, without needing to go via the ESG research provider.
- While the ESG research providers see their clients having increasing interest in ESG information, they do not have detailed information on how their data are actually being used, which data are seen as being of more or less value, etc. In part, this reflects the reality that many clients are developing their approach to ESG integration and so it is premature for them to specify the data that they need for this process. However, it also seems to reflect more general lack of information about clients' research processes and methods. A recurring message from the interviews was that investors/clients generally do a very poor job of explaining where/how they use ESG information and to what extent they find it useful.
- The one point where there is a detailed dialogue is when a client is making a decision on the appointment or reappointment of an ESG research provider. This process tends to involve meetings, demonstrations and explanations on the research methodology and outputs, as well as extensive discussion of how the data and information may be used.
- The research providers do make significant efforts to address this lack of communication and feedback. Approximately half conduct yearly client surveys or organise meetings and events to evaluate client needs, others seek to have regular (6-12 monthly) meetings with key clients, and others track what data/information clients are downloading to evaluate usage.

6. CHANGING EXPECTATIONS AND DEMAND

Acknowledging the issues around the lack of client feedback noted above, the ESG research providers agreed that clients are paying much more attention to ESG factors in their investment research. This has been driven by a range of factors: the growing recognition that these issues can be financially material; the sense that it may be possible to generate better investment performance through a focus on these issues; the fact that ESG data and analysis is increasingly robust; the availability of these data (both through the ESG research providers' own platforms and from providers such as Bloomberg) that makes it much easier to collate and analyse ESG data sets; wider market pressures as a result of the Principles for Responsible Investment.

This change is starting to affect ESG research providers. Most of those interviewed commented that clients are increasingly asking about the 'investment relevance' of the research that they provide, even for products (e.g. sector screens) that were primarily established to support ethical (screened) funds. This, in turn, has meant that the ESG research providers have had to

2. http://www.riacademy.org/

think about both what sort of research they produce and about how they support this research (e.g. in helping clients think through the investment implications of the research).

While ESG research providers do expect growth in market interest in ESG information, they also noted that ESG integration is not progressing as fast as many assume and that there are many analysts and investment managers who have vet to consider how they might incorporate ESG information into their investment processes. There are various reasons, although the two that were consistently identified by interviewees as being important were (a) scepticism that a focus on ESG issues can add investment value, and (b) concern that the research and other transaction costs associated with ESG integration outweigh the investment benefits that accrue.

"While ESG research providers do expect growth in market interest in ESG information, they also noted Benchmark companies, to identify leaders/laggards or good/ that ESG integration is not progressing as fast as many assume and that there are many analysts and investment managers who have yet to consider how they might incorporate ESG information into their investment processes."

7. INVESTMENT TIME-HORIZONS

One of the major challenges that ESG research providers are encountering relates to investment timeframes. A number of those interviewed noted that their clients often want daily (or even 'instantaneous') updates even though ESG research providers' research processes (information gathering, checking, etc.) generally operate on much longer timeframes. Of perhaps greater concern is that, when looking at financial impacts, most clients are primarily interested in information on near term (3-6 month) financial impacts, whereas many of the issues analysed by the ESG research organisations play out over much longer periods. A number of those interviewed commented that their clients' lack of interest in long-term impacts and in wider debates (e.g. around sustainable financial markets) reflected, at least in part, the lack of interest being paid by investment managers' clients (i.e. asset owners) to these issues. That is, the relative lack of attention on longer-term issues in the discussions between ESG research providers and their clients reflects the investment objectives that these clients have been charged with delivering.

"The relative lack of attention on longer-term issues in the discussions between ESG research providers and their clients reflects the investment objectives that these clients have been charged with delivering."

8. PRODUCT ADAPTATION AND EXPANSION

Apart from more explicitly linking their research to investment value drivers, the ESG research providers noted that they are also being pressed by their clients to develop their research in a number of other ways. Clients are looking for the ESG research providers to:

- Move beyond listed equities and provide ratings for asset classes such as private equity and fixed income. While the basic research methodologies are the same, this research is much more difficult because reporting is, generally, much less well developed than listed companies.
- Provide quantitative rather than qualitative ratings of companies. Most of the research providers indicated that they are now able to provide both quantitative and qualitative assessments of companies.
- poor performers. Most of the research providers indicated that this type of analysis is reasonably straightforward to carry out based on their company data and information.
- Improve their coverage of emerging market companies.
- Provide access to raw data. Most of the research providers indicated that this is now a standard part of their service offering to clients.
- Provide much guicker access to information and commentary/analysis.
- Be more opinionated, in particular on the investment implications of ESG issues. A number of the research providers commented that they do not see themselves as investment analysts and that they are very uncomfortable with making recommendations on investment issues and impacts.

9. RESOURCES

All of the organisations we interviewed welcomed the greater attention being paid by investors to ESG issues. However, they also noted that this presented commercial challenges for them, in particular in relation to resources.

While the research providers were, broadly, satisfied that they had sufficient research/analytical resources to deliver their core products and services, they were concerned about the resource implications of the questions being asked by their clients. They noted that (for example) increasing the number of companies they cover, broadening their research to other asset classes, and providing clients with assistance with assessing the investment implications of particular ESG issues all had resource implications. They noted that this type of advice was generally not included in their core service proposition or contracts (which are generally for the provision of research and data), and that their clients simply expected to provide this additional advice and support within the terms of their existing contracts/service agreements. This concern was exacerbated by (a) the sense that clients would be unwilling to pay for this sort of advice

and support, (b) the risk that the investment industry moves relatively slowly in terms of ESG integration (i.e. that they invest in resources for a market that may not actually emerge).

Another issue raised was that while there is a consensus that the data and information provided by ESG research providers needs to evolve to meet clients' demands, clients are also reluctant to see significant changes in their research methods. A number of those interviewed noted that their clients do not want any significant changes to the methodology as many have built their investment processes (in particular, for screened funds) specifically around the research providers' systems and want it to be constant, reliable and comparable. That is, there is a significant degree of lock-in within the investment industry.

TABLE 2B: INTERVIEWEES

Name	Position	Organisation
Hans-Ulrich Beck	Head, Research & Product Development	Sustainalytics
Joshua Kendall	Client Relations and Communications Manager, EMEA	GMI Ratings
Danielle Wilson	Senior Risk Analyst	Maplecroft
Stephen Hine	Head of Responsible Investment Development	EIRIS
Fredric Nyström	Key Account Manager & Engagement Coordinator	GES
Martina Macpherson	Vice President, Marketing	MSCI
Antoine Begasse	Project Manager	Vigeo
Dominique Blanc	Head of SRI Research	Novethic
Tony Campos	Senior Executive, Responsible Investment	FTSE
Till Jung	Director International Relations	oekom

APPENDIX 3: INVESTMENT BANKS (SELL-SIDE)

INTRODUCTION

Investment banks (the 'sell-side') are a hugely important interface between companies and institutional investors. In the specific context of this project – Building the Capacity of Investment Actors to Use ESG Information – one of the critical roles of sell-side analysts (also referred to as equity research analysts) is the provision of research/analysis to institutional investors on the 'buy side' (investment managers, asset owners, insurance companies, etc). This research is used by buy-side analysts to inform their decisions on whether to buy or sell certain stocks.

The views that sell-side analysts express about issues – including environmental, social and governance (ESG) issues – and about company strategies are important; the views expressed by the sell-side have a large effect on market perceptions about particular stocks and about the issues that are relevant to these stocks. The sell-side also has extensive engagement with company management and, as a consequence, the level of attention paid by the sell-side to ESG issues provides a clear signal to corporate management about the importance assigned by institutional investors to these issues. Finally, the sell-side is important not only because of its influence but because many of the most interesting and innovative examples of how to integrate ESG issues into investment analysis and decision-making have come from the sell-side.

METHODOLOGY

We interviewed nine current or former sell-side analysts in the period December-January 2013 (see table 3A). These individuals were chosen because of their extensive experience in analysing ESG-related information for the purposes of investment decision-making, their exposure to a variety of client bases (in terms of geographies, asset classes, approaches to responsible investment), and their representativeness (in terms of the commercial and other pressures that they face) of the ESG research industry as a whole.

The interviews focused on the following broad issues:

- The quality of ESG-related information provided by companies.
- The key challenges sell-side analysts face in integrating ESG issues into their investment models.
- The skills/expertise needed to effectively analyse ESG issues.
- How the sell-side's clients (institutional investors on the buy-side) use ESG information.
- How the demand for ESG-related research is likely to evolve over time.

Following the interviews, a draft of this Appendix was circulated to the individuals interviewed for review and comment.

Note: While the views and findings presented here are based on the interviews and the subsequent feedback received, they should not be taken as formal statements of any individual's views on responsible investment or the capital markets.

FINDINGS

1. ESG ISSUES ARE MATERIAL AND ARE RECOGNISED AS IMPORTANT DRIVERS OF INVESTMENT VALUE

Institutional investors' overarching objective is to deliver investment performance/outperformance. The interviewees were at pains to point out that, within this frame of reference. if information (ESG-related or otherwise) can be used it will be used, and that ESG issues are treated no differently to other investment issues in that regard. Interviewees commented that it is simply incorrect to suggest that the investment industry doesn't understand ESG issues or the importance of ESG analysis. In fact, they agreed that the importance of ESG issues is widely recognised and accepted by the market, and that investors are very aware of the investment implications of issues such as climate change. They also noted that simply because a sell-side analysts does not explicitly write about ESG issues does not mean that s/he does not understand the issues; it is more usually the case that these issues are not seen as being of particular relevance to the stock(s) being reviewed over the timeframe in question.

"It is simply incorrect to suggest that the investment industry doesn't understand ESG issues or the importance of ESG analysis."

Investors use ESG information in a variety of ways. That is, rather than being a 'one size fits all' approach, the integration of ESG issues into investment research and decision-making can take a variety of forms. As one interviewee noted: "Finance doesn't work on data; it is a market of ideas and there is no single answer on how to analyse ESG issues. The challenge for investors is to decide the process that enables them to deliver the investment ideas that their clients want." While there are multiple ways to take account of ESG issues in investment research, analysts generally focus on the issues that they see as financially material, and pay much less attention to those ESG issues that are not seen as important drivers of investment value.

"Analysts generally focus on the issues that they see as financially material, and pay much less attention to those ESG issues that are not seen as important drivers of investment value."

One of the key challenges identified by the interviewees was how to incorporate ESG related data into "traditional" investment analysis. One interviewee argued that equity investment processes typically comprise the following stages: (a) forming a view of the macroeconomic environment, (ii) translating this view on the macroeconomic environment view into a series of 'input assumptions' (for example, in relation to demand growth, price changes, input costs) that can be used in investment models, (c) incorporating these input assumptions into some form of earnings or valuation model, (d) comparing the resulting earnings or valuation estimates with share prices, and (e)

identifying valuation anomalies which, when combined with view on upcoming catalysts or events, are used to determine overall investment views (which is generally an estimate of 'fair value' and a view on the investment decisions that should be taken based on this assessment). Interviewees argued that most ESG factors don't easily fit into this sort of process, noting that most of the input variables to valuation models are continuous and quantitative variables by nature (e.g. the forecasts for the price of oil move up and down in small increments). In contrast, 'classic' ESG information generated by specialist research providers or contained in company reporting tends to be relatively static (e.g. governance conditions), often qualitative (e.g. whether a company complies with legislation or not), often subjective, often lacking rigour (or, at least, not assured to the same degree as financial data), and frequently concerned about low probability or longer-term events or impacts. Interviewees acknowledged that properly accounting for ESG issues in investment analysis will require significant changes in (or rethinking of) investment processes and also significant changes in investors' views and attitudes (e.g. a willingness to think about longer-term factors, a willingness to explicitly account for low probability events in investment models).

"Properly accounting for ESG issues in investment analysiswill require significant changes in (or rethinking of) investment processes and significant changes in views and attitudes."

All of the interviewees stressed that the role of sell-side analysts is to provide an objective assessment of the likely future financial performance of stocks, not to offer ethical opinions on these stocks. For example, there is not necessarily a universal view on whether a particular set of ESG-related actions (e.g. a commitment to reducing greenhouse gas emissions) will be positive or negative for a business. This also applies to the analysis of public policy, with interviewees stressing that their role is to determine the most likely direction of public policy rather than assuming that policymakers will act in a way that is best for society, the economy or the environment.

2. ESG INFORMATION: DATA QUALITY

All of the interviewees agreed that company reporting on ESG issues – both in terms of breadth and quality – has improved significantly over the past decade. However, this reporting still falls short of the quality required. The major issues identified were:

- While some companies provide very high quality information (in terms of breadth and rigour), others do not report on ESG issues at all. Emerging market company disclosures are seen as being particularly limited.
- The information provided is generally not comparable, with inconsistencies in calculation methodologies and the scope of reporting making it very difficult to make meaningful comparisons between companies. This is compounded by the general lack of clarity around how the data were calculated, the scope/boundaries of reporting and the definitions of the indicators being reported. Interviewees acknowledged that the standardisation of ESG data is very difficult and may not be a realistic goal. However, they were also of the view that

companies could do much more to put their data into context by, for example, clearly defining the scope of the data and clearly specifying what the indicators cover (e.g. do employee turnover numbers include or exclude redundancies, what level of senior management is being referred to when companies report the proportion of women in senior management, do employee costs include or exclude elements such as employer pensions contributions and national insurance).

- Company reporting is often static, with relatively little change in the information and text provided from year to year. This makes it difficult to determine what, if any, changes have occurred in performance.
- ESG-related information is usually only reported once a year and is generally backward looking. This contrasts with other investment-relevant parameters (e.g. oil prices, share prices) which are updated much more frequently, and with financial information which tends to be much more forward-looking. As noted by one interviewee: "You can't have an integrated approach with backward looking data."
- Companies often do not put their ESG information into a business context, with relatively few explicitly discussing the risks and/or opportunities presented by these issues, the regulatory context, or the financial implications of these issues. This is compounded by the common tendency for companies to report on multiple indicators (to meet the demand from their various stakeholders) and their general reluctance to explicitly state which, if any, ESG issues are important value drivers for their business.
- Companies rarely discuss the implications of business strategy for ESG-related performance (e.g. what do job cuts mean for human capital or environmental performance?).

"You can't have an integrated approach with backward looking data."

Integrated reporting is seen as playing a critical role in aligning financial and non-financial performance reporting, as it will force companies to talk about how ESG issues are relevant to their business models and to strategy. This, in turn, should encourage companies to provide more forward-looking information, to focus on material ESG issues and to put ESG issues into a business context. Interviewees cautioned that while they are interested in more consistent and comparable reporting, they do not think that companies should be forced into reporting in the same way or against the same set of indicators. They agreed that companies should report on those metrics that they think are important and relevant to their businesses.

"Integrated reporting is seen as playing a critical role in aligning financial and non-financial performance reporting, as it will force companies to talk about how ESG issues are relevant to their business models and to strategy."

While interviewees were critical of the quality of the data provided by companies, their specific criticisms and reflections – and the aspects they identified as being of greater or lesser importance – depended on how they actually used these data.

^{1.} See, for example, the case-studies presented in Principles for Responsible Investment [PRI] (2013), Integrated Analysis: How investors are addressing environmental, social and governance factors in fundamental equity valuations - A Report from the PRI ESG Integration Working Group (PRI, London).

Those who were interested in making comparisons between companies on aspects of ESG performance tended to be more interested in the comparability and robustness of the data, whereas those who were interested in assessing business or financial implications were more interested in the company's assessment of the financial significance of different issues and of how these issues related to issues such as strategy and capital investment. In practice, most analysts do both.

A number of interviewees commented that the sell-side's approach to analysing ESG issues has shifted dramatically, from one where their research was based primarily on data availability to one where they first define what they need to understand for their investment decision-making and then they look for that information. For many, this is still seen as a work-inprogress, with interviewees pointing to the issues with data and data quality (discussed above), the challenges associated with developing clear relationships between ESG performance and drivers of investment performance, and the need to delineate between those ESG issues that are already (whether implicitly or explicitly) included in investment analysis and those that are not.

3. TIMEFRAMES

One of the major challenges for ESG integration is that of investment timeframes. The interviewees noted that the majority of buy-side clients tend to be predominantly interested in short-term drivers of investment value in their investment research, with the consequent downplaying or underemphasising of longer-term drivers of investment value. A number of those interviewed noted that most ESG issues are either intangible or long-term and that it is, therefore, difficult to reflect these issues in current valuations.

"The majority of buy-side clients tend to be predominantly interested in short-term drivers of investment value in their investment research, with the consequent downplaying or underemphasising of longer-term drivers of investment value."

4. SKILLS

The interviewees were in broad agreement that the key skills required for sell-side and buy-side analysts relate to the ability to analyse the investment implications of ESG issues, with interviewees pointing to the growing number of buy-side responsible investment analysts, in particular at a junior level, studying for the CFA qualification. Whereas knowledge of ESG issues is useful (and some knowledge/familiarity with the issues is essential), the key is how this knowledge may be used in investment decision-making. Among the comments made by interviewees were:

 "The key challenge is how to decipher ESG-related information and to incorporate it in a useful way into valuations and buy/sell decisions".

- "For sell-side analysts looking at ESG issues, knowledge of the drivers of investment value – for example how companies make money, how they compete, business fundamentals, industry positioning – and equity market knowledge are more important than knowledge of the specific ESG issues".
- "It is easier to teach ESG to a good analyst than to teach an ESG specialist to be a good equity analyst"

"For sell-side analysts looking at ESG issues, knowledge of the drivers of investment value and equity market knowledge are more important than knowledge of the specific ESG issues".

There was, however, a consensus that in order to effectively integrate ESG issues into investment research, there is a need an internal focal point (an individual or a group) for this research. This role could have a number of different functions, depending on the organisation – it could be to filter information in/out, to conduct specific research on these issues, to develop a process to bring relevant ESG-related research to the attention of analysts and fund managers, or to ensure that relevant ESG-related information is both identified and understood.

5.MARKET DEMAND

Interviewees reported that their buy-side clients are paying much more attention to how ESG factors are being included in investment research, are demanding more research on these issues and are willing to pay for this research. This has been driven by a range of factors, including:

- The growing recognition that ESG issues can be financially material:
- The sense that it may be possible to generate better investment performance through a focus on ESG issues;
- Events such as the BP Deepwater Horizon spill which have sharpened investors' focus on the potential for catastrophic events to damage investment returns.
- The growth in the number of asset owner signatories to the Principles for Responsible Investment. This has created pressure for investment managers to sign up to the principles and, critically, to demonstrate that they are paying due attention to ESG issues in their investment practices and research.

For some sell-side organisations, the growth in market interest has seen them establish teams or structured processes for evaluating the investment implications of ESG issues and has led to a significant increase in the volume and the quality of the research that they produce on these issues. One interviewee commented: "Client demand and, importantly, client willingness to pay has seen ESG move from being an occasional research subject to one that is much more systematically researched and analysed".

"Client demand and, importantly, client willingness to pay has seen ESG move from being an occasional research subject to one that is much more systematically researched and analysed".

There was a general agreement that client demand for and interest in ESG-related research is likely to increase. One interviewee expressed concern that this may not lead to the development of better research, arguing that: "The broker model incentivises the best fit for most, where the best fit encourages breadth rather than depth". However, a number of interviewees reported the opposite, stating that their clients frequently want them to go beyond the material contained in written research reports.

A number of interviewees noted that further growth in the quantity and quality of research provided will require that more asset owners press their investment managers to integrate ESG issues into their investment practices. This will require the development of a robust body of evidence on the materiality of ESG issues to investment performance and on the benefits to investment performance of focusing on these issues.

TABLE 3A: INTERVIEWEES

Name	Organisation
Meg Brown	Citigroup
Andrew Howard	Goldman Sachs
Julie Hudson	UBS
Hubert Jeaneau	UBS
Aimee Kaye	Macquarie Securities
Deana Mitchell	Macquarie Securities
Mike Tyrrell	SRI-Connect
Stephane Voisin	Chevreux
Niamh Whooley	Societe Generale

APPENDIX 4: COMPANIES

INTRODUCTION

From an investment perspective, companies are important for a number of reasons:

- They are a major source of the ESG-related information used by investors, ESG research providers and others to evaluate company practices and performance.
- They have impacts, positive and negative, on society, on the environment and on the economy.
- Their governance and their management of social and environmental issues can be critical determinants of their financial and their investment performance.
- They are affected and influenced by investors. This may be through investment decisions impacting on their share price or cost of capital, or through investors using their formal powers and informal influence to encourage changes in governance practices, reporting or environmental or social performance.
- They can be affected and influenced by actors such as NGOs and policy makers (e.g. through NGO campaigns, through regulatory interventions), both directly and through these actors exerting pressure on investors.

"Companies are a major source of the ESG-related information used by investors, ESG research providers and others to evaluate company practices and performance".

METHODOLOGY

In the period August to September 2012, we interviewed a total of twelve – nine European and three American – companies, covering the following sectors: aerospace, food & beverage, industrial equipment, oil & gas, pharmaceutical, transport, utilities (see Table 4A). The companies interviewed were selected based on their location, their sector and their level of disclosure to the UN Global Compact. In relation to the latter point, we focused on companies that had achieved the Global Compact advanced level¹ of disclosure (i.e. those that provide substantial disclosures on ESG issues), as this allowed information on a wide range of sustainability issues to be collected during the interviews.

We conducted a one hour structured interview with each organisation focusing on the:

- Their approach to sustainability reporting, including how information on sustainability performance is communicated internally and externally.
- Organisational capacity and resources, with a particular focus on the research/analytical skills and competences required of their staff.

- The key audiences for their sustainability information, with a particular focus on how investors use this information.
- The barriers to building and implementing a long term sustainability strategy.

Following the interviews, a draft of this Appendix was circulated to the individuals interviewed for review and comment.

Note: While the views and findings presented here are based on the interviews and the subsequent feedback received, they should not be taken as formal statements of any individual organisation's position on responsible investment or the capital markets.

A NOTE ON TERMINOLOGY

Companies use a variety of terms to describe the reports they produce on ESG issues, including sustainability reports, corporate (social) responsibility (CSR) reports, and social and environmental reports. They also use a variety of terms to describe the issues covered in these reports, including ESG issues, social and environmental issues, and CSR issues. For consistency with the language used throughout this report, we refer to the issues that are the subject of this reporting as ESG issues, and we refer to the stand-alone reports that many companies produce on these issues as sustainability reports.

SOME QUALIFICATIONS TO THE RESEARCH FINDINGS

There are three important limitations to the research. The first is that the companies interviewed are recognised as leaders for the quality of their reporting on ESG issues, with a number of them presenting sustainability-related issues as central business drivers. It is, therefore, not unsurprising that they have sought to proactively communicate with investors (and other stakeholders) on these issues. This appetite for engagement and communication may not be as great in companies whose reporting is not of a similar quality or who do not see sustainability issues as such important drivers of business value.

The second is that the findings relate primarily to equity investors. It is probably fair to say that responsible investment, in particular engagement/active ownership, is significantly more developed – and certainly has been systematically practised for a much longer time – in listed equity than in other asset classes. Moreover, much of this work has focused on the largest companies. The consequence is that the level of investor interest presented here may not be representative of the level of investor interest in ESG issues in other asset classes or in smaller companies.

The third is that the geographic (Europe and North America) and company (major multinationals) focus may also overstate the level of investor interest in ESG-related issues, as these regions have been at the forefront of debates on responsible investment.

KEY FINDINGS

The interviews provided a series of important insights into how companies approach reporting on ESG issues and the dialogue that they have with investors on these issues. Across the twelve companies the key conclusions in terms of the motivations for reporting, the challenges they encounter in reporting, and the nature of the dialogue they have with investors were strikingly consistent.

1. WHY DO COMPANIES PRODUCE SUSTAINABILITY REPORTS?

The publication of sustainability reports is motivated by internal and external factors. Internally, the reporting process helps companies to better coordinate and manage their sustainability-related activities and helps to better structure their communication around these issues. Externally, the reporting process enables companies to satisfy, at least in part, the information demands from stakeholders (investors, NGOs, clients, governments) and also provides a basis for discussions with these stakeholders.

2. WHAT DO COMPANIES REPORT?

The twelve companies interviewed all identified the Global Reporting Initiative (GRI) guidelines as an important input to the decisions they made on which ESG indicators to report. In addition, the frameworks offered by voluntary initiatives such as the UN Global Compact, the Carbon Disclosure Project and the Dow Jones Sustainability Index were cited as important influences on the information reported.

All of the companies stated that their sustainability reports had grown in content over the past few years. Most companies have significantly increased the number of key performance indicators (KPIs) that they report against to accommodate changes in reporting frameworks and to meet the demands of stakeholders, with different stakeholders having very different interests and often requiring very different information to understand company performance on the issue(s) in question. The increase in the volume of reporting and number of KPIs being reported means that it can be more difficult for stakeholders to navigate through the volume of information being provided by companies.

"Most companies have significantly increased the number of key performance indicators (KPIs) that they report against to accommodate changes in reporting frameworks and to meet the demands of stakeholders, with different stakeholders having very different interests and often requiring very different information to understand company performance on the issue(s) in question."

The companies interviewed all have well-established processes for determining which ESG issues are material to their

business as a whole and to particular operating divisions. They commented that their consultation with external stakeholders generally confirms the appropriateness of ESG priorities determined by their internal analysis. They also noted that there is general organisational support (at the corporate and operational levels) for embedding ESG factors with a clear business case throughout their operations, and that their Boards are actively engaged in the planning and evaluation of corporate sustainability plans and strategies. This integration is being seen in reporting, with reporting evolving away from simply reporting against externally defined indicators and measures, towards a more strategic communication about the organisation and its priorities.

3. DATA QUALITY

The companies interviewed offered a number of general reflections on data and data quality:

- Companies are continuing to improve the quality of the data they use in their sustainability reports, through strengthening internal controls, formalising reporting requirements and establishing systems (databases, spreadsheets) that enable the automatic reporting of ESG data.
- Aggregating data from the site to the corporate level is an on-going challenge, given the inevitable variations in data gathering and analysis processes. A wider issue for companies is that the adoption of overly prescriptive reporting protocols and frameworks may limit the flexibility of countries or regions to improve sustainability performance, may act as a disincentive to innovation, and may obscure sustainability efforts at the local level.
- While it is generally reasonably straightforward to gather data from activities and operations owned and managed directly by the company, it is much more difficult to establish indicators and to collect data relating to the performance of suppliers and to the impacts of product use by consumers.

4. CAPACITY AND RESOURCES

None of those interviewed identified skills or knowledge as a particular issue for their organisation. There was a general consensus that the skills and knowledge required were available internally or, if needed, could be supplemented by suitably qualified external consultants.

None of the companies indicated that they had particular problems accessing the resources they needed for reporting on ESG issues (i.e. there was a general sense that their reporting and communications activities were reasonably well resourced), although a number commented that the ever-increasing number of KPIs that they were reporting could overload their data management and communication processes.

5. THE FORM OF REPORTING

For each of the companies interviewed, the main vehicles for communicating ESG-related information

1. For more information, visit the Global Compact Differentiation Programme page at http://www.unglobalcompact.org/COP/differentiation_programme.html

is the annual sustainability report and/or the annual integrated report. These reports are generally used as the main point of reference for all communications.

However, companies also recognise that they need to cater to the specific needs of different stakeholders, and all of the companies interviewed noted that they are improving the interactivity of their web sites to cater to the different interests of their stakeholders. For example, some sites allow visitors to build their own sustainability report and others allow stakeholders to drill down into ESG data and information.

A number of companies commented that while integrated reporting offers the potential for companies to present their key sustainability data in a concise and readable manner, integrated reporting will not meet the needs of many important stakeholders. Companies noted that the information needs of different stakeholders and the increasing number of in-depth information requests on specific sustainability issues means that companies actually need to continue to broaden the coverage of their reporting and, increasingly, provide data all the way down to the local level.

"A number of companies commented that while integrated reporting offers the potential for companies to present their key sustainability data in a concise and readable manner, integrated reporting will not meet the needs of many important stakeholders."

6. INVESTORS' INTERESTS

Investor interest in sustainability issues has increased significantly over the past few years, as has the range of ESG issues that are of interest to investors. While the information requests from investors interested in financial issues tend to be relatively homogenous, requests for information in relation to sustainability issues vary greatly.

While the information requests from investors interested in financial issues tend to be relatively homogenous, requests for information in relation to sustainability issues vary greatly.

One of the particular challenges for companies is how to respond efficiently to the increasing number of information requests from rating agencies and SRI analysts. Because of the wide range of questions and methodologies used to assess sustainability performance, companies often have to organise one-on-one meetings to respond effectively to specific queries. Companies had different views on these meetings. Some saw them as something of a waste of time, covering issues that the company considered to be adequately covered in its formal reports or focusing on issues that the company did not see as material. Others saw these meetings more positively, providing them with an opportunity to engage with a key stakeholder and to put the company's data and performance into the context of the business' overall priorities.

7. THE RELATIONSHIP BETWEEN FINANCIAL AND NON-FINANCIAL FACTORS

While the companies interviewed have reported an improvement in the (internal) collaboration between their sustainability managers and their investor relations managers, most of those interviewed noted that there is still a persistent gap in communication between ESG analysts and their mainstream counterparts within the same investment organisation. For example:

- Investors rarely link (or integrate) questions about financial and extra-financial information (e.g. how do sustainability issues relate to business issues such as efficiency, costs or competitive advantage). Greater integration of this type would greatly simplify corporate communication efforts in relation to sustainability performance, and would also provide an important signal to management about the importance investors assign to sustainability issues.
- Most discussions with investors are still dominated by short-term interests. Generally, sustainability-related questions are not among the top five issues on the agenda of mainstream investors. Focusing on the larger challenges and the associated long-term investments in sustainability and risk management would be more helpful for communicating the value of ESG performance in the global market.

"Investors rarely link (or integrate) questions about financial and extra-financial information".

8. INVESTOR CAPACITY AND KNOWLEDGE

A number of the companies interviewed commented that there is a significant difference in the knowledge of 'mainstream investors' (or investment analysts) and responsible investment analysts. Their perception was that while mainstream analysts tend to work closely with companies in a specific sector and have a detailed knowledge of the companies, the sector, the value drivers, etc., responsible investment analysts tend not to have the same level of knowledge or understanding. This is of particular importance when responsible investors make suggestions on how companies should manage particular issues, where their lack of understanding of the business often means that the suggestions cannot be implemented or are not relevant to the business. The interviewees acknowledged that this is changing and that responsible investment analysts are making more effort to understand their businesses and are increasingly focusing their attention on issues that are more clearly linked to business risks and opportunities.

Companies see their dialogue with investors on ESG issues as valuable, as it provides confirmation that investors are interested in these issues and it exposes the company to a variety of opinions and views. Companies noted that the most fruitful dialogue between them and their shareholders on ESG issues tends to take place when both a mainstream analyst and a responsible investment analyst from the same financial institution are present or, at least, when a responsible investment analyst has consulted with his/her mainstream counterparts before a dialogue with the company takes place.

"Companies see their dialogue with investors on ESG issues as valuable, as it provides confirmation that investors are interested in these issues and it exposes the company to a variety of opinions and views."

Some companies expressed concern about the time and resource implications of providing information to ESG research providers and rating agencies. These concerns are exacerbated by the general focus of these organisations on ESG issues rather than on the business implications of these issues, and the lack of transparency about the clients of these organisations (which means that it is difficult for companies to determine which requests should be given more priority).

9. CHANGING THE DIALOGUE WITH INVESTORS

The companies interviewed acknowledged that they could do more to encourage investors to take more interest in sustainability issues, in particular through proactively explaining the links between their sustainability performance and their profitability (over the short and the long-term). However,

they were also aware that in order to move ESG issues up the investor agenda, they would need to present concrete examples of ESG issues having a real impact on the company's ability to grow profitably. While companies can provide examples of ESG issues providing real financial benefits, they are concerned that the relatively long pay-back periods mean that investors are not interested in these examples.

"While companies can provide examples of ESG issues providing real financial benefits, they are concerned that the relatively long pay-back periods mean that investors are not interested in these examples."

A number of the companies interviewed were more philosophical about investor engagement; while they would welcome more investor interest in and questions on ESG issues, they recognise that they cannot wait for these questions to be asked before developing their strategies on these issues. Their view is that the pressures from other stakeholders mean that ESG issues are important business issues and need to be managed as such, irrespective of whether or not investors express interest.

 4 | 4

TABLE 4A: INTERVIEWEES

Name	Position	Organisation
Karin Holmquist	Vice President, Corporate Responsibility	Atlas Copco
Mala Chakraborti	Sustainability Coordinator, Corporate Communications	Atlas Copco
Mattias Olsson	Vice President, Investor Relations	Atlas Copco
Cassandra Garber	Senior Communications Manager, Corporate External Affairs	Coca-Cola
Jeff Seabright	Vice President, Environment and Water Resources	Coca-Cola
Mark Preisinger	Director, Corporate Governance	Coca-Cola
Missy Owens	Director, Public Affairs and Government Relations	Coca-Cola
Chiara Mingoli	CSR Specialist	Enel
Matteo Cavadini	Officer, Investor Relations	Enel
Pedro Canamero	Manager, Equity Investor Relations	Enel
Claudia Vignati	Vice President, Investor Relations	eni
Domenica Di Donato	Manager, Sustainability Planning, Reporting and Professional Community	eni
Raffaella Bordogna	Manager, Sustainability Reporting	eni
Rosanna Bolzoni	SRI Manager, Investor Relations	eni
Bob Corcoran	Vice President, Corporate Citizenship	GE
Ellen Morgenstern	Manager, Citizenship Communications	GE
Mark Nordstrom	Senior Counsel, Labour and Employment	GE
Trevor Schauenberg	Vice President, Corporate Investor Communications	GE
Annette Stube	Director, Group Sustainability	Maersk
John Kornerup Bang	Lead Advisor, Environment and Sustainability Trends	Maersk
Stephanie Fell	Officer, Investor Relations	Maersk
Christian Frutiger	Manager, Public Affairs	Nestle
Ian Metcalfe	Officer, Investor Relations	Nestle
Carrie Scott	Head of Corporate Responsibility Communications	Novartis
Dorje Mundle	Head of Corporate Responsibility Management	Novartis
Susanne Schaffert	Global Head, Investor Relations	Novartis
Jenny Flezzani	Senior Manager, Corporate Responsibility	Pfizer
Manoëlle Lepoutre	Executive Vice President, Sustainable Development and Environment	Total
Vanessa Jaeger-Canovas	Investor Relations Manager, CSR	Total
Rachel Cowburn-Walden	Global External Affairs Manager – Corporate Responsibility	Unilever
Roger Seabrook	Vice President of Investor Relations	Unilever

APPENDIX 5: NON-GOVERNMENTAL ORGANISATIONS (NGOs)

INTRODUCTION

Non-governmental organisations (NGOs) have a critical role to play in responsible investment. They can exert influence on companies, investors and governments, both directly and through their influence on other stakeholders (in particular, the media, government and consumers). The specific engagement or campaigning tactics used by NGOs depend upon a range of factors such as the maturity of issue being addressed, the responses and responsiveness of the industry sector, the type of NGO taking action and the region/country where outcomes could be achieved as a result of investment decisions.

While investors are commonly cited as an important target for NGOs, few NGOs have sought to systematically engage with investors and there is limited information on the outcomes that have resulted from this engagement. The consequence is that relatively little is known about the reasons why NGOs focus on investors, about the effectiveness of this activity, or about the factors that make NGO campaigns effective in this area.

METHODOLOGY

In November 2012, the PRI convened a half-day workshop of seven NGOs (see Table 5A for a list of attendees and Table 5B for the workshop agenda) to discuss these questions. The NGOs were chosen because they have all proactively engaged with the investment community, albeit on very different issues (human rights, climate change, farm animal welfare, the environment, responsible investment). The NGOs have used a variety of strategies (including direct dialogue, partnerships, media campaigns and name-and-shame campaigns), and have developed a range of tools (such as benchmarks, research reports and case-studies) to support this work.

The workshop focused on the following themes:

- Why do NGOs focus on investors? What do NGOs want to achieve through this engagement?
- How do investors respond to NGO campaigns and engagement?
- Why do investors respond in the way that they do?
- Do NGOs have the capacity (skills, resources, expertise) to effectively engage with investors?

Following the workshop, a draft of this Appendix was circulated to the NGO participants and to a number of other NGOs (see Table 5A) for review and comment.

SOME QUALIFICATIONS TO THE FINDINGS

The views and findings presented here are based on the comments made and opinions expressed at the workshop and on the subsequent feedback received on the draft of this Appendix. However, these views and findings should not be taken as formal statements of any NGO's position on responsible investment or the capital markets.

The material presented in this Appendix reflects NGOs' perspectives on the capital markets and on responsible

investment more generally. We have not had this Appendix reviewed by other investment-related stakeholders. While we recognise that not all of these findings will be supported by other stakeholders (and we discuss the major areas of disagreement in the main report), we also see these findings as providing a hugely important critical perspective on responsible investment practice and pointing to some important capacity issues that need to be addressed.

KEY FINDINGS

1. WHY DO NGOS ENGAGE WITH INVESTORS? WHY DO NGOS SEE INVESTORS AS IMPORTANT?

NGOs engage with investors for a variety of reasons, including:

- To leverage investor influence with companies (i.e. to harness investor influence to encourage changes in companies' disclosures, practices, processes, and performance).
- To leverage investors' relationships with companies to enable NGOs to gain access to companies.
- To leverage the involvement of others (e.g. NGOs may target investors but their ultimate aim may to be stimulate government action on an issue).
- To lend credibility to the issues that are of concern to NGOs (e.g. so that NGOs can point to investors as a stakeholder concerned about the issue in question).
- To build their knowledge. This may be relatively general (e.g. to understand specific aspects of the investment system) or, more commonly, directed at supporting or informing campaigning activities (e.g. to understand how investors or companies view the issue in question, to understand the factors that influence or are likely to influence company responses, to gain access to information that is not in the public domain, to identify key opinion formers or influencers).
- To raise investor awareness of particular issues, with the aim of encouraging investors to take action on the issues in question.
- To influence investment decisions.
- To champion or encourage improved practices in the investment industry, both at the level of the individual investment organisation and across the investment industry as a whole.
- To create support for wider changes in a sector or in relation to a particular issue. NGOs are very aware of the risk of NGO campaigning/advocacy activity merely displacing negative behaviour from one company to another when conducted through bilateral interactions. One reason the investment community is of such importance is because of its potential to encourage more responsible behaviour across an industry sector.

"One reason the investment community is of such importance is because of its potential to encourage more responsible behaviour across an industry sector."

2. HOW DO INVESTORS RESPOND? **NGO PERCEPTIONS**

NGOs acknowledge that investors have contributed to a range of positive outcomes, notably through encouraging improved corporate disclosures (e.g. on greenhouse gas emissions) and through encouraging companies to improve their policies, practices and processes on various ESG issues and on other areas of "shared value".

However, NGOs' expectations on the contribution that investors can make to improved performance remain relatively modest. This reflects NGOs' perceptions of the influence that investors can actually exert, the outcomes that have resulted from NGOs' previous engagement with investors, and the difficulty in effecting changes where the business case for action is limited. It also reflects the tensions between what NGOs ask and what can realistically be achieved (either in terms of investors' ability to exert influence, or in terms of companies' or society's ability to respond). NGOs recognise that investors frequently cannot or will not take action until other changes (e.g. in legislation) have already occurred.

"NGOs recognise that investors frequently cannot or will not take action until other changes (e.g. in legislation) have already occurred."

In relation to investors' appetite to take action, NGOs perceive that, even if there is a compelling business case or if the costs to companies are modest, investors are often very slow to take any action (or to communicate their time frames for responses), that investors tend to give companies the benefit of the doubt, and that most investors cannot push beyond incremental improvements and call for fundamental shifts in the nature of a business.

The effectiveness of investor action is seen as limited because most investors do not have an escalation strategy beyond dialogue with companies. While NGOs acknowledge the importance of engagement as a responsible investment strategy, they also note that very few investors are willing to even consider divestment in the event that engagement proves ineffective. However, NGOs also recognise that the case for divestment is not unequivocal as, if investors divest, they often lose any ability they have to exert influence (i.e. the company may be unwilling to maintain dialogue) and the decision to divest is unlikely to have a significant effect on the company's share price.

3. RESPONSIBLE INVESTMENT AND **INVESTMENT PRACTICE**

The NGO participants offered a number of reflections on the relationship between responsible investment (or responsible investment teams) and the actions of the investment organisation as a whole.

First, they noted that it is often not clear what level of organisational buy in to responsible investment exists (e.g. is responsible investment a central part of the organisation's

1. For a discussion of the reasons why investors use collaborative initiatives to engage with public policy makers, see Appendix 5.

activities or just one person acting in isolation). Their perception is that there is often a significant disconnect between the messages presented by sales/marketing teams, responsible investment teams, risk teams, mainstream analysts and fund managers, and senior management, and they pointed to the fact that responsible investment (or ESG) professionals often do not have the authority to make the decisions that NGOs want them to (e.g. on divestment) as evidence of this disconnect.

Second, there is a significant difference in timeframes and in underlying assumptions. While NGOs recognise that they need to provide a convincing business case to gain the attention of investors, they are aware that most of the business case arguments they can muster relate to the medium or longerterm, whereas investors often work to a much shorter time frame. Short holding periods mean that it is often impossible to effectively integrate ESG issues into investment views, and that investment managers are reluctant to focus on these issues. The issue of timeframes is compounded by the very different assumptions used by investors and NGOs (e.g. in relation to whether or not particular legislation will be introduced, whether a particular company will be held liable for particular social or environmental impacts). The consequence is that risks need to be of a high probability and immediacy for investors to pay attention to them. NGOs recognise that through campaigning they can change the risk ratios – i.e. they can make an issue more material to investors by changes in legislation, or by naming and shaming one company so that the whole sector is affected.

"The issue of timeframes is compounded by the very different assumptions used by investors and NGOs... The consequence is that risks need to be of a high probability and immediacy for investors to pay attention to them."

Third, the range of responsible investment approaches has led to the creation of funds which conflict with NGOs' views on responsible companies. For example, best in class funds that focus on management systems and processes may not pay sufficient attention to company performance, and screened (ethical) funds may allow investments in companies with significant environmental footprints.

Fourth, investors tend to rely on 'conventional' information sources (the financial press, investment banks, etc) and often do not proactively engage with other sources, in particular NGOs and civil society organisations who often have detailed on-theground performance information that is not otherwise available.

Fifth, in relation to collaborative investor initiatives, NGOs argued that these initiatives often do not effectively engage with external organisations (such as NGOs), nor are they willing to act as a conduit for these external organisations to channel information back to their members. NGOs also expressed concern that investors often look to third party organisations (e.g. the Carbon Disclosure Project. the Principles for Responsible Investment) to lead their engagement activities, suggesting a general lack of investor interest in the issue in question and/or capacity/ resource constraints within the investor organisations.

Sixth, NGOs pointed to a number of governance failings within the investment community, highlighting in particular the relationship between companies and investors (which was characterised as a client-customer relationship, where the company rather than the investor is in the role of the client with investors telling NGOs that they do not wish to damage their relationships with companies by pressing them to take action on particular ESG issues), the lack of transparency (see further below), the lack of accountability of investment managers to their asset owner clients, the lack of accountability of asset owners (e.g. pension funds) to their beneficiaries, and the short termism of markets and remuneration metrics.

Finally, NGOs noted that, despite the growth of initiatives such as the PRI, many investors have yet to make commitments to responsible investment and the level of investor knowledge of ESG issues varies greatly across the industry.

4. NGO CAPACITY

NGOs recognise that they have capacity limitations. The most significant of these are (acknowledging that the relative importance of these differs between organisations):

- NGOs may not have all the expertise that they need. This reflects the complexity of the financial markets where the knowledge and skills required to, for example, engage effectively with asset managers may be quite different to those required to engage effectively with private equity or with project finance.
- NGOs operate on relatively modest budgets and, within the resources allocated for investor-focused campaigning, often try to cover a variety of issues and, importantly, a variety of investors and investor types. This issue is often compounded by the lack of understanding within NGOs of the complexity of the investment/ finance sector which means that finance sector-focused campaigners are often required to cover a whole series of issues that fall well outside their core expertise.
- NGO structures may limit their ability to engage effectively with investors. For example, some of the international NGOs have finance specialists/campaigners in each of their major offices. This gives them what looks like a critical mass but presents issues in terms of coordination and effectiveness. NGOs recognise that they need to build organisational structures that enable them to effectively influence the investment industry (e.g. through having their staff work closely together, through consolidating these teams in one or two locations, through building virtual networks, through working with similar groups in the local region).
- This reflects the following realities: these donors and foundations have limited understanding of the capital markets (and are still trying to work out where they should put resources), capital markets campaigning is relatively novel, and many donors and foundations have board members with a financial/investment background who don't think NGOs should be meddling with the finance system.

- NGOs recognise that they need to leverage the influence of others (e.g. pension fund beneficiaries and trustees) if they are to be effective.
- NGOs lack credibility in the city and, even when NGOs hire people with a financial background, investors often fail to pay attention to them simply because they work for NGOs.
- There are significant information asymmetries between investors and NGOs. While investors have ready access to huge amounts of data and information, NGOs tend not to have anything like the same level of access.
- The reality is that influencing investors relies on personal contacts and relationships that NGOs don't usually have. In most cases, NGOs have not recognised the need to invest time and effort to develop these relationships and contacts.

"Because the value of capital market campaigning remains relatively unproven, NGOs are often reluctant to commit resources to this area of campaigning."

There is a need to build capacity across NGOs about responsible investment. Specific capacity needs are:

- Pension fund beneficiaries should be made aware of what they should expect from the individuals charged with managing their money. This also applies to NGO pension fund trustees who need to ensure that their own pension fund is investing in line with their organisation's mission and values.
- Before engaging with investors, NGOs should be absolutely certain as to what their purpose is, having worked out the finer details of the moral case versus business case.
- NGOs considering engaging with investors should start by engaging with and learning from NGOs that have already done this sort of work. They should consider collaborating with NGOs who already have a productive relationship with the investment world. NGOs should consider developing a central resource/body of expertise on capital market campaigning – what works, what doesn't work, case-studies, how to brief investors, who to target,2 etc. For example, in the UK, FairPensions provides support and advice to NGOs seeking to engage with the investment community.

"NGOs considering engaging with investors should start by engaging with and learning from NGOs that have already done this sort of work."

5. THE CASE FOR DISCLOSURE

NGOs see improved disclosure - by companies and by investors - as a critical goal. Disclosure is important both internally (as it focuses management attention on the issues in question) and externally (through enabling the accountability that companies and investors should have to society).

^{2.} For example, NGOs are often impressed by relatively small amounts of money in fund management terms (e.g. \$1bn of assets under management) and so they often overrate the influence of small ethical investors

NGOs noted that investors tend to publish relatively little information on their approach to responsible investment. Even basic information (e.g. voting records) is not generally available, and industry bodies have lobbied strongly against the mandatory disclosure of this information. NGOs are of the view that better reporting by investors on their engagement practices and on other aspects of responsible investment (e.g. public policy engagement) would be hugely valuable in enabling NGOs to assess the contribution made by investors, and would also help provide the basis for a better informed dialogue between NGOs and investors on responsible investment and related issues.

NGOs also criticised company reporting, noting that companies are often unclear about their precise targets and about how ESG issues relate to their business strategies. Data quality and lack of information are also significant issues, in particular in emerging markets. NGOs see that they have an important role to play in ensuring that investors are aware of the companies' on the ground' performance and impact, as it is often difficult for investors to obtain this sort of information through other sources.

Integrated reporting is seen as having a hugely important role to play in linking sustainability and strategy. However, NGOs do not see integrated reporting as a substitute for reporting on ESG issues. Rather they want reporting on both strategy and performance.

"NGOs do not see integrated reporting as a substitute for reporting on ESG issues. Rather they want reporting on both strategy and performance."

6. ADDRESSING COMPLEXITY

NGOs acknowledged that they need to be able to explain

complex ESG issues in terms that investors can understand and act effectively on. To that end, they have developed a range of tools (benchmarks, key performance indicators) and have adopted a range of strategies (name and shame, awards). NGOs acknowledge that such simplification also presents risks, in particular that it may lead to companies and investors concluding that they will be satisfied with relatively modest outcomes (e.g. improved policies rather than improved performance).

7. CAMPAIGNING: THE FUTURE

NGOs see constructive engagement with the investment community as hugely important. NGOs recognise that they need to find allies in the investment community but that developing these relationships requires patience and that they need to see investor engagement as integral to campaign planning, not as an add-on at the last minute.

"NGOs recognise that they need to find allies in the investment community but that developing these relationships requires patience and that they need to see investor engagement as integral to campaign planning, not as an add-on at the last minute."

NGOs are also aware that investor engagement presents real risks and that they need to tread a fine line between being critical (and so running the risk of investors ignoring rather than engaging with the ESG issues that are of concern) and being too friendly (which may undermine their ability to use more traditional negative campaigning strategies).

TABLE 5A: WORKSHOP PARTICIPANTS AND REVIEWERS WORKSHOP PARTICIPANTS

Name	Position	Organisation
Nicola Amos	Programme Director	Business Benchmark on Farm Animal Welfare
Raymond Dhirani	Finance Policy Officer	WWF
Emanuele Fanelli	Senior Vice President – Investor Initiatives	Carbon Disclosure Project
Mia Fernyhough	UK Food Business Manager	Compassion in World Farming
Peter Frankenthal	UK Business and Human Rights Manager	Amnesty International
Chris Gee	External Relations Manager (Corporate)	World Society for the Protection of Animals
Catherine Howarth	Chief Executive	FairPensions
Katie Beith	Head of Implementation Support	PRI
Karin Malmberg	Implementation Support Manager	PRI
Natasha Buckley	Implementation Support Assistant	PRI
Rory Sullivan	Independent Adviser	PRI

Other reviewers of the draft appendix:

Name	Position	Organisation
Robert Barrington	Director of External Affairs	Transparency International UK
James Leaton	Research Director	Carbon Tracker

TABLE 5B: WORKSHOP AGENDA

PRI/NGO WORKSHOP

Building the Capacity of Investment Actors to Use Environmental, Social and Governance (ESG) Information

9.00	Welcomes and Introductions
9.10	Brief Overview of the PRI's Capacity Needs Project
9.20	NGO Perspectives
10.15	Q&A
10.30	Break
10.45	Open discussion around the following themes:
	How useful is the information provided by companies/investors for the work that NGOs have done?
	What skills and expertise have NGOs needed (a) for research, (b) for engagement with investors? Has this expertise been available in-house or has it needed to be sourced externally?
	How have investors responded? What factors have influenced these responses?
	How might NGOs improve the quality and effectiveness of their engagement with companies and investors (e.g. do NGOs need to escalate their engagement)?
	What needs to change?
11.50	Wrap Up and Next Steps

APPENDIX 6: BUSINESS SCHOOLS

INTRODUCTION

Universities, business schools and similar institutions have a critical role to play in the development of ESG capacity across the investment industry. There are two reasons. The first is that virtually all those individuals that join the investment industry in the future will hold university degrees, with many also likely to hold postgraduate qualifications and/or formal professional qualifications (see, for example, the expectations of ESG Research providers as set out in Appendix 2). The training and education these individuals have received will be key determinants of their views on the relevance of ESG issues to investment practice. For example, as noted in Appendix 1, the fact that the traditional training for financial analysts did not include ESG issues has resulted in many having limited interest in ESG issues.

"The training and education these individuals have received will be key determinants of their views on the relevance of ESG issues to investment practice."

The second is that academic research has a critical role to play in advancing ESG practice. This may be through providing robust assessments of investment and ESG practice, through linking practice to theory, and through bringing insights from academic research (across a range of disciplines, not just finance and economics) to practitioners' attention.

"Academic research has a critical role to play in advancing ESG practice."

METHODOLOGY

We decided to concentrate on business schools as a distinct subset of the university sector for a number of reasons. The first is the growing demand for business and postgraduate qualifications in the responsible investment industry. While somewhat anecdotal, there appears to be growing interest in graduates with a business or financial (rather than an environmental or social issues) background for roles in responsible investment and this is likely to continue as investors focus on the integration of ESG issues into their investment processes (see the discussion in Appendix 1) and as ESG research providers are increasingly expected to set out the investment implications of their research (see Appendix 2). The second is that a number of business schools/ MBA programmes already offer courses on ESG issues and/ or responsible investment. The third is that many business schools are signatories to the Principles for Responsible Management Education (PRME), which commits them to integrating sustainability issues into their syllabuses.1 A number of business schools have already made significant progress in this regard; the challenges they have encountered in

integrating sustainability issues into their curricula are likely to be very similar to those that will be encountered in integrating ESG issues and/or responsible investment into curricula.

The research involved:

- A review of the key literature on the integration of sustainability and related issues into business school syllabuses. Of particular relevance to this research were the PRME publication *Inspirational Guide: Implementing* the PRME in Executive Degree Programs² and the Aspen Institute's Beyond Grey Pinstripes survey.³
- A conference call with PRME to obtain their views on the potential for business schools to integrate responsible investment into MBA curricula, and on capacity and other challenges that might be encountered. We also discussed the potential for business schools to conduct more research on responsible investment and related issues.
- A review of the courses being offered by top European and (using the Aspen Institute's Beyond Grey Pinstripes survey) American universities to identify courses/modules on responsible investment.
- Interviews in the period October-December 2012 with ten European and North American academics on the running or management of courses or modules covering responsible investment (see Table 6A) to discuss the drivers for establishing these courses, the challenges encountered and the lessons learned. We also discussed the potential for a greater research focus on responsible investment and related issues. Note: While the views and findings presented here are based on the interviews and the subsequent feedback received, they should not be taken as formal statements of any individual's position on responsible investment.

Overall, the research provided us with a series of important insights into the level of interest that business schools have in teaching and researching responsible investment, as well as the capacity for and other challenges to the greater incorporation of responsible investment into business school syllabuses.

SOME COMMENTS ON THE RESEARCH FINDINGS

We would offer the following comments on the robustness and applicability of the research findings. The first is that the general findings (about the key obstacles, the process, the academic drivers) are relevant to most universities teaching business and related subjects.

The second is that the interest that individual business schools or university departments have in responsible investment will depend on the specific courses that they offer and the likely employment opportunities that will be taken up by graduates. For example, it is likely that courses focused on public sector management will probably be less interested in responsible investment, whereas courses where many of the graduates end up working in the investment industry

nstitute's Beyond Grey Pinstripes survey.3

FINDINGS: RESPONSIBLE

1. RELATIVELY FEW BUSINESS SCHOOLS COVER RESPONSIBLE INVESTMENT

INVESTMENT ON THE SYLLABUS

or in large corporations may well be very interested.

The third is that the model of general business graduates

working in the investment industry is not a universal model.

For example, in Germany, it is generally the case that those

have studied finance or related subjects. The consequence

is that some of the conclusions presented here may not

be relevant to that particular employment market.

individuals gaining employment in the investment industry will

In the course of our research, we identified 24 business schools in the United States that mentioned responsible investing and, within that group, eight that offered responsible investment as a dedicated elective, course or special topic within a course. We found a similar picture in Europe, with a small number of business schools (e.g. HEC Paris) offering modules on responsible investment, a number offering modules on specific responsible investment-related issues (e.g. Islamic Finance, Carbon Finance) and quite a few offering courses on related subjects such as corporate social responsibility (where responsible investment is covered as one element of the course) and environmental or ESG risk management.

2. GETTING RESPONSIBLE INVESTMENT ON TO THE CURRICULUM

In broad terms, in order to get responsible investment integrated into business/MBA courses, four things are needed:

- There must be a clear market demand. Specifically, the investment industry needs to signal that knowledge of responsible investment is an important requirement for individuals seeking employment in the industry, and the investment industry also needs to set out the specific competencies and knowledge of responsible investment that it thinks are important.
- There must be clear student demand. A number of interviewees pointed to significant student interest in courses on responsible investment, noting that these students appear to be more interest-led rather than careerdriven, with a number attributing this to the changing political climate following the global financial crisis.
- Internal obstacles must be overcome. There is huge pressure to extend the range of issues covered on already crowded MBA courses (e.g. the increased emphasis on ethics in the wake of the financial crisis). Given the relative novelty of responsible investment as a mainstream investment practice, most academics are likely to be sceptical about the value of adding responsible investment to the curriculum. The key to overcoming these obstacles is a clear market demand, but change is also likely to require senior management leadership.

Content needs to be developed and provided.

3. KEY QUESTIONS FOR BUSINESS SCHOOLS

When considering whether to include responsible investment (as, indeed, with any new subject area) on the syllabus, business schools need to:

- Establish what skills and competencies they are trying to develop in their students. For example, they may decide that they want students to graduate with an in-depth, technical knowledge of responsible investment (e.g. of how to integrate ESG issues into investment processes and decisionmaking) or they may decide that they wish to provide their students with a general knowledge of responsible investment.
- Establish where responsible investment fits into their curriculum, e.g. is it to be presented as part of finance, as part of CSR, as part of business ethics?
- Establish how content is to be developed and delivered. Courses may be delivered by external lecturer(s), by internal staff with relevant academic/practitioner experience, or some combination of both. The approach adopted, together with the specified learning goals, will define the training materials (case-studies, books, videos, etc.) needed to supplement the taught material.

4. CAPACITY ISSUES: VALUES, ATTITUDES AND BELIEFS

To date, the inclusion of responsible investment on MBA curricula can usually be attributed to the efforts of individual academics who have championed the issue or integrated it into the materials that they teach. As yet, most academics are relatively unfamiliar with responsible investment and/or do not see it as a particularly important part of the investment world. These perceptions are reinforced by the lack of explicit demand from the investment industry for graduates with an understanding of responsible investment. However, while academics may be relatively unfamiliar with responsible investment, business schools are increasingly interested in sustainability and ethical issues as a consequence of the global financial crisis and the growing awareness of the business implications of issues such as climate change.

"As yet, most academics are relatively unfamiliar with responsible investment and/ or do not see it as a particularly important part of the investment world. These perceptions are reinforced by the lack of explicit demand from the investment industry for graduates with an understanding of responsible investment."

5. SKILLS, KNOWLEDGE AND EXPERTISE

One of the main obstacles to the greater integration of responsible investment into business courses is the lack of

 [&]quot;The mission of the Principles for Responsible Management Education (PRME) initiative is to inspire and champion responsible management education, research and thought leadership globally... They seek to establish a process of continuous improvement among institutions of management education in order to develop a new generation of business leaders capable of managing the complex challenges faced by business and society in the 21st century." (http://www.unprme.org/).

^{2.} PRME and Foundation for the Global Compact (2012), Inspirational Guide for the Implementation of PRME: Placing sustainability at the heart of management education (GSE Research Limited, Leeds).

http://www.beyondgreypinstripes.org/

APPENDIX 7: POLICYMAKERS

available and appropriate materials (e.g. relevant case-studies) for the teachers of such courses. This means that academics interested in developing such courses generally need to start from scratch.

A number of those interviewed acknowledged that academic research is lagging behind industry practice at this point in this time. While they were of the view that the development of course materials is best done by academics (as they will know how best to design materials such as case studies and lecture notes that can be used by others), they stressed the importance of proactively engaging with investors to understand how investors take account of ESG issues in their investment practices.

FINDINGS: RESPONSIBLE INVESTMENT AND RESEARCH

1. ACADEMIC RESEARCH IS NOT FOCUSED ON PRACTITIONER NEEDS

There is a general view among the responsible investment practitioner community that academic research does not focus on investors' needs. Academic research has been criticised for being too narrowly focused on quantitative studies (especially the performance of ethical/screened funds), rather than focusing on wider issues such as the contribution that responsible investment has made to improving corporate behaviour and to the functioning of the capital markets, strategic asset allocation, the impacts of externalities on large diversified portfolios, and the changing structures and governance of global capital markets. A related criticism has

been that this research is not sufficiently interdisciplinary; for example, with notable exceptions, there has been little research on responsible investment by academics in areas such as management, law, institutions, economics, ethnography, psychology, anthropology, politics, and international affairs.

2. THERE ARE OBSTACLES TO A GREATER FOCUS ON PRACTITIONER NEEDS

Interviewees identified two important obstacles to academics producing more practitioner-relevant research on responsible investment. The first is the limited availability of robust information from investors and companies. However, as discussed in Section 3 of the main report, there are significant limitations in the quality of the information being provided by companies and investors, which limits the usefulness of this information to researchers.

"There are significant limitations in the quality of the information being provided by companies and investors, which limits the usefulness of this information to researchers."

The second is that the manner in which academics are assessed is primarily on the basis of highly ranked articles in highly ranked journals. In the investment and business areas, the most highly ranked journals are interested in quantitative studies; these journals are much less interested in qualitative studies or in interdisciplinary research. The consequence is that academics tend to focus on research which is more likely to enable them to publish in these journals.

TABLE 6A: INTERVIEWEES

Name	School/Organisation
Dr Diane-Laure Arjalies Dr Afshin Mehrpouya	HEC Paris
Dr John Byrd	Denver Business School, University of Colorado
Dr Sandra Dow	Monterey Institute of International Studies, California
Matthew Gitsham	Ashridge Business School
Jonas Haertle	The Principles for Responsible Management Education
Professor Jeremy Moon	International Centre for Corporate Social Responsibility, Nottingham University Business School
Professor Thomas Nist	Duquesne University, Pennsylvania
Dr Todd Shank	St Petersburg College of Business, University of South Florida
Professor Bruce Usher	Columbia Business School, New York

INTRODUCTION

There are limits to the role that investors can play in delivering a more sustainable economy. Investors alone can only go so far in encouraging responsible corporate practices, and are – often because of concerns about breaching their fiduciary duties – reluctant to invest in areas or activities that do not provide reasonable returns, even if these provide significant societal benefits. Public policy has a critical role to play in correcting market failures and addressing information asymmetries, thereby creating the conditions to maximise investors' contribution to sustainable development. Policymakers can do this in a variety of ways, including: providing the regulatory/policy frameworks that incentivise companies to act in particular ways, enabling stakeholders to hold companies to account (e.g. through requiring companies to report systematically on social and environmental impacts) and through creating the structures and context within which investors can maximise their contribution to the goals of sustainable development.1

"Public policy has a critical role to play in correcting market failures and addressing information asymmetries, thereby creating the conditions to maximise investors' contribution to sustainable development."

Investors have long recognised that it is in their interest to engage in public policy debates – for example on market-wide codes and standards on corporate governance. Many investors also acknowledge that it is their long-term financial interest to encourage appropriate domestic and international government action on environmental issues such as climate change and social issues such as human rights. The global financial crisis, which has demonstrated the potential for macro-level ESG and systemic issues to undermine investors' interests, has added a new dimension to the rationale for investors to engage with policy-makers. Engagement with policy makers is now recognised as an integral part of how investors give effect to their responsible investment commitments.

"Engagement with policy makers is now recognised as an integral part of how investors give effect to their responsible investment commitments."

Investors can contribute to the policy process in a number of ways. They can support policy makers in taking effective action on specific ESG issues, they can help develop the building blocks (e.g. effective self-regulatory mechanisms) for policy implementation, they can encourage companies to improve their management of ESG issues, and they can encourage better reporting/disclosures by companies² which, in turn, should allow other actors to hold companies

(and investors) to account for their ESG performance. In recent years, investors have engaged with policymakers on systemic issues relating to the structure and operation of the financial markets (in particular in the wake of the global financial crisis), on the role that investors play in the governance of companies and how this can be structured and facilitated (e.g. ensuring that acting in concert legislation does not prevent investor engagement on ESG issues), as well as on specific governance (e.g. remuneration), economic (e.g. bribery and corruption), environmental (e.g. climate change) and social (e.g. human rights) issues.

The contribution that can be made by investors is also recognised by policymakers. Investors are increasingly seen as a key stakeholder by policy makers, and investors' views have been sought on a range of issues around the design and implementation of public policy, both on governance and financial markets-related issues and on environmental and social issues.

"Investors are increasingly seen as a key stakeholder by policy makers, and investors' views have been sought on a range of issues around the design and implementation of public policy, both on governance and financial markets-related issues and on environmental and social issues."

METHODOLOGY

The objectives of this research were to assess the capacity of policy makers that have been engaged with or by investors, to assess the capacity of the investors that have engaged with policy makers, and to understand the factors that have influenced the effectiveness of this engagement.

To meet these objectives, we interviewed 11 individuals (see Table 7A) in the period November to December 2012. These individuals were chosen because (a) as investors, they have played an active role in public policy debates on ESG issues, or (b) as policy makers, they have engaged with investors on ESG issues as part of their work. In a number of cases, the individuals interviewed had been on both sides at various points in their careers, i.e. both as an investor and as a politician or a policy maker.

The issues that these individuals have been involved with cover the broad spectrum of ESG and related issues, including corporate governance, the operation of financial markets (e.g. acting in concert issues), remuneration, climate change, reporting/disclosure, and health and safety. Their experience covered a range of asset classes (i.e. not just listed equities) and policy dialogue at the national and international levels.

For example, this could be through the direct funding and/or promotional support for responsible investment-related activities that require public sector involvement to stimulate or assist the market (e.g. the Swedish government's support for the PRI in Emerging Markets project, the Dutch government's support for the Natural Value Initiative on Biodiversity, the Australian government's support for the Responsible Investment Academy), supporting collaborations between policy-makers and investors in dialogue with companies, regulating to support responsible investment practice (e.g. the UK Pension Fund SRI Disclosure Regulation), and government pension fund adoption of responsible investment practices.

^{2.} This can be through direct engagement with companies, through engagement with relevant standard-setting bodies, or through encouraging regulatory bodies or quasi-regulators (e.g. stock exchanges, accountancy bodies) to set standards on ESG disclosure.

We conducted a one hour structured interview with each individual. For the policy makers, the main subjects covered were:

- The process of engagement with investors, covering subjects such as how the engagement was initiated, how the engagement proceeded and the information that investors provided.
- The engagement outcomes, including analysis of how, if at all, the investor engagement influenced the decisions reached and actions taken.
- The policy makers' understanding of investors and investment, and their ability to engage effectively with investors.
- The investors' understanding of the policy issue in question and the policy process in general.

Similar questions, although focused on the needs, capacities and interests of investors, were asked of the investors that were interviewed.

Following the interviews, a draft of this Appendix was circulated to the individuals interviewed for review and comment.

• Well informed research on the issue in question, including an understanding of the constraints on policymakers.

Note: While the views and findings presented here are based on the interviews and the subsequent feedback received, they should not be taken as formal statements of any individual's position on responsible investment or the capital markets.

There is one important clarification that needs to be made about the findings below which is that the focus is on policy bureaucrats (i.e. those individuals charged with briefing ministers and politicians about specific issues) rather than on politicians. Engaging with bureaucrats – which tends to be a process of dialogue and information-sharing – is very different to engaging with the politicians, where the process is often much more about the harnessing and deployment of power/leverage (whether financial, legitimacy, column inches, potential influence on votes or perceptions). Engagement with both political and bureaucratic processes may be necessary to achieve the desired policy outcomes.

"Engagement with both political and bureaucratic processes may be necessary to achieve the desired policy outcomes."

KEY FINDINGS

1.POLICY ENGAGEMENT MUST START WITH A CLEAR AGENDA

"The starting point for public policy engagement is a clear understanding of what the goals of the engagement are. This, in turn, should define the advocacy/influence strategy."

The starting point for public policy engagement is a clear understanding of what the goals of the engagement are. This, in turn, should define the advocacy/influence strategy. While this may seem obvious, many of those interviewed suggested that much investor engagement is ineffective because the participants seem to have a limited understanding of what they are trying to achieve from their engagement with policy makers, with some commenting that some investors engaged with public policymakers simply because they thought it was expected of them (e.g. because they were signatories to PRI) or because it seemed like an interesting thing to do.

While the relative importance will differ depending on the specific issue and policy maker in question, the interviewees identified a number of elements that are common to successful engagement:

- A clear and coherent articulation of why investors are interested in the particular issue in question (which should include an explanation of their commitments to responsible investment, and of how they give effect to these commitments).
- Well informed research on the issue in question, including an understanding of the constraints on policymakers (both on the specific issue in question but also the wider context within which the policymaker is working).
- Reasonably well developed proposals or ideas on the actions that could be taken. A number of those interviewed noted that it was not enough simply to oppose the action being proposed by policymakers.
- A willingness to respond to feedback from regulators (e.g. to update or provide new research, to offer alternative proposals).
- The ability to deal with questions on the issue in question, on the proposals being advanced, and on wider investment issues.
- A clear understanding of who in the policymaker community and in the political community – could take forward the ideas/proposals forward.
- Well briefed participants. A number of those interviewed stressed the importance of ensuring that all meeting attendees were fully briefed on the issue, on the key messages, and on the roles that would be played in the meeting.
- The development of relationships with other stakeholders (e.g. civil society organisations, trade unions, NGOs, industry bodies). These organisations play a number of important roles: they can add credibility to the investor agenda, they can provide content or technical advice, they can help investors navigate the policy process.
- The willingness to be consistent and to stick with the issue for the duration of the policy development process, which can often be over a number of years or parliamentary cycles.

2.POLICYMAKERS GENERALLY WELCOME INVESTOR INPUT

There was a general view that investor input to public policy debates on ESG issues is welcomed by policymakers. There

are various reasons: investors are seen as an important stakeholder; the agendas being pursued by investors (in particular those with commitments to responsible investment or active ownership) often align well with those of policymakers; investors can often be a countervailing voice to other lobby groups; the financing of public policy initiatives is a key challenge for policymakers and investors offer specific expertise on how public policy can be designed and implemented to ensure private sector involvement.

However, it was also noted that policymakers often do not see investors as a discrete stakeholder group, instead frequently seeing them as part of the corporate community and assuming that they have very similar views to companies.

Policymakers can facilitate investor input through proactively reaching out to investors, through signalling their openness to investor input and through providing the opportunities (e.g. consultation processes, workshops) where investors can provide input.

3. TRUST AND CAPACITY-BUILDING WITH POLICYMAKERS ARE NECESSARY

It is important to acknowledge that policymakers may also have preconceptions about investors' interests, and may be sceptical about investors' motivations. For example, some of the policymakers interviewed noted that investors often call for policy measures that they have limited intention of using (e.g. on corporate disclosure where relatively few investors actually use ESG information, on acting in concert when relatively few investors seem to be collaborating with others when engaging with companies), that there is often a disconnect between the rhetoric of responsible investment and the investment decisions that are made (e.g. investors calling for policy action on climate change but continuing to invest heavily in coal) and that the level of organisational buy-in to responsible investment is often questionable (e.g. it is often relatively junior staff who lead policy engagement rather than senior management). A number of those interviewed also commented that investors tend to be much more interested in engaging on issues where the financial impacts on companies are likely to be relatively modest, and much less willing to engage on issues that are financially material (or, more specifically, that are likely to result in significant costs for at least some companies), on issues where there is not a relatively short term benefit to companies, or on issues of market failure (where the benefits accrue to society as a whole rather than to the individual investor).

"It is important to acknowledge that policymakers may also have preconceptions about investors' interests, and may be sceptical about investors' motivations.... In part, these views reflect legitimate concerns about the motivations of investors, but they also reflect the common lack of detailed knowledge of the investment industry among policymakers.

In part, these views reflect legitimate concerns about the motivations of investors, but they also reflect the common

lack of detailed knowledge of the investment industry among policymakers. While policymakers in finance and similar departments generally have a good understanding of the structure and operation of the capital markets, bureaucrats in other departments tend to have a relatively limited understanding of capital markets. Even within finance departments, while many will have some familiarity with investors' role on corporate governance relatively few will have much understanding of responsible investment or of investors' wider interest in environmental and social issues.

Interviewees noted that, across policymakers (in financial and in other departments), the most common misconception is that responsible investment is primarily about ethical investment (and screened funds), rather than seeing responsible investment as a mainstream investment approach to the management of ESG issues. This is an issue that often needs to be addressed/overcome in the early stages of any policy dialogue.

Investors need to recognise that these issues (the potential lack of trust and the potential lack of understanding) coexist and they need to manage/address them together, as it is frequently difficult to disentangle the two. The interviewees offered a number of suggestions on how this could be done (although they also noted that relative value of these depends on the issues and policymakers involved):

- Investors should provide a clear explanation of why they
 are interested in the ESG issue in question, and should
 ensure that regulators are aware of the purpose and goals
 of their engagement (i.e. not just the what but the why).
- Investors should ensure that the investor representative(s) are credible and trusted by policymakers. The interviewees noted that credibility depends on the specific context; it may require that the investors represent large organisations (thereby demonstrating that the investment industry is engaged) and that these organisations have a strong track-record on responsible investment, that the investors understand the wider policy context (e.g. government pension funds), that the investors have relevant knowledge/expertise (e.g. of the legal/regulatory context, of international best practice), and that the investors can demonstrate that other stakeholders (e.g. companies, civil society organisations) support the positions that they are advancing.
- Investors should proactively build personal relationships and contacts with policymakers.

4. PUBLIC POLICY ENGAGEMENT IS DIFFERENT TO COMPANY ENGAGEMENT

While there are some similarities, the reality is that, for investors, public policy engagement presents different issues to company engagement. Important areas of difference are:

 Public policy engagement often involves much longer timeframes than company engagement. Investing time (elapsed time) is hugely important, in developing trust, good relationships, and common understanding of interests. It also requires that investors are patient, and willing to commit to engagement over long periods of time.

- Regular changes in personnel/government mean that it is often necessary to restart some of the engagement process and to restart the process of developing the relationships. It also means that it may be necessary to build capacity before substantive dialogue can commence or recommence.
- Public policy lobbying in contrast to, for example, company engagement – is seen by many investors as falling outside their 'core business'. This is compounded by the frequent lack of understanding of the differences between political lobbying and policymaker engagement.
- Investors need to offer proposals and specific recommendations. This differs from company engagement where it is often sufficient for investors to identify a problem but where management is then charged with addressing the issue or identifying solutions.
- Investors need to understand the political context, in particular the benefits to the policymaker or politician of taking action or from the proposed course of action.
- Public policy engagement frequently requires that investors engage with or develop common positions with other stakeholders, in particular NGOs and civil society organisations.

"Public policy engagement often involves much longer timeframes than company engagement. Investing time (elapsed time) is hugely important, in developing trust, good relationships, and common understanding of interests."

5. INVESTORS OFTEN ENGAGE COLLABORATIVELY WITH POLICYMAKERS

A number of the investors interviewed noted that their resources for public policy engagement are relatively limited. There are different reasons: public policy engagement, in particular on ESG issues, is often not seen as an organisational priority; there is often scepticism about the business value

of this work; public policy engagement can take a long time and the outcomes are often not clear cut (or easy to link to the engagement activity); there is lack of client demand or interest; there is a lack of support for the idea that investors have a responsibility to take action on market failures; there is a lack of understanding of the long-term investment benefits of well-designed and effectively implemented public policy.

While some investors do seek to engage directly with policymakers, most investor engagement with policymakers is through collaborative initiatives, whether formal investor collaborations such as the PRI or the international investor climate change networks³, or through groups of investors convened by one or more individual investors4. Collaborations have the advantages of having other investors involved in public policy engagement (i.e. they can offer significant additional leverage), they generally require relatively few resources from most of the participants (as they usually involve one or two organisations taking on most of the administrative, research and other tasks that are important for effective engagement) and they are generally more suited to maintaining the long-term focus required to deliver change.

"Most investor engagement with policymakers is through collaborative initiatives, whether formal investor collaborations such as the PRI or the international investor climate change networks, or through groups of investors convened by one or more individual investors."

Collaborative initiatives also face a number of practical challenges. Decision-making can be more difficult, given the very different values that different organisations and individuals bring to these discussions. In addition, there is often a need to build capacity so that all of the participants understand the issue, why they need to be involved and what the proposed actions/outcomes should be. Finally, collaborative initiatives may find their credibility challenged if stakeholders perceive that the initiative does not have high level buy-in from the investor participants.

TABLE 7A INTERVIEWEES

Name	Position	Organisation
Matt Christensen	Global Head of Responsible Investment	AXA Investment Managers
Richard Connellan	(former) Executive Director	South African Securities Regulation Panel (now the Takeover Regulation Panel)
David Couldridge	Senior Investment Analyst	Element Investment Managers
Kris Douma	Head of Responsible Investment and Governance	Mn Services
Paul Druckman	Chief Executive Officer	International Integrated Reporting Council
Nathan Fabian	Chief Executive	Investor Group on Climate Change Australia/New Zealand
Mais Hayek	Manager - Continental Europe	Hermes Equity Ownership Services
Rob Lake	Director of Responsible Investment	Principles for Responsible Investment
Olajobi Makinwa	Head, Transparency & Anti-Corruption Initiatives	UN Global Compact
Steve Waygood	Chief Responsible Investment Officer	Aviva Investors
Sue Whitehead	Team Leader, Sustainable Business and Environmental Reporting	Defra

^{3.} IIGCC, IGCC, INCR, AIGCC

^{4.} Acknowledging that these collaborations are often supported by one of the formal investor collaborations.

APPENDIX 8: REPORT REVIEWERS

REPORT REVIEW PROCESS

In December 2012, ICGN's Integrated Business Reporting Committee (IBRC), the directors of the PRI and a small group of signatories were provided with the opportunity to review an earlier draft of this report. Details of the individuals that provided comment and their organisational affiliations are provided in the tables below.

Note: While the views and findings presented in the report have been informed by the reviewers' comments, the material presented in the report and the associated Appendices should not be interpreted as formal statements by any of the individuals listed below on responsible investment or on the capital markets more generally.

TABLE 8A: IBRC REVIEWERS

Name	Organisation
Aaron Bernstein	Harvard Law School Program on Corporate Governance
Frank Curtiss (Chair)	Railpen Investments
Jean-Philippe Desmartin	Oddo Securities
Farha-Joyce Haboucha	Rockefeller Financial Asset Management
Mary Hartman Morris	CalPERS
Alan Willis	Alan Willis & Associates

TABLE 8B: OTHER REVIEWERS

Name	Organisation
Helen Charrier	Caisse des Dépôts
Rob Lake	PRI
Lorenzo Saa	PRI
Rick Stathers	Schroder Investment Management
Mike Tyrrell	SRI-Connect
Olivia Watson	PRI

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