IFC
International Finance Corporation
World Bank Group

“Who Cares Wins”: One Year On

A Review of the Integration of Environmental, Social and Governance Value Drivers in Asset Management, Financial Research and Investment Processes

THE GLOBAL COMPACT

This report was commissioned by the IFC through its Sustainable Financial Markets Facility (SFMF), a multi-donor technical assistance facility established in 2002 to promote environmentally and socially responsible business practices in the financial sector in emerging markets. The SFMF is currently funded by IFC and the governments of the Netherlands, Switzerland and Norway.

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1. Introduction

This draft report has been prepared by the International Finance Corporation (IFC) in association with the Global Compact to briefly review progress over the last year against the recommendations of the Global Compact's June 2004 report, “Who Cares Wins: Connecting Financial Markets to a Changing World”. The current report highlights areas of progress, identifies key trends and notes areas where the call for action has yet to be met.

It is important to stress that this mapping is not intended to be exhaustive. Rather, it simply seeks to provide a snapshot of recent industry initiatives as they relate to the recommendations set out in the “Who Cares Wins” report.

The draft report has been prepared to coincide with the Zurich summit “Investing for Long-Term Value, 25 Aug 2005, with the intention of providing an informal starting point for discussion and brainstorming at this important event. At this stage, the draft report is being circulated to participants in the August 25th event only. It is currently envisaged that the report will be updated and finalized based on feedback from participants prior to publication.

1.1 The Global Compact

The United Nations Global Compact was launched in 2000 with the aim of promoting responsible global corporate citizenship. To date, more than 2000 companies and other stakeholders, from over 80 countries, have now joined the Global Compact's network. For companies, the Global Compact is seen as a platform to manage both risks and opportunities.

In January 2004, recognising the important role the financial sector needs to play to ensure the Global Compact's objectives are met, a group of leading financial institutions were invited to form a joint financial sector initiative under the leadership of the Global Compact. The explicit aim of this initiative was to develop guidelines and recommendations on how to integrate environmental, social and corporate governance (ESG) issues in asset management, securities brokerage services and associated research functions, and to suggest ways in which various financial sectors, such as stock exchanges and pension funds, consider ESG issues.

1.2 Who Cares Wins

After a period of consultation, a group of 18 financial institutions from 9 countries with combined assets under management of over US$6 trillion, published and publicly endorsed a report in June 2004, entitled

"Who Cares Wins: Connecting Financial Markets to a Changing World." The focus of the report is a series of recommendations, targeting different financial sector actors, which taken together seek to address the central issue of integrating ESG value drivers into financial market research, analysis and investment. These recommendations are summarized in Figure 1 below and have been endorsed by:

- ABN Amro
- Aviva
- Banco do Brasil
- Bank Sarasin
- BNP Paribas
- Calvert Group
- China Minsheng Bank
- CNP Assurances
- Credit Suisse Group
- Deutsche Bank
- Goldman Sachs
- Henderson Global Investors
- HSBC
- IFC
- Innovest
- ISIS Asset Management
- KLP Insurance
- Mitsui Sumitomo Insurance
- Morgan Stanley
- RCM
- UBS
- Westpac
- World Bank Group

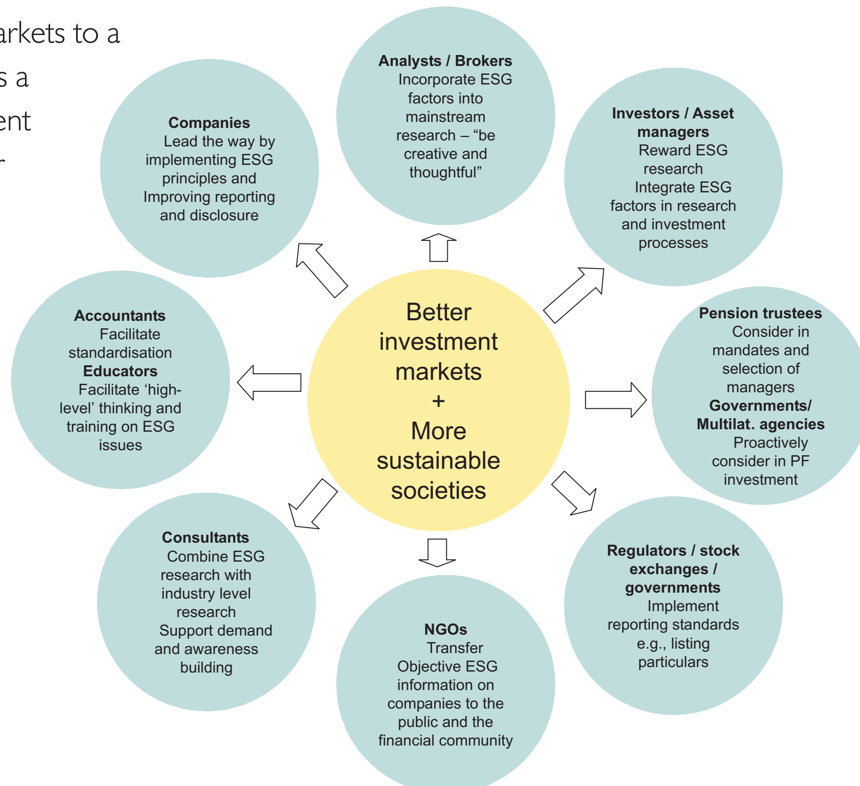

Figure 1: Financial Sector Actors and Roles (as identified in the "Who Cares Wins" report)

1.3 International Finance Corporation

IFC is one of several leading institutions whose CEOs have endorsed the Who Cares Wins report. As the private sector arm of the World Bank Group, IFC's mission is to promote sustainable private sector investment in developing countries. IFC invests around US$5 billion a year in a wide range of private sector projects and asset classes, to which it applies rigorous social, environmental and corporate governance standards.

In December 2004, the UN Secretary-General and IFC's Executive Vice President agreed that IFC would deepen its support to the Global Compact by providing active long term collaboration on the Compact's work in the financial sector, especially work related to Who Cares Wins follow-up and the advancement of ESG issues in emerging markets.

2. "Who Care Wins": Favourable Industry Tailwinds

Before reviewing specific developments undertaken by financial institutions, it is instructive to reflect briefly on the favourable industry backdrop of the past year. Taken together, the following events have proved instrumental in encouraging investors and analysts to consider ESG issues:

High Oil Prices

A combination of strong energy demand driven by rapid economic growth in China and India, limited new supply and a heightened risk premium following geo-political developments in the Middle East, all contributed to a dramatic increase in oil prices over the year, as seen in figure 1. One important consequence has been the stimulation of investor interest in issues such as energy usage and levels of energy intensity amongst companies, as well as consideration of alternative "clean energy" sources and technologies. For example, high oil prices have led to a significant improvement in the competitive positioning of solar power and wind-dependent generation companies. At the same time, consumer preferences have shifted towards more energy-efficient products. The strong growth of small and

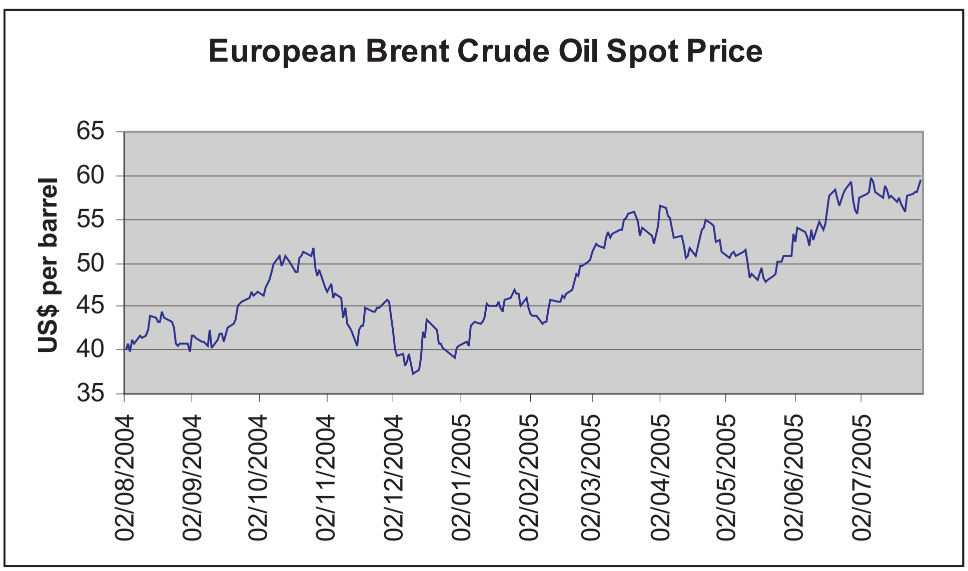

Figure 2: The rising price of Oil *Source: Bloomberg*

"hybrid" vehicle sales in the United States is in part attributable to high gasoline prices at the pump.

ETS and High Carbon Prices

The launch of the EU Emissions Trading Scheme (ETS) on 1st January 2005 provided a framework by which both analysts and investors can better quantify the direct economic costs of corporate emissions and evaluate companies' emissions reduction strategies. While coverage of the scheme is restricted to Europe, its impact has been felt globally, as many non-European firms also have operations in the region. The threefold rise in the price of carbon dioxide emissions since the launch of the ETS has added further impetus to such analysis.

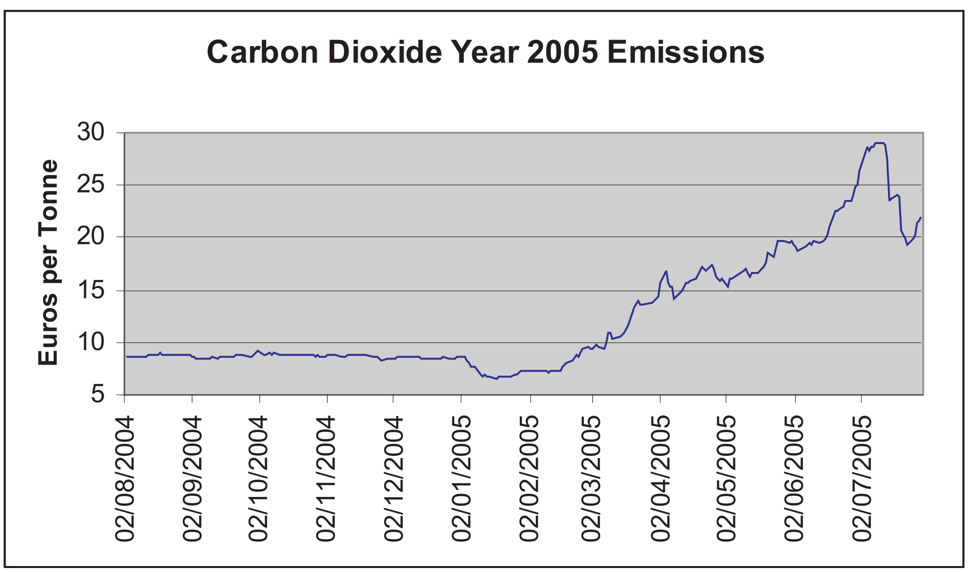

Figure 3: The rising price of carbon dioxide emissions *Source: Bloomberg*

Kyoto and G8

The eventual implementation of the Kyoto Treaty, on February 16th 2005, and the emphasis placed on environmental and social issues leading up to and during the G8 Gleneagles Summit on July 6-8th 2005, have both helped to keep ESG issues at the forefront of investors' and analysts' minds over recent months.

Increased Risk Appetite, Ageing Populations and Emerging Markets

Low interest rates helped drive a marked increase in the global appetite for risk. Amongst other consequences, this led to significant new investment flows into emerging markets, reflected in investment returns of over 47% in the year to 31st July. At the same time, a growing number of pension funds have gone in search of higher returns from 'alternative' asset classes, including emerging markets, in order to meet the demographic challenges posed by ageing populations and unfunded pension fund liabilities. Given the increased risks associated with the asset class, this new interest in emerging markets has prompted some investors to consider ESG-related strategies as an important risk-management tool.

Increase in "Clean Technology" Investment Opportunities
Over the year a steady stream of previously unlisted "clean technology" companies migrated to regional stock markets, offering many investors the first opportunity to gain portfolio exposure to new and emerging sustainability-related sectors and themes.

Breach of Trust
Several large financial institutions faced allegations of breach of trust. In particular, concerns over perceived conflicts of interest and the mis-selling of products have led to positive changes in industry practices and increased the focus on ethical conduct.

New Social Issues
As a result of globalisation, an increasing number of companies, through expanded supply chains and a greater reliance on contracting and sourcing in the developing world, are confronting a range of new material social issues including labour conditions, HIV/AIDS, conflict and high levels of poverty and inequality.

The Asian Tsunami
The Asia Tsunami of December 2004 prompted many companies to develop new, or refine existing, corporate responsibility programmes. Of note was contribution not just of financial resources but also employees' skills, time and expertise where appropriate, as well as the healthy emphasis placed on learning from individual company experiences and mistakes, in order to improve the corporate sector's ability to respond to future emergencies.

3. Key Developments in the last year

The report's authors have attempted to prepare a global 'map' of progress and key initiatives over the last 12 months in each part of the investment supply chain identified in the Who Cares Wins report (see Figure 1). The full results are tabulated in Appendix 1. It is important to stress that this mapping is not intended to be exhaustive. Instead it simply seeks to provide a snapshot of recent industry initiatives as they relate to the recommendations set out in the "Who Cares Wins" report.

A summary of key developments is presented in Table 1. Encouragingly, the past twelve months have witnessed a number of significant developments within the financial sector, which taken together represent an important step towards to the integration of ESG issues into analysis, asset management and securities brokerage.

Quality and Quantity
Most striking is the quality and quantity of new initiatives and reports. In the majority of areas identified by the "Who Cares Wins" report, good

Table I: A summary of key developments (excerpt from Appendix 1)

Financial Sector Actor	Major Developments in the Past Year
Pension Fund Trustees	■ Investor Network on Climate Change (INCR) conference, subsequent "Investor Call for Action" (May 05) and publication of "Investor Guide to Climate Risk." (July 05) ■ Enhanced Analytics Initiative launched (EAI) (Oct 04) ■ Principles for Responsible Investment launched (PRI) (June 05) ■ Increased investment in clean technology sector including US$1bn commitment from INCR Call to Action signatories ■ US pension fund collaborative engagement - e.g. 15 US pension funds sent letters to 43 power sector companies requesting climate risk reports (July 05)
Governments/ Multilateral Agencies	■ Le Fonds de Réserve pour les Retraites (FRR), a French Government pension reserve fund set up in 2003, launched a new 600 million euros European Equity "Socially Responsible Investment" mandate (June 05)
Consultants	■ Mercer build SRI team
Investors/Asset Managers/ Buy-Side Research	■ EAI ■ Conference Board's ESG Tool for Analysts ■ World Economic Forum and AccountAbility published "Mainstreaming Responsible Investment" (Jan 05) ■ Strong growth in "clean technology" private equity funds ■ Third Round of Carbon Disclosure Project launched. 143 institutional investors with assets of $20trillion wrote to the 500 largest listed global companies (Feb 05) ■ Generation Investment Management launched
Investment Brokers/ Sell-Side Research	■ EAI ■ Conference Board's ESG Tool for Analysts ■ Goldman Sachs, UBS and Citigroup all established new SRI teams ■ New sell-side research commitment, often in collaboration with specialist NGOs/SRI firms. For example, Merrill Lynch initiated partnership with WRI to publish: "Energy Security and Climate Change: Investing in the Clean Car Revolution" (July 05) ■ Prompted in part by Rainforest Action Network's Global Finance Campaign, several leading US banks launched firm-wide ESG policies, including JP Morgan, Bank of America, Wells Fargo and Citigroup. ■ IFC designed emerging markets research competition
Academic Institutions/ Educators	■ Mistra (Swedish Foundation for Strategic Environmental Research) launched three year major research programme on "Behavioural Impediments to Sustainable Investment" and "Sustainable Development The New Role of Institutional Investors" (June 05)
Regulators	■ Few significant regulatory developments ■ UK Government passed "Operating Financial Review", requiring listed companies to disclose relevant ESG information (April 05) ■ Germany passed regulation which mandates corporate pension funds to disclose any policies they have on social, environmental and ethical issues (July 05)
Stock Exchanges	■ London Stock Exchange set up Corporate Responsibility Exchange
Companies	■ Many examples of new ESG-related strategies, including launch of General Electric's "Ecomagination" (May 05) ■ Global Compact network increased from around 1400 to over 2000 companies ■ GRI reporting companies grew from 450 to over 700 ■ Leading up to G8 summit, the heads of 23 global companies released a joint statement expressing strong support for action to mitigate climate change (June 05)
NGOs	■ WRI collaborated with Ceres, SAM Group and Merrill Lynch to produce a series of high quality, original research reports ■ WWF and Allianz produced joint report "Climate Change and the Financial Sector: An Agenda for Change"
Emerging Markets	■ Countries such as Brazil, South Africa and Korea continued to be progressive on the development of ESG related investment ■ Unlike the way "SRI" has developed in Europe and USA, in many emerging markets ESG is a mainstreaming action from the outset

progress has been made. Almost without exception, emphasis has been placed on integrating and embedding ESG issues at the heart of the investment process, rather than positioning them as optional add-ons to be considered only by those with a specialist SRI interest.

New Faces and Firms

Until recently the consideration of ESG issues was largely restricted to specialist firms within the SRI industry. However, the last twelve months have witnessed an important step-change in this dynamic, as several pivotal financial institutions from outside the traditional SRI space made new business commitments to ESG integration, including Goldman Sachs, UBS, Citigroup and Mercer.

Climate as a Catalyst

Although developments covered the spectrum of environmental, social and governance issues, climate change proved to be a particularly powerful catalyst. Most notable was the Investor Network on Climate Risk (INCR) conference hosted by Ceres in May 2005 which gathered together an impressive collection of leading US state, city, labour and religious pension funds, as well as several large European investors. The outcome was an “Investor Call for Action”, containing ten recommendations addressing climate change as well as a series of specific commitments from signatories. These are outlined in Appendix 2.

Collaboration

Collaboration was a dominant theme with the evolution of several large international initiatives such as PRI, EAI, CDP, GRI, INCR and IIGCC (the industry's penchant for acronyms remains undiminished!). In addition, on the research side there was a notable trend of partnership between traditional sell-side research firms, NGOs and specialist SRI firms. Examples included reports such as “Energy Security and Climate Change: Investing in the Clean Car Revolution” (WRI and Merrill Lynch), “Climate Change and the Financial Sector: An Agenda for Action” (WWF and Allianz) and “Thoughts on SRI Research.” (Morgan Stanley and Oxford Analytica), as well as broad-based research tie-ups between UBS and Innovest and West-LB and the SiRi Group. Whether this level of collaboration will continue, once in-house capabilities to integrate ESG research are further developed within the traditional sell-side firms, remains to be seen.

Collaboration is also at the forefront of the forthcoming "Investing for Long-Term Value" conference (25 August 2005) in Zurich. Under the auspices of the Global Compact, Swiss Government and IFC, this is a follow-through event to the initial Global Compact meeting in 2004 which produced “Who Cares Wins”. This second conference seeks to bring together leading financial-sector experts from a range of firms to take stock of initiatives, research and innovations.

Innovative Responses

Several new initiatives launched last year are particularly notable for the high level of innovation and originality they bring to tackling perceived gaps and market failures. These include:

- The Enhanced Analytics Initiative (box 1)
- The Principles of Responsible Investment Initiative (box 2)
- IFC Emerging Markets Sustainability Research Grant Competition (box 3)
- Conference Board's Framework to Factor ESG Criteria into Investment Analysis (box 4)

Box 1: The Enhanced Analytics Initiative (EAI)

The EAI was launched last October by a group of leading European investors with the stated aim of promoting better research on ESG issues from sell-side analysts by explicitly requesting and rewarding such research. Each member of the Initiative committed to allocate 5% of their brokerage commission (currently around US$5m for the second half of 2005) to those research houses, identified by a six monthly evaluation, as being most effective at analysing extra-financial issues and intangibles.

The second six monthly evaluation in June 2005 examined 84 reports from 23 research providers and singled out four institutions (Bernstein Research, CM-CIC Securities, Dresdner Kleinwort Wasserstein and UBS Investment Research) for the research they produced between November 2004 and April 2005. Following the report EAI Chairman Philippe Lespinard concluded:

> *"Progress has certainly been made since the last evaluation in January 2005, but the outcome that we really require is consistently good research across a range of sectors and issues that is directly applicable at company level. This is still some way off but we are confident that the increasing membership of the EAI and the increased incentives that this entails will help research houses to deliver the breakthrough that long-term asset owners and their fund managers require."*

Other findings so far include a bias towards certain sectors such as utilities, and issues such as climate change, while the majority of reports remain equity rather credit focused. Since the launch, two new institutions (Hermes Pensions Management and SPF Beheer) have joined, taking the number of full members to nine.

Box 2: The Principles for Responsible Investment Initiative (PRI)

Launched by the Secretary-General, and co-sponsored by UNEP-FI and The Global Compact, the PRI is currently developing global ESG guidelines for public pension funds. A core group of international institutional investors is currently developing the principles. The UN is playing a convening and facilitating role, understanding that the final principles scheduled for release in March 2006 will be "owned" by the investors themselves. Endorsing funds will include PRI and the concept of ESG in their own investment mandates and processes.

Box 3: IFC Emerging Markets Sustainability Research Grant Competition

As part of its work on sustainable investment in emerging markets, the IFC developed a competition making available up to $500,000 in grant(s) to analysts, rating companies, and other providers who will increase the availability and quality of sustainability-related research on emerging markets listed companies.

The project is premised on the belief that while more investors would like access to good quality, affordable research, there is currently a lack of infrastructure in place to meet this demand. This has created one of the major short-term market barriers to increased sustainable investment in emerging markets. IFC believes that this barrier can be overcome, by building the professional capacity for research and analysis in emerging markets and combining local expertise with international best practice. The grant competition will be open to a wide range of organizations, from mainstream broker dealers to more specialized firms.

A panel of internal and external experts will evaluate submissions based on the quality of the research and their coverage of a range of environmental, social, and governance issues affecting long-term shareholder value of emerging market companies. Detailed information for applicants will be posted on the IFC website in October 2005: www.ifc.org

Box 4: "Expanding the Investment Frontier": A framework to factor ESG criteria into investment analysis

As a direct outcome of last year's "Who Cares Wins" project, The Conference Board convened a working group of "Who Cares Wins" endorsers to develop industry tools to assist the analysis of ESG issues.

- An analysis was conducted of 10 major business sectors and the 10 most significant ESG factors for each sector were compiled.
- A Discounted Cash Flow (DCF) modelling procedure was developed as a Framework and documented to illustrate how these factors could be systematically evaluated.
- An application of the conceptual approach was applied to the energy sector to illustrate how it works.
- "Scaled back" approaches to applying the Framework were suggested to address the potential complexity of the model Framework and illustrate how it can be flexibly applied depending on different analysts' preferences and interests.

As a result, the Group has developed - for tentative release in August/September 2005 by The Conference Board -- an analysis of emerging ESG factors in ten industries, in addition to a tool linking specific ESG issues to company value drivers.

4. Key Gaps and Issues for Future Consideration

4.1 Key Gaps

The mapping in Appendix 1 also highlights some of the areas where progress has been slow, with the key gaps summarised in Table 2.

4.2 Issues for Future Consideration

Follow-Through

Generally the level of follow-through and momentum for existing initiatives appears to be good. However, it was not uncommon to come across websites from previous initiatives which had not been updated for at

Table 2: A summary of key gaps (excerpt from Appendix 1)

Financial Sector Actor	Key Gaps
Pension Fund Trustees	▪ Pension fund trustee consideration of ESG issues in formulation of mandates and manager selection still not widespread ▪ EAI requires broadened and deepened membership to fulfil potential
Governments/Multilateral Agencies	▪ Opportunities for further progress by government and multilateral pension funds to integrate sustainable investment principles taking into account their fiduciary duty.
Consultants and Academic Institutions	▪ Greater technical research still required from consultants and academics on the implications of ESG integration in different asset classes and with different styles, for both returns and alternative measures of risk
Investors/ Asset Managers/ Buy-Side Research	▪ Indications that the industry as a whole is still getting even more short term. Specific initiatives needs to ensure this short-term industry takes account of ESG issues ▪ More emphasis needs to be placed on the time horizon of incentivisation programmes for investment professionals ▪ EAI requires broadened and deepened membership to fulfill potential ▪ Fund managers slow to develop high quality long-term investment products
Investment Brokers/ Sell-Side Research	▪ Expansion of geographical industry coverage of ESG research required
Regulators	▪ Regulators have not taken an active role in some cases their interventions have made it more difficult, rather than easier, for investors to focus on long-term horizons and ESG integration (e.g. accounting and reporting rules forcing pension funds to report on a quarterly basis)
Stock Exchanges	▪ Follow-through required after promising initial dialogue. Focus on practical measures that also make business sense for the exchanges
Companies	▪ Better identification and communication of key strategic ESG challenges and value drivers ▪ ESG reporting could be more investor friendly
Emerging Markets	▪ Most traditional emerging markets research still too short-term, with insufficient attention paid to ESG issues ▪ Broaden geographical research and sales focus of SRI teams within investment banks

least twelve months. Given the exciting positioning of new initiatives such as EAI and PRI, thought should be given to ensuring they remain fresh and dynamic as they evolve over time. There is scope to broaden awareness of these initiatives beyond direct participants. Likewise, it would be interesting to gain a better understanding of the end-usage of new reports and toolkits, if only to refine future publications to ensure maximum impact. Where, when and by whom are they being read?

In the Shadow of a Green Bubble?
In at least some areas, ESG-related investment has achieved a fashionable status in recent months. For example, in a trend mildly reminiscent of the internet era, it has been possible for a number of conceptual "clean technology" companies, lacking either tangible revenues or assets, to gain easy access to investors' capital. Whilst attractive returns have helped stimulate investor interest, there is a danger that this interest could rise and fall along with the returns, unless the underlying spirit of ESG integration is properly embedded. It is important to ensure that the current vogue for clean technology investment does not overshadow consideration of other environmental, social and governance aspects.

Leadership on Product-Development
The relationship between investment banks, asset managers, consultants and pension fund trustees is extremely inter-dependent. As a result there is a danger that different actors sometimes adopt a wait-and-react approach to product development, rather than taking the lead. The dearth of innovative long-term products is an example of such a stalemate. In order to encourage the development of leadership products, it is important that financial institutions are able to adopt their own long-term business development plans.

The Line of Greatest Resistance
Further work is still required to convince pension fund trustees, regulators and investors that the integration of ESG issues is about creating value rather than reducing returns. As a recent consultant survey notes:

"For many trustees, socially responsible investment still conjures up visions of negatively screened funds with an 'agenda' to pursue, a view being reflected in the comparatively small amount of assets under management."

Investment Time Horizons
The continued growth in hedge fund assets reinforces the specific challenge of aligning the integration of ESG issues with the short investment time-horizon of this asset class. More work is required to understand how such integration is best achieved. For example, the practice of stock lending in its present format, whereby long-term investors transfer ownership rights

of their shares to hedge funds in exchange for a fee, has potential negative implications on corporate governance and the concept of shareholder responsibility. Further consideration of these issues may identify ways in which such effects can be mitigated or removed.

Fixing the Investment Value Chain

A greater focus is still required to address key structural issues within the core investment process. Examples include the short-term focus of incentivisation and reward structures for asset managers, analysts and brokers, the inflexibility of the current commission allocation process and the over-emphasis on risk defined primarily in relation to index weightings. Meanwhile the potential conflict of interest between asset managers and investment banks has yet to be fully addressed, particularly in light of the significant growth in proprietary trading desks and prime broking.

Quality of Emerging Markets Investment

While it is too early to judge whether recent liquidity-driven flows to emerging markets will ultimately prove to be a blessing or a curse, much will depend on the underlying quality of these flows. Addressing the present gap in the research infrastructure is one step towards improving this quality, but further advances are required in other areas. Despite some progress, only a minority of emerging markets investors currently seek to integrate ESG issues into their investment decisions. Given the specific ESG challenges of many emerging markets, it is imperative that this changes sooner rather than later. Pension funds have an important role to play in demanding greater consideration of ESG issues from existing emerging markets fund managers. Meanwhile, most investment in the asset class is still restricted to a small number of rapidly growing countries, and there is significant scope for private equity investors (particularly those with an ESG focus) to help catalyse investor interest in new 'frontier markets'.

The new search for commodities

Rising prices of oil and other commodity prices have created new challenges for investors, as companies step up exploration and production activities in locations posing significant environmental and human rights challenges. Investors must work hard to ensure their companies are not tempted to take short-cuts that boost short-term profits at the expense of long-term sustainability.

An Exceptional Year?

The progress made last year in tackling the issues raised in the “Who Cares Wins” report is extremely encouraging. Placed in an historical context the developments were in several ways exceptional, not least for the new broader commitment from leading financial institutions and the level of innovation and originality displayed by a series of new initiatives. Although maintaining such momentum will be difficult, it is an achievable (and necessary) goal, particularly in light of the healthy roots put down by many financial sector institutions over the past twelve months.

Appendix 1: International Mapping of Developments since July 2004

Financial Market Actor	WCW 2004 Recommendations	Areas of Progress and Examples	Outstanding Issues
Pension Fund Trustees	Consider ESG issues in formulation of mandates/ selection of managers	Mandates/ Manager Selection • Modest progress on new mandates and manager selection. Large pension funds continued to lead the way, including ABP, USS, PGGM, CalPERS and CalSTRS. Guidelines and Training • The Carbon Trust, Mercers and the Institutional Investor Group on Climate Change (IIGCC) report: "A Climate for Change – A Trustee's Guide to Understanding and Addressing Climate Risk."[1] • EUROSIF/ UKSIF report: "Transparency Guidelines for Developing ESG Issues within Institutional Investment." (ongoing)[2] • EUROSIF report: Pension Fund Trustee Toolkit (Dec 04)[3] • UKSIF Just Pensions toolkit: "Responsible Investment Trustee Toolkit" (April 05)[4] • UKSIF Just Pensions developed five new sector reports for trustees on ESG issues, taking total number to nine. Topics include: food, tobacco, retail and construction industries[5] (July 04 – June 05) Collaborative Initiatives US and European Pension Funds played important roles in both the launch and development of various collaborative initiatives including: • INCR conference and subsequent "Investor Call for Action" (May 05) and publication of "Investor Guide to Climate Risk[6] (July 05) • Several examples of US pension funds collaborating on ESG engagement with companies and industries. For example, 15 US pension fund investors sent letters to 43 of the country's 50 largest investor-owned greenhouse gas emitters in power sector, requesting climate risk reports. (July 05). In another example, four of Wal-Mart's largest institutional shareholders from the US and Europe wrote an open letter to Roland Hernandez, Chairman of Wal-Mart's audit committee, expressing "serious concerns about the reports of legal and a regulatory non-compliance at Wal-Mart" (June 05) • Enhanced Analytics Initiative (EAI)[7] (launched Oct 04) • Pension Principles for Responsible Investment Initiative (PRI)[8] (June 05) • Institutional Investors Group on Climate Change (IIGCC) and the Climate Group announced plans for a joint venture to generate an independent but co-ordinated international response to climate change from the international institutional investment community.[9]	ESG consideration in mandates/ manager selection still not widespread

	Lengthen mandate time horizon	• Evolution of single issue initiatives including The Pharmaceutical Shareowners Group[10] and PharmaFutures[11] Clean Technology Investments • INCR Call for Action included commitment from signatories to employ $1bn in new clean technology asset class (May 05) • CalPERS made first $15m investment of new Environmental Technology Program, which aims to invest $200m in firms providing environmental technology solutions (May 2005)[12] Long-Term Investment • Small but increasing interest in long-term mandates, partly driven by consultant interest, most notably from Watson Wyatt.[13] Emerging Markets • Brazil – pension fund association ABRAPP[14] initiated process to develop principles for responsible investment (Nov 04) • Peru – state pension funds invest in local microfinance projects • Chile – signs of interest in investing in 'globally responsible' investment funds • Future stages of PRI to involve active engagement with emerging market pension fund trustees.	Broaden consideration of long-term mandates Re-examine stock lending practices in light of potential negative consequences on ESG consideration
Government/ Multilateral Agencies	Investment of pension funds according to sustainable development principles	Several positive examples of Government pension funds publicly embracing ESG integration, including: • Le Fonds de Réserve pour les Retraites (FRR), a French Government pension reserve fund set up in 2003 to meet the expected shortfall from the existing Pay-As-You-Go state pension scheme, launched a new 600 million euros European Equity "Socially Responsible Investment" mandate to be allocated to up to 6 managers offering different SRI strategies.(June 04) Meanwhile, existing mainstream managers of the Fund are requested to fully incorporate the 10 Global Compact principles into their analysis and to implement an active proxy voting policy based on a set of publicly-disclosed guidelines.[15] • Australia's VicSuper Fund builds on its commitment to develop a "Sustainable Super Fund" with publication of their first Sustainability Report "What in the world has sustainability got to do with superannuation?" compiled in accordance with GRI Principles. (Oct 04) The New Zealand Superannuation Fund, initially launched in 2003, continued to allocate new mandates with consideration to ESG issues.[16] • The Norwegian Government Petroleum Fund adopted new "Ethical Guidelines"[17] (Dec 04) UN joint staff pension fund agreed to incorporate ESG factors into investment process Environment Agency Active Pension Fund placed its £1bn pension scheme out for a series of tenders, inviting asset managers to propose investment strategies that would specifically integrate the environmental performance, both past and future, into their investment strategies (2004).	Concerns remain over fiduciary impact of ESG mandates

<table>
<tr><td></td><td></td><td>Emerging Markets
IFC developing proposals for creation of new funds for long term, ESG-oriented investment in emerging market listed equities
EBRD assessing similar opportunities in Central & Eastern Europe
Increasing evidence that Chinese government has a long term appreciation of the significance of ESG factors in future on-shore and off-shore listing of Chinese private and state owned enterprises, and is already beginning to lay down a proactive strategy to manage these risks/opportunities.
More evidence that other Asian governments are addressing both funding and pension management issues to increase transparency and independence for outside managers.</td><td></td></tr>
<tr><td>Consultants</td><td>Consider ESG issues in formulation of mandates and selection of managers

Contribute to industry ESG research and share with financial market actors</td><td>Some evidence of new commitment to ESG integration by consultants. Of note, Mercer increased commitment to ESG analysis with development of dedicated SRI team, while Watson Wyatt continued development of long-term mandates.
UKSIF publishes “Investing Responsibly: A Technical Guide for Financial Advisors”[18] (June 05)
A Mercers’ SRI investor survey found majority of 195 managers questioned believed most SRI issues would be integrated into mainstream within 10 years.[19]
Emerging Markets
Efforts to integrate international equities as an asset class into Asian pension funds will raise issues touching on ESG analysis. The growing interest in new Asian asset classes such as real estate, infrastructure, and private equity will offer similar challenges. Governance risks could dominate the picture initially.</td><td>Scope for greater proactive leadership on ESG integration, rather than being reactive to client demand

Broaden appreciation of value creation proposition within wider consultant industry

More technical research required on implications for returns and alternative measures of risk for different asset classes and different investment styles - including growth/value, contrarian/ momentum, quantitative/ qualitative, small cap/ large cap and short-term/long-term</td></tr>
<tr><td>Investors/ Asset Managers/ Buy-Side Research</td><td>Request/ Reward ESG research

Integrate ESG factors into research/ Investment processes</td><td>EAI provides innovative link between request and reward
Small but growing allocation of commissions specifically for SRI research in Europe – 2005 6.25% of total broker commission devoted to SRI, up from 4.26% in 2004 and 1.17% in 2003.[20]
Greater use by asset managers of ESG research from independent specialists such as Innovest and CoreRatings
World Economic Forum and AccountAbility published “Mainstreaming Responsible Investment”, a report offering similar recommendations to the “Who Cares Wins” report.[21] (Jan 05)</td><td>Broaden and deepen EAI membership participation beyond 9 full members

Re-examine bespoke research payment methods including redirected commissions and unbundling</td></tr>
</table>

	Encourage companies to produce ESG information Develop/ Communicate proxy voting strategies on ESG issues Lengthen time horizon	• Conference Board's ESG sector analysis and tool development stemming from "Who Cares Wins" • Generation Investment Management launched with high-profile emphasis on long-term investment and integrated analysis of sustainability issues[22] (Nov 04) • Innovest Strategic Value Advisors develop a positive screening tool based entirely on The Global Compact. • Strong growth in "clean technology" private equity funds • US social research analysts (SIRAN) at 18 firms, representing over US$230bn in assets under management, issued a collective statement calling for companies to produce annual sustainability reports based on GRI guidelines.[23] (Oct 04) • Third round of Carbon Disclosure Project launched. 143 institutional investors with assets of $20 trillion wrote to the 500 largest listed global companies, to request disclosure of "investment-relevant information concerning their greenhouse gas emissions."[24] (Feb 05) • Launch of Global Reporting Initiative "G3" included formation of Investors Consultation Group to consider recommendations for improving the usefulness of GRI reports for financial analysts and investors (June 05) • Fall in US shareholder resolutions in 2005 season – around 570 shareholder proposals to date, down from 708 in 2004 and 698 in 2003. To date 85 proposals have won majority support in 2005, compared to 138 in 2004 and 172 in 2003.[25] Interpretation could be positive or negative. • "Review of the Impediments to voting UK shares: progress one year on"[26] by Paul Myners to The Shareholder Voting Working Group highlighted progress on electronic voting which was regarded as one of the biggest barriers to proxy voting. By the end of 2004 88 of the FTSE 100 companies facilitated CREST's electronic voting service, compared with 47 the previous year. (March 05) • EUROSIF piloted transparency guidelines for engagement and voting in institutional investment[27] (Oct 04) Emerging Markets • Countries such as Brazil, South Africa and Korea continued to be progressive on the development of ESG related investment. • Brazil: FGV-SP and the IFC hosted a two day conference on Sustainable Finance in Emerging Markets in Sao Paulo (Nov 04). • South Africa: Old Mutual Asset Management (OMAM), Unity Corporation and Community Growth Funds convened an SRI conference in May 2005 to generate proposals for the development of "SRI" in the South African market. • It should be noted that integration of ESG in many emerging markets -unlike the way "SRI" has developed in Europe and the U.S. -to a greater extent is a mainstreaming action from the outset, both for financial institutions, companies and their supply chains. Issues of HIV/AIDS, corruption and	Some companies frustrated by lack of feedback by investors on ESG strategies and communication Greater product innovation required to meet long-term horizons Stronger links required between ESG-aware private equity and listed equity investors, particularly in frontier emerging markets

		transparency, are material especially in the extractive but also in the financial sectors.	
Investment Brokers/ Sell-Side Research	Incorporate ESG factors into mainstream research Widen sector coverage from traditional sensitive sectors	• EAI • Conference Board's ESG sector analysis and tool development stemming from "Who Cares Wins" New Sell-Side ESG Research Commitment, including: • Goldman Sachs, UBS and Citigroup established new SRI teams • UBS hired Innovest to provide research to facilitate integration of ESG into their mainstream analysis New Sell-Side ESG Research Reports, including: • Citigroup "Sustainable Investment Themes: A guide to the environmental and social factors affecting each industry sector" and "Crossing the River…and interpreting sustainable development for financial markets" (both July 05) • Morgan Stanley "Thoughts on SRI Research"[28] (June 2005) in conjunction with Oxford Analytica. • Merrill Lynch initiated collaboration with WRI to publish "Energy Security and Climate Change: Investing in the Clean Car Revolution" (July 05) • UBS now produces an "SRI Monthly: Trends and Changes" report US Financial Firms embrace ESG at corporate level • Prompted in part by Rainforest Action Network's Global Finance Campaign, several leading US banks launched firm-wide ESG policies, including JP Morgan, Bank of America, Wells Fargo and Citigroup. [29] Emerging Markets • IFC prepares US$0.5M million research competition to catalyse ESG emerging markets research (launch in Autumn 2005)[30] • ASRIA commenced ESG briefings for investors and analysts. Topics so far include the environmental, health and safety performance of companies and "ISO14001, what do investors need to know?"[31] This will be followed by research to examine the ESG risks for the main listed sectors in Asian markets. • ASRIA teamed up with Bank Sarasin to publish " 'Made in China' – Is this a Sustainable Label?"[32] (Sep 04) • CLSA continued to stand out for corporate governance and other ESG-related research in Asia. Publications included: ➢ "Corporate Governance in Asia: Spreading the word –Changing Rules in Asia" (Sep 04) – tracks corporate governance progress in 450 regional companies ➢ "Captains of Industry: A survey of corporate culture in Asia", including research on executive and director compensation, human resource management and community relations.	Integration of ESG still primarily limited to traditional sectors and thematic research. More scope to embed into core stock analysis. Link ESG information, such as GRI data, into traditional research platforms Broaden geographical research and sales focus of SRI teams within investment banks Most traditional emerging markets research still too short-term, with insufficient attention paid to ESG issues

		➢ CLSA U Education syllabus for investors included reports and expert presentations on biofuels, fuel cells, the end of oil and carbon management • Integration of ESG issues in some Brazilian sell-side research (ABN AMRO Banco Real) • Innovest increased coverage of emerging markets companies • Innovest and Rexiter Capital Management launched first Emerging Markets SRI Strategy • UBS's SRI Monthly has a strong Asian and Emerging Markets focus. Topics in the August report included an analysis of the impact of EU trade reforms on South African sugar companies, the development of the Chinese pharmaceutical industry, the biodiesel potential of Malaysian plantation companies and Asian water treatment opportunities. • APIMEC (Brazil) and IFC started ESG training program for equity analysts	
Academic Institutions/ Educators	Support analysts with high-level research	• Mistra (Swedish Foundation for Strategic Environmental Research) commenced new three year major research programme, allocating SEK21million to research "Behavioural Impediments to Sustainable Investment" (Göteborg University) and SEK12m to research "Sustainable Development – The New Role of Institutional Investors".[33] (June 05) • University of California Berkeley's Center for Responsible Business addressed ESG issues through annual social metrics conference Emerging Markets • Brazil: FGV-SP (Sao Paulo business school) assisting Bovespa to develop sustainability index and providing sustainable finance training across the national financial sector.	Further academic research required on: (a) link between successful ESG management and value creation (b) relationship between ESG integration and portfolio risk/return profiles for different asset classes and investor styles (c) ESG integration and behavioural finance Greater links required between consultants and academic institutions to improve dissemination of academic research within the financial community
Regulators	Shape legal frameworks Require minimum degree of disclosure/ accountability from companies	• UK Government brought into law the "Operating Financial Review", which requires listed companies to disclose relevant ESG information.[34] (April 2005) Too early to judge impact. • Germany passed regulation which mandates corporate pension funds to disclose any policies they have on social, environmental and ethical issues (July 05) • Support for market-based solutions with companies themselves calling for stricter (clearer) market-based regulations. For example, leading up to the G8 Summit, the heads of twenty-three global companies released a statement on June 9th 2005 expressing strong support for action to mitigate climate change. It included a call upon governments to establish "clear, transparent, and consistent price signals" through creation of a long-term policy	Regulators have not taken an active role in the field – in some cases their interventions have made it more difficult, rather than easier, for investors to focus on long-term horizons and ESG integration (e.g. accounting and reporting rules forcing pension funds to report on a quarterly basis) The June 9th corporate statement highlights the

		framework that includes all major emitters of greenhouse gases.[35] Emerging Markets • After significant upgrades in corporate law and listing rules in recent years, Asian regulators have begun to focus on tougher enforcement. More timely disclosure of related party transactions has been a particular focus in Hong Kong and China. • Chinese regulators have worked to resolve issues with non-tradable shares, typically held by government entities, which have hampered the development of the domestic stock market. • Adequate supervision of Asia's government-controlled listed companies remains a challenge. The Malaysian government's investment arm has endorsed the use of key performance indicators (KPIs) to enhance accountability.	need for technology incentive programs that use performance-based standards to accelerate commercialization of low carbon technologies. It also calls for a "new partnership" between the G8 countries and China, India, Brazil, South Africa, and Mexico to facilitate private investment in low carbon infrastructure.
Stock Exchanges	Include ESG criteria in listing particulars +/or raise awareness of ESG issues	• The Global Compact, IFC and World Federation of Exchanges discussed potential collaboration on areas such as support for emerging market companies on investor relations, solutions for information and disclosure for local exchanges. • Four stock exchanges joined The Global Compact: Euronext, Bovespa, Istanbul and Jakarta • London Stock Exchange set up corporate responsibility exchange to facilitate investor relations/ alleviate questionnaire fatigue[36] Emerging Markets • Bovespa has developed a Sustainability Index which will be launched in Dec 2005 • Bovespa, Istanbul and Jakarta stock exchanges join Global Compact	Follow-through required after promising initial dialogue
Companies	Take leadership role with ESG strategy implementation Improving reporting and disclosure	• Many positive examples of companies embracing ESG strategies. Most notable was the launch of General Electric's "Ecomagination", targeting revenues of $20bn from clean technologies by 2010.[37] (May 05). Elsewhere, 10 leading US companies announced greenhouse gas reduction commitments as part of the US Environmental Protection Agency's Climate Leaders project.[38] (May 05) • Global Compact companies increased from 1400 to over 2000. During the period policy was announced requiring participants to issue annual communication on ESG implementation • Proliferation of company and sector codes of conduct, including The Common Code for the Coffee Community[39] (Sep 04) and The Electronics Industry Code of Conduct (Oct 04)[40] • Number of companies producing GRI reports increased from 450 to over 700. • KPMG found 52% of global 250 firms issue separate corporate responsibility reports, compared to 45% in 2002. The number of reports with an assurance statement increased marginally to 30% for global 250 companies from 29% in	Better identification and communication of key strategic ESG challenges and value drivers required CSR reports often not in investor friendly format

		2002.[41] According to SIRAN, 58 of S&P 100 companies now present ESG information on their websites and 39 issue CSR reports, 24 of which are based on GRI.[42] (July 05) • Launch of "One-Report" by SRI World Group consolidates data requests within GRI framework to facilitate corporate responses to ESG requests from investors and analysts.[43] Emerging Markets • ESG reporting is more common and increasing in markets such as Brazil, Korea etc. Participation in global SRI indices and expansion of initiatives such as the Carbon Disclosure Project has triggered improved disclosure by a select group of Asian companies. Regulated Asian companies and those with a multinational business lead the way. Sustainability reporting emerging in Korea, Hong Kong, and Singapore, has been often encouraged by award schemes. • The majority of listed companies in Brazil do publish (some) information on their social and environmental practices; 11 companies in Brazil (25 in Latin America)publish reports based on the GRI guidelines. • 4 Brazilian companies was included in the Dow Jones Sustainability Index • Natura, a sustainability leader in Brazil, had a very successful IPO in 2004.	Reporting on ESG performance is done by some sector leaders, particularly in high impact sectors, but widespread reporting still to be adopted There is room for initiatives such as the Extractive Industries Transparency Initiative (EITI) and others to be developed and replicated across manufacturing and public sectors to help the mainstreaming of ESG.
Accounting/ rating agencies and index providers	Establish consistent standards and frameworks	• ISO established Working Group on Social Responsibility, to begin work on launch of a Social Responsibility ISO 26000 standard, targeting publication in 2008.[44] (Mar 05) • EUROSIF – voluntary transparency guidelines introduced, aimed at improving quality of reporting to private investors and fund managers.[45] • Several new SRI/ESG indices launched, including FTSE4Good Japan, AuSSI (SAM's Australian SRI Index) and KLD Select Social Index, a US-based index weighted not by market capitalisation but on the basis of social and environmental performance • Tel-Aviv Stock Exchange launched the Maala Socially Responsible Investing (SRI) Index.[46] (Feb 05) • Trucost investigated environmental disclosure levels in the annual reports and accounts of FTSE All-share companies.[47] Emerging Markets • Launch of CBC Globally Responsible Investment Index with optimized weighting for emerging market stocks • Reputex (Australia) planning expansion into China and specialized CSR/Governance rating product for the Chinese market	Further work needed to provide investors with independent, comparable, quantitative data on companies' environmental performance, presented in both quantity and financial terms (to facilitate the incorporation of environmental factors into investment decision-making)

NGOs	Provide objective information on companies to public/ financial community	Innovative research produced, often in conjunction with financial institutions. World Resources Institute (WRI), an independent US-based non-profit organisation, stood out for its original research contribution, including: • Framing Climate Change Risk in Portfolio Management (joint report with Ceres) • Questions and Answers for Investors on Climate Risk (with Ceres) • Transparency Issues with ACEA: Are Investors Driving Blindly (with SAM Group) • Energy Security and Climate Change: Investing in the Clean Car Revolution (with Merrill Lynch).[48] • WWF and Allianz produced joint report "Climate Change and the Financial Sector: An Agenda for Action."[49] • Web-based Business and Human Rights Resource Centre (Jan 05) launched officially. The Centre provides shared research on 2000 companies for campaigners and investors in a user-friendly format.[50] Emerging Markets • India: Centre for Social Markets (CSM) hosted local awareness raising conference on SRI	

Appendix 2: Investors' Network on Climate Risk

(Excerpt from "A New Call of Action: Managing Climate Risk and Capturing the Opportunities" May 10th, 2005"[51])

Institutional investors

1. Call to Action: Invest capital, individually or collectively, in companies developing and deploying clean technologies, which we believe will enhance and sustain the long-term viability of corporate assets and shareholder value.

   Our Commitment: Our collective goal in the next year is to seek to deploy $1 billion of capital to achieve attractive investment returns over the long term and help catalyze adoption of clean technology in the broader marketplace, while at the same time adhering to the fiduciary standards that govern our overall actions.

2. Call to Action: Support for and success of appropriate shareholder resolutions and company engagement to improve corporate disclosure and governance on climate risk.

   Our Commitment: We will develop through the Investor Network on Climate Risk (INCR) a model climate risk policy for institutional investors. This policy will specifically address shareholder resolutions, proxy voting, and corporate dialogue on climate risk. We will share the policy with other institutional investors and with fund managers.

3. Call to Action: Adopt a reliable and generally accepted global standard for disclosure of climate risk.

   Our Commitment: We pledge to work with investors around the world to develop such a standard.

4. Call to Action: Promote information sharing among the growing number of institutional investors and organizations around the world concerned about climate risk.

   Our Commitment: We will build a new forum for international investor collaboration on climate risk.

Fund managers and financial advisors

5. Call to Action: Improve capacity to assess climate risk.

   Our Commitment: We will require and validate that relevant investment managers, seeking to manage our fund assets, describe the resources, expertise and process that they use to assess the risks associated with climate change.

6. Call to Action: Improve mutual fund engagement in addressing climate risk.

   Our Commitment: INCR will publish an annual scorecard showcasing how mutual funds vote on climate change shareholder resolutions.

Companies

7. Call to Action: All publicly-held companies in the auto, electric power, and oil and gas sectors should follow the lead of some companies and report within a year how likely scenarios for climate change, future greenhouse gas limits, and dwindling access to inexpensive energy will affect their businesses and competitiveness, and to identify steps they are taking to reduce those financial impacts and seize new emerging market opportunities.

   Our Commitment: We will engage with these companies to consider and address climate risk.

8. Call to Action: Renew dialogue between investors and all companies that have already disclosed their climate risk to focus on steps that investors and companies can take to address this risk.

   Our Commitment: We will engage with companies, recognize leaders, and promote best practices.

9. Call to Action: Help investors assess climate risk.

   Our Commitment: Through INCR, we will produce the "Corporate Governance Score Card on Climate Risk", an annual corporate governance scorecard of 100 large emitters of greenhouse gases. We will distribute this scorecard throughout the investor community by the end of 2005. This report will inform them of the efforts that companies and their boards of directors are taking to consider and address climate risk.

Government

10. Call to Action: The Securities and Exchange Commission (SEC) to require that companies disclose the risk associated with climate change as part of their securities filings.

    Our Commitment: We will work with the SEC to disclose climate risk.

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