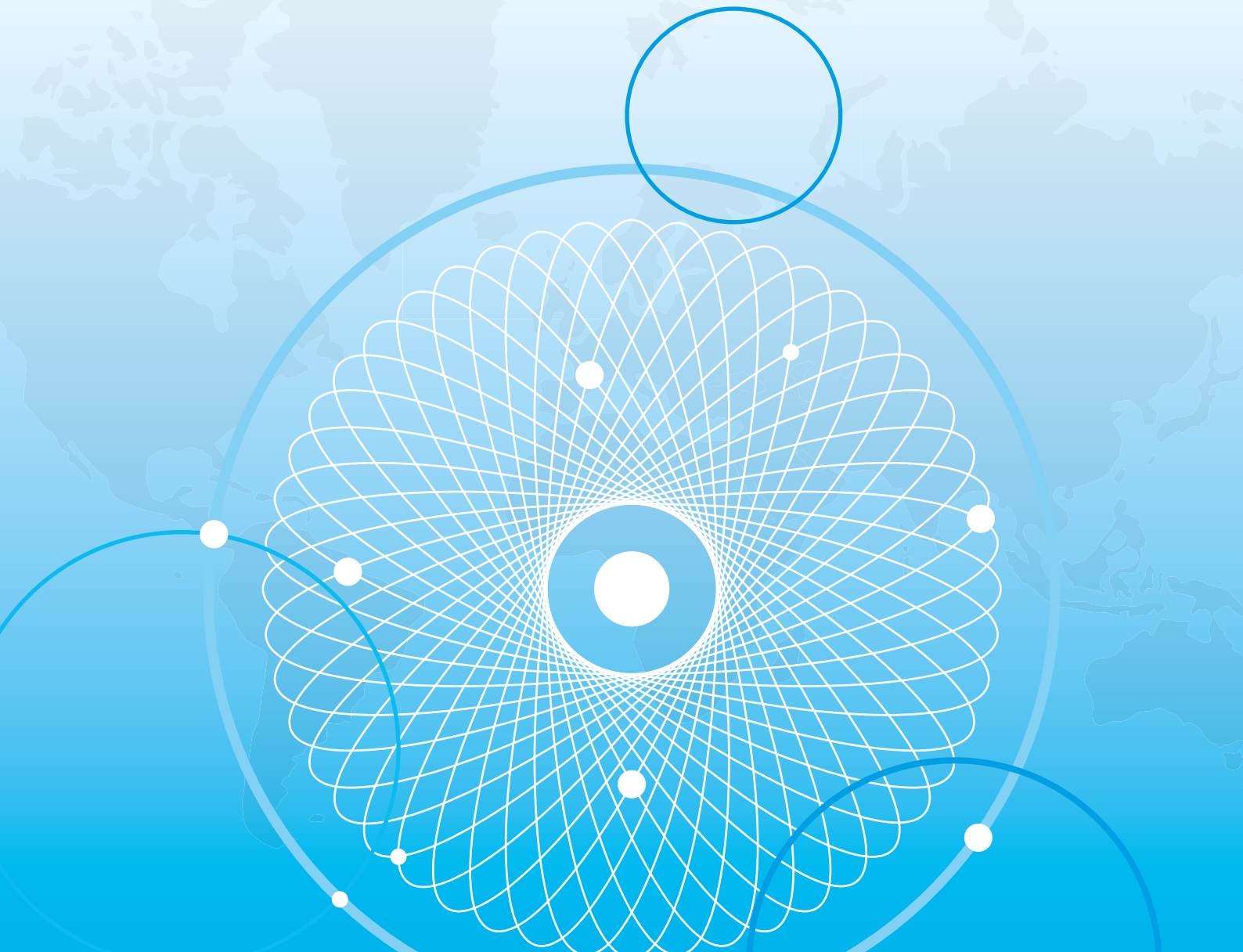


POLICY FRAMEWORKS FOR LONG-TERM
RESPONSIBLE INVESTMENT:

THE CASE FOR INVESTOR ENGAGEMENT IN PUBLIC POLICY



THE SIX PRINCIPLES

- 1** We will incorporate ESG issues into investment analysis and decision-making processes.
- 2** We will be active owners and incorporate ESG issues into our ownership policies and practices.
- 3** We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- 4** We will promote acceptance and implementation of the Principles within the investment industry.
- 5** We will work together to enhance our effectiveness in implementing the Principles.
- 6** We will each report on our activities and progress towards implementing the Principles.



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Thank you to the PRI Policy and Research Steering Committee:

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THE AIMS OF THIS REPORT:

- To show why public policy engagement is essential for long-term investors.
- To give examples of how investors have engaged in public policy and the lessons learned.
- To offer practical recommendations for long-term investors, policymakers and the PRI to better integrate environmental, social and governance factors in the public policymaking process.

About the UNEP Inquiry:

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme to advance policy options to deliver a step change in the financial system's effectiveness in mobilising capital towards a green and inclusive economy - in other words, sustainable development. Established in early 2014, it will publish its final report in the second half of 2015. For more information, see www.unep.org/inquiry.

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FOREWORD

Over 1.5 million public servants rely on CalPERS to manage their retirement savings. It's a weighty obligation that requires keeping an eye on not only the next quarter, but also on the next quarter century and beyond. As a long-term investor, CalPERS employs strategies that are designed to achieve sustainable, risk-adjusted returns for our members.

Our work is grounded in our Investment Beliefs. A core belief is: a long time investment horizon is a responsibility and an advantage. Investing for the long-term requires strategies that create long-term sustainable value, mitigate multi-faceted risks, and strengthen both local and global economies. The common denominator in being able to do all of that effectively is having a stable and forward-thinking policy foundation.

As large investors it's easy to focus on singular issue areas – corporate governance, labor practices, fossil fuels and the like. But cohesive and coordinated policy advocacy is necessary to effectively engage in these areas and to ensure sustainable outcomes. While many of us have coordinated with groups like PRI to make significant progress in enacting change, we acknowledge the growing number of complex and evolving issues around these topics.

Collectively, as sophisticated, long-term investors, we are moving into uncharted territory. There is much to be done. Our partnerships and collaborative efforts will be more important than ever to increase our impact on the development of the appropriate public policy.

Anne Stausboll
CEO, CalPERS
Advisory Council Member, UNEP Inquiry



Anne Stausboll

Environmental threats – such as climate change – evolve over the long-term and require a long-term response. Investing institutions allocate the world's savings between alternative capital investments and can play a crucial role in ensuring that investment takes account of long-term threats and opportunities. Responsible investment which takes a long-term view can be good for the environment and for returns to savers.

Many major financial institutions are already focused on long-term sustainability. Many asset managers disclose how they take climate change and other risks into account in their investments, and encourage the companies in which they invest to disclose their environmental impact, to describe the resulting risks, and to specify the actions they are taking. Many insurance companies have been leaders in highlighting the costs and risks of environmental damage. And major disinvestments from fossil fuel companies – in particular from coal - are helping to shift investment towards clean technology.

But individual and voluntary action alone cannot deliver a financial system appropriately focused on long-term objectives. Public policy is also needed. Without public standards on disclosure of risk, less responsible companies and investing institutions may enjoy short-term advantages. Without a clear commitment to robust carbon pricing, the incentives to develop clean energy and improve energy efficiency will still be too weak. Financial institutions which want to adopt long-term horizons and to act responsibly in investors and society's long term interest, cannot therefore avoid engagement in the public policy debates which will shape the context in which they operate.

Lord Adair Turner
Senior Fellow, *The Institute for New Economic Thinking*
Advisory Council Member, UNEP Inquiry



Lord Adair Turner

INTRODUCTION

Public policy sets the rules of the game.

Public policy critically affects the ability of long-term investors to generate sustainable returns and create value. Public policy also affects the sustainability and stability of financial markets, as well as social, environmental and economic systems.

Policy engagement by long-term investors is therefore a natural and necessary extension of an investor's responsibilities and fiduciary duties to the interests of beneficiaries.

The importance of public policy for long-term investors has grown in recent years, due to:

- Legislative reform of the financial sector in the wake of the global financial crisis.
- Governmental need for investors as a source of long-term finance.
- The increasing impact of environmental, social and governance factors on the ability of investors to deliver long-term returns.

By signing the United Nations-supported Principles for Responsible Investment, 1300 finance sector institutions, with a total US\$45 trillion of assets¹ under management, have committed to identify and removing "obstacles to a sustainable financial system that lie within market practices, structures and regulation".² This commitment is part of a growing global momentum identified by the UNEP Inquiry that links financial reform and sustainability.³

Despite this commitment, many PRI signatories are not yet actively engaging with policymakers, due to:

- Scepticism about whether public policy engagement will make a difference.
- A lack of understanding regarding how to influence policy processes.
- Concern about the costs and timeframes involved in public policy engagement.

This report challenges these assumptions and concerns, with five examples – from the USA, France, South Africa, Japan and the EU – of how long-term investors have engaged with and influenced public policy.

Based on interviews with an international group of investors and policymakers, this report provides the first analysis of the "why, what and how" of policy engagement by investors to build a sustainable financial system. It offers practical, effective recommendations, proposing a five-step approach, the 5c's, to improve the integration of investor perspectives on environmental, social and governance (ESG) factors in the public policymaking process.

What is long-term responsible investment?

Long-term responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the financial market. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems.⁴

Why should policymakers listen to long-term investors?

Over the past decade, a credible body of long-term investors has emerged, seeking policy change that sets the rules of the game in favour of sustainable value creation.

These investors support policy measures that strengthen ESG integration, strengthen the stability and integrity of the finance sector, and deliver wider economic benefits.

These goals align with the needs and interests of policymakers interested in long-term economic growth, competitiveness, employment, innovation, skills development and education, environmental protection, and social stability.

1 Correct as of 15 November 2014

2 See <http://www.unpri.org/wp-content/uploads/PRworkprogramme.pdf>

3 UNEP Inquiry, Aligning the Financial System with Sustainable Development – Insights from Practice, October 2014

4 PRI Briefing notes co-funded by the European Commission, see www.unpri.org/introducing-responsible-investment

THE STRATEGIC CASE FOR PUBLIC POLICY ENGAGEMENT

ABOUT THIS REPORT

The fourth Principle for Responsible Investment states “We will promote acceptance and implementation of the Principles within the investment industry”, including action to “support regulatory or policy developments that enable implementation of the Principles”.⁵

Further to this, in January 2014, a PRI signatory survey (conducted by Right Lane) found that 92% of the survey respondents supported the PRI addressing the obstacles to sustainable financial markets that lie within market cultures, structures and regulations. 76% of the respondents agreed that the PRI has a role to play in influencing public policy with regard to long-term investment.⁶

However, practice is lagging. The results of the 2014 PRI reporting and assessment framework⁷ show that, of 814 investor signatories, only 332 indicated that they – individually or in collaboration with others – had conducted dialogue with public policymakers or standard-setters in support of long-term investment in the previous year.

The available evidence suggests that these investors have played a constructive and effective role in policy debates on issues such as corporate governance, climate change and financial regulation. Yet much more could be achieved if more long-term investors were actively involved in these efforts and they took a more strategic approach to policy engagement.

Strengthening long-term investor involvement in the ‘rules of the game’ that govern the financial system is a strategic area of interest for the UNEP Inquiry. The PRI and the Inquiry decided to collaborate to produce the first document of its kind to clearly set out the case for investor engagement in the policy for long-term investment.

This report provides the rationale for policy engagement as well as practical guidance for both investors and policymakers. This guidance is based on a review of the experiences and lessons learned from five case studies in which investors were engaged in the policymaking process. In each case, investors and policymakers were interviewed to understand the origins and motivations of the policy measure, the engagement process, the influence of investors on the policy process, the lessons learned and, where available, the outcomes achieved.

This report will be used to frame and direct the PRI's Policy and Research workstream⁸ which was set up in 2013 as it looks to encourage investor engagement in policy.

“A dual shift in policy engagement is required if the financial system is to respond to rising global challenges:

First, long-term investors need to commit to support the design and implementation of effective policy frameworks.

Second, policymakers need to understand how long-term investors can provide distinctive inputs that contribute to sustainable development.”

Nick Robins, Co-Director, UNEP Inquiry into the Design of a Sustainable Financial System

“Public policy engagement is not easy. Long-term investors cannot assume that it will work in a similar way to corporate engagement. They have to commit for the long haul to realise the benefits.”

Bryan Thomson, SVP, Equities, bclMC and Chair, PRI Policy and Research Steering Committee

5 See <http://www.unpri.org/viewer/?file=wp-content/uploads/PRworkprogramme.pdf>

6 See <http://www.unpri.org/pri-signatory-survey-results/>

7 Report on Progress 2014 at http://www.unpri.org/wp-content/uploads/2014_report_on_progress.pdf

8 <http://www.unpri.org/areas-of-work/policy-and-research/>

WHY ARE LONG-TERM INVESTORS INTERESTED IN PUBLIC POLICY?

Public policy plays a critical role in regulating and framing the relationship between companies and their investors and, in turn, the relationship between companies, investors and wider society. Policy sets the rules of the game; it defines roles, responsibilities and accountabilities, it creates risks and opportunities, and it mediates between competing interests.

A well-designed and implemented policy framework promotes economic development, fosters social inclusion and protects the environment. For long-term investors, effective policies are needed to ensure market integrity, resolve market failures and reform damaging government actions.

Historically, however, investors have taken a narrow approach to public policy.⁹ Investors have become engaged on an issue-by-issue basis. Too often, the focus has been on the symptoms of a particular problem, rather than on the underlying causes.

Three main factors have driven public policy up the investor agenda.

- **Financial Reform:** In the wake of the global financial crisis, governments are proposing and implementing an extensive series of regulations to reform the financial sector.

These include new requirements for risk management, for capital reserves and transparency. They also grant significant new inspection and enforcement powers to regulatory bodies.

This has potentially profound and often unintended implications for investors and capital markets:

- Requiring investors to introduce new risk management processes and to strengthen existing processes.
- Strengthening the role and responsibility of investors in the governance of corporations.
- Imposing new requirements concerning investors' management of cash flows and capital reserves.

While these regulations aim to restore stability and integrity to the capital markets, they also affect operational costs, balance sheet strength and asset allocation decisions.

- **Economic Recovery:** Governments would like to stimulate economic recovery by mobilising investment in the real economy. With public spending constrained, and many banks still in the process of rebuilding their balance sheets, governments are looking to investors as a potential source of long-term finance, for example with regard to infrastructure and low carbon innovation.
- **Sustainability:** Environmental, social and governance factors – climate change, energy security, human rights, income inequality, international development and water stress – are having an increasing impact on the ability of investors to deliver long-term returns. The solutions to these rely on resolving both the market and the policy failures at the heart of these problems.

“Public policy engagement is a clear priority for us. It is an area where we can deliver the greatest gains in terms of our long-term investment objectives, and we can deliver these gains at a modest cost.”

Philippe Desfossés, CEO, ERAFP

“Collaborating on policy to promote a stable and effective financial system in support of sustainable development is one of the key ways in which the finance sector can be a force for good.”

Katherine Garrett-Cox, Chief Executive, Alliance Trust PLC

⁹ See the [PRI reporting and assessment framework](#)

THE 2014 GLOBAL INVESTOR STATEMENT ON CLIMATE CHANGE

CLIMATE SUMMIT 2014

CATALYZING ACTION

At the UN Secretary-General Ban Ki-moon's Climate Summit, nearly 350 global investors representing over \$24 trillion in assets called on government leaders to provide stable, reliable and economically meaningful carbon pricing, as well as to develop plans to phase out subsidies for fossil fuels.

<http://investorsonclimatechange.org/>

“The Climate Summit provided a platform for hundreds of investors from all parts of the world to deliver a strong and unified message to policymakers.”

Stephanie Pfeifer, CEO, Institutional Investors Group on Climate Change

FROM SILOS TO SYSTEMS: THE NEED FOR CHANGE

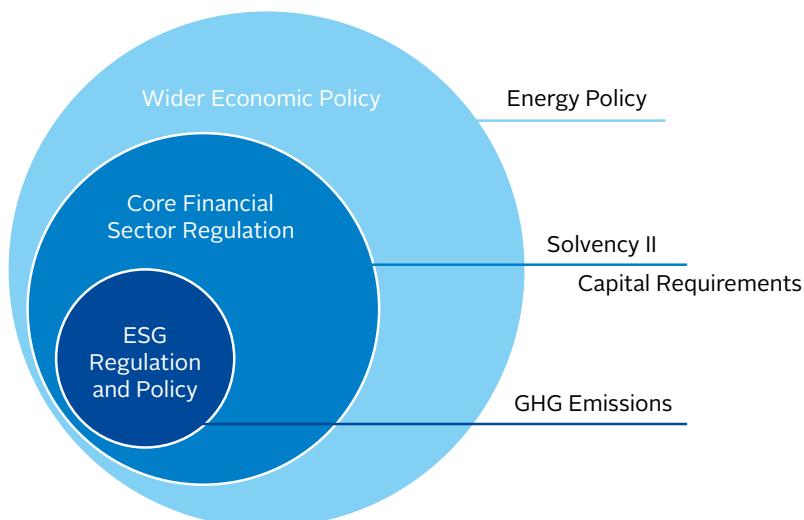
Many of the critical financial risks facing long-term investors require policies that work across three levels:

- Measures that regulate specific ESG integration in investment practice.
- Core financial sector regulations.
- Wider macroeconomic policies.

For example, efforts to reduce greenhouse gas emissions can involve policies across all three levels: new disclosure requirements on companies, the integration of carbon risks in investment research and decision-making, and ending fossil fuel subsidies in the energy sector. As the recent 2014 *Global Investor Statement on Climate Change* illustrates, long-term investors are already seeking policy action across all three levels.

Responding to this reality requires policy engagement that cuts across government departments and regulators, as well as across international boundaries. Ultimately, it requires investors to recognise that by influencing the frameworks that shape the entire marketplace, policy engagement is a necessary and effective complement to case-by-case corporate engagement.

POLICIES MUST WORK ACROSS THREE LEVELS:



RESPONSIBLE LONG-TERM INVESTMENT: THE SPECTRUM OF POLICY PRIORITIES

For long-term investors, there is a wide spectrum of policies that could be relevant. In the first level of public policy, which focuses on the specific ESG aspects of investing, policymakers have five broad tools at their disposal:

- **Exclusions:** Policy could prohibit investors from owning or lending to particular companies or sectors. Examples include bans on the financing of controversial weapons, or government prohibitions on investments in countries subject to UN sanctions.
- **Incentives:** Policy could incentivise investors to preferentially invest in particular sectors or activities. This could include tax incentives for specific assets, already widely used for infrastructure investment.
- **Responsibilities:** Policy could require or encourage investors to take account of ESG factors in their investment decision-making process. This includes ensuring that relevant sustainability factors are incorporated within the interpretation and delivery of fiduciary duty and other responsibilities.
- **Stewardship:** Policy could require investors to play an active role in the governance of companies in which they are invested.
- **Reporting:** Policy could require investors to report on ESG risks and ESG performance of their assets. Examples include pension fund regulations which require pension funds to publish a formal ESG policy and to report how ESG is integrated in the selection, appointment and monitoring of investments.

More broadly at the international level, there are three priority areas where long-term investors are pooling efforts to ensure policy alignment with long-term value creation:

- **G-20:** Bringing together the world's leading economies, the G-20 coordinates global policy on a range of issues critical for long-term investors, notably continuing financial reform and frameworks for long-term finance.
- **Sustainable Development:** In September 2015, the UN and its member states will adopt a new set of sustainable development goals, looking ahead to 2030. Mobilising institutional capital will be critical to its success.¹⁰
- **Climate Change:** In December 2015, governments will finalise a new climate change agreement in Paris. Investors have been actively working with governments to put in place policies that leverage private capital for low-carbon, climate resilient development.

“The PRI has partnered with the UNEP Inquiry on this report based on our shared interest in delivering effective policy frameworks that align investment with long-term sustainable development.

Our aims are to set out the case for investor engagement in the policy process, and to provide practical, evidence-based proposals on how this engagement might be implemented.”

Martin Skancke, Chair, UN-supported Principles for Responsible Investment

“Short-termism in investment markets is a major obstacle to companies embedding sustainability in their strategic planning and capital investment decisions. In order to address this issue, a long-term approach makes sense for both asset owners and companies, because it allows for increased focus on long-term value drivers and management of different forms of capital.”

Georg Kell, Executive Director, UN Global Compact

¹⁰ See <http://sustainabledevelopment.un.org/content/documents/4588FINAL%20REPORT%20ICESDF.pdf> and <http://www.aviva.com/research-and-discussion/roadmap-sustainable-capital-markets/>

WHAT MAKES PUBLIC POLICY ENGAGEMENT DIFFERENT?

Public policy can be defined as a course or principle of action adopted or proposed by government agencies and bodies. In total, public policy encompasses the system of laws, regulatory measures, administrative mechanisms, courses of action and funding priorities concerning a given topic implemented by a governmental entity or its representatives.

Public policy engagement by investors differs from corporate engagement in three important ways:¹¹

- **Public policy engagement involves longer timeframes than corporate engagement.** For example, the SEC adopted binding guidance requiring companies to report on material, climate change related risks, seven years after Ceres first called for these disclosures.
- **Investors are often not the most important stakeholders.** In corporate engagements, the relationship between companies and the investors who own them is clearly defined. In contrast, the policy process involves multiple stakeholders, such as companies, non-governmental organisations, trade unions and consumers, frequently with competing interests. This means that investors tend to become involved at the later stages of the policy process.
- **Policymakers need to balance a range of factors in their decisions.** For policymakers, the implications for investors are just one of many considerations, and are not necessarily the most important. Policymakers need to consider a wide range of factors when designing and implementing policy, including overall effectiveness, economic efficiency, regional and employment consequences, competitiveness effects, learning and innovation benefits, and public acceptability, as well as alignment with wider social, environmental and economic priorities. Policymakers often assume that the interests of corporations and those of long-term investors are the same.

“I believe our industry has a fiduciary duty to do what we can to protect and enhance the value of client assets. I think this includes putting pressure on policymakers to address the key sustainability challenges within our capital markets and the broader economy.”

Euan Munro, Chief Executive, Aviva Investors

“If policymakers are to effectively engage the investment community, they need to start by explicitly acknowledging the importance of investors and they need to demonstrate this through, for example, ensuring that investors are properly represented on key working groups.”

Robin Edme, Conseiller Finance, Responsible CGDD/SEEI

¹¹ The PRI promotes Collaborative Engagement in Public Policy in addition to Corporate Engagements. More info at http://www.unpri.org/wp-content/uploads/PRI_IntroductoryGuidetoCollaborativeEngagement.pdf

POLICY ENGAGEMENT FOR THE LONG-TERM: LESSONS FROM PRACTICE

Long-term investor commitment to policy engagement is growing, but is still at an early stage of development. Investors are experienced in engaging with companies to bring about change in business practices, but many are less comfortable about policy engagement. Traditionally, there has been:

- Scepticism about whether public policy engagement will have an impact.
- A perception that policy engagement is the same as political lobbying.
- Concern about free-riders, in that other investors who do not take part will benefit.
- A lack of understanding of policy processes.
- Caution about the cost and long timeframes involved in policy engagement.

Increasingly, long-term input from investors is welcomed by policymakers for a variety of reasons:

- The agendas supported by long-term investors often align well with those of policymakers.
- These 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 facilitate private sector finance involvement.
- Investors can provide data or information that is not otherwise available.

This report profiles five international case studies to better understand the current state of play on the role of long-term investor engagement in the public policy process. In each case study, investors and policymakers were interviewed to reflect both perspectives.

These particular case studies were chosen for two reasons:

- They identify the practical challenges that must be addressed, and demonstrate the role that investors, policymakers and the PRI can play to enable long-term investors to make a meaningful contribution to the public policy process.
- They focus on the specific role that investors can play in the implementation and enforcement of policy. Government bodies are not only looking at how investors are regulated, but also at the role that investors might play in improving environmental, social and governance outcomes, and in wider economic policy.

The case studies are not designed to be definitive. Instead, they are the first set of real world examples on this subject that could be expanded in the future.

Overall, the case studies generated five key lessons for investors:

- Understand the policy life cycle.
- Achieve institutional buy-in.
- Implement a structured approach.
- Address resource constraints and create a single investor voice through collaboration.
- Build trusted relationships with policymakers.

GRENELLE II

France: Corporate and investor ESG disclosure

SOLVENCY II

European Union: Long-term insurance regulation

STEWARDSHIP CODE

Japan: Responsible investment and active ownership

CODE FOR RESPONSIBLE INVESTING IN SOUTH AFRICA (CRISA)

South Africa: Responsible investment and active ownership

SEC GUIDANCE ON CLIMATE CHANGE DISCLOSURE

USA: Corporate climate disclosure

For summaries of the case studies, see page 16.

UNDERSTANDING THE POLICY LIFE-CYCLE

The process of public policy has a number of stages which interact in a dynamic fashion: identification, information gathering, decision-making, implementation, evaluation, termination and renewal. Investors need to understand their role for each.

01

IDENTIFICATION

Decisions need to be made on what, whether and how to proceed. This will involve discussions about the issue, the information needed, the key actors to be consulted and the policy options that may be available.

Policy processes may be initiated by investors concerned about gaps in regulatory frameworks (e.g. Ceres call for the SEC to require the disclosure of climate change related information in SEC filings), or about weaknesses in the implementation of regulation (e.g. the Code for Responsible Investing in South Africa was catalysed by investors concerned that asset owners were not sufficiently active in terms of corporate governance).



02

INFORMATION GATHERING

This will involve reviews of the available evidence, and discussions with key stakeholders and opinion

formers. It will also include some initial analysis of the issue in question, of the options for action, and of the merits of alternative courses of action.

Investors can contribute by providing information on current practice (e.g. the insurance industry provided this input on Solvency II), and through providing practical support to policymakers (e.g. Japanese investment trade bodies helped to co-ordinate policymakers' dialogue with investors on the Japanese Stewardship Code).

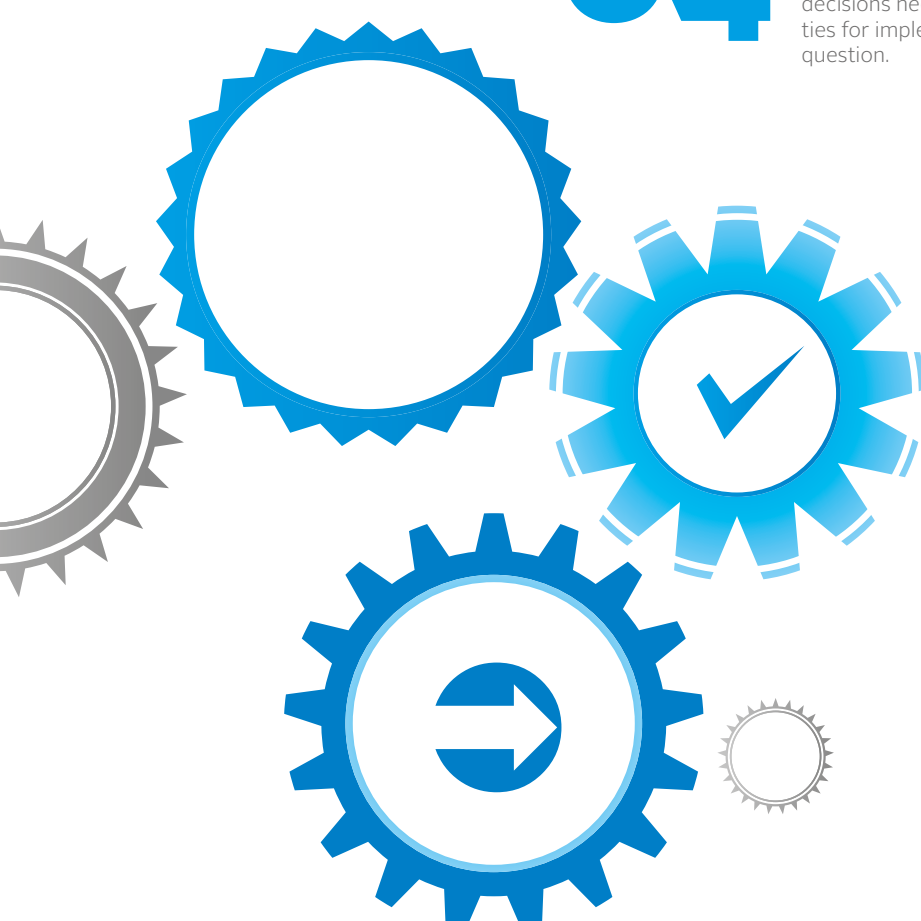
03

CONSIDERATION AND DECISION-MAKING

When making a decision on the policy measures to be adopted, policymakers will assess the likely effectiveness of the options available (including the 'do nothing' option), the financial costs and benefits

of taking action, and the political implications of taking action.

Investors may contribute to formal consultation processes (such as those that led to the French Grenelle II legislation and that informed the Japanese Stewardship Code). They may also publicly set out their views and lend explicit support to their preferred policy options.



IMPLEMENTATION

04

Depending on the case in question, further guidance or rules may need to be developed, and decisions need to be made regarding responsibilities for implementing the policy measure in question.

EVALUATION

05

This involves reviewing the effectiveness, the dependability, the cost, the intended and unintended consequences, and other relevant features of the policy measure in question.

Investors can contribute by providing evidence of the impacts and implications of the policy measure in question (e.g. Ceres produces annual reports tracking the number of companies reporting on climate change in their SEC filings and analyses the quality of these disclosures). Investors can also advise on how the policy measure may be strengthened or on whether the policy measure is no longer relevant.

TERMINATION OR RENEWAL

06

Termination may be explicitly built into the policy measure, the policy measure may lose relevance or may not be implemented. It is frequently the case that terminated policy measures reappear in another form, such as in another piece of legislative or led by another agency.

Both the French Grenelle II legislation and the European Solvency II legislation can be seen as examples of legislation renewal, where the new legislation revised, updated and, in some ways, replaced existing bodies of legislation.

In many cases, the policy process is ongoing – requiring a long-term stance for effective engagement from investors.

ACHIEVING ORGANISATIONAL BUY-IN TO POLICY ENGAGEMENT

Leading long-term investors have learned that engagement promotes more effective public policy. Intention is one thing, but effective policy engagement can only come with the commitment of human and financial resources. This starts with support from the Chief Executive and Board for policy engagement followed by the provision of dedicated organisational support and resources.

The case studies reviewed here suggest there are three arguments for building organisational buy-in for policy engagement:

- Policy engagement is a natural extension of conventional investor responsibilities and fiduciary duties to the long-term interests of beneficiaries and savers. For example, encouraging better corporate disclosure on environmental, social and governance issues is essential for investors to incorporate these issues into their investment decision-making processes. Similarly, requiring investors to engage constructively with the companies in which they are invested is an integral part of the process of long-term value creation.
- Policy engagement can be an effective tool for shaping framework conditions for underlying investments. The case studies show examples where investor engagement has been critical in aligning market conditions with long-term interests. For example, pan-European insurance industry engagement with Solvency II was important in terms of enabling the European Commission to respond appropriately to pressures from member states for favourable treatment for national insurance companies.
- Concerns about public policy engagement being seen as political lobbying tend to be overstated. Becoming involved in partisan political processes is clearly not in the best interests of ultimate beneficiaries. Providing expert advice to both civil servants and elected representatives is a legitimate and necessary role of investors. The value of advice on current investment practice, how policy might be designed, how policy might be implemented and the contribution that could be made by investors is a core theme for all of the case studies presented in this report.

IMPLEMENTING A STRUCTURED APPROACH

Many long-term investors do not currently have structured systems and processes for policy engagement. To ensure an effective, structured and coordinated approach to policy engagement, investment organisations need to:

- Ensure that there is senior management support for policy engagement on long-term investment-related issues, and to clearly signal this support to the entire organisation.
- Ensure that long-term investment issues are properly integrated into policy engagement.
- Collaborate with other investors to build a consensus to facilitate the presentation of a single voice to policymakers.
- Report on actions to stakeholder and beneficiaries.

“Public policy engagement is an integral part of our approach to long-term investment. While our resources are limited, we maximise our effectiveness through collaborating with other like-minded investors.”

Mark Mansley, CIO, Environment Agency Pension Fund

Issue	Key Actions
Board and senior management	<p>Ensure that the organisation has a formal position statement on public policy engagement that explicitly addresses long-term investment-related issues, and that aligns with the organisation's broader commitment to long-term investment.¹²</p> <p>Ensure that appropriate resources are allocated to public policy engagement on long-term investment-related issues.</p> <p>Allocate responsibility for ensuring that the organisation's public policy engagement aligns with its wider organisational commitments to long-term investment.</p> <p>Ensure that policy engagement conducted by industry bodies is consistent with the organisation's own policy engagement.¹³</p>
Senior management	<p>Assign responsibility for ensuring that specific public policy engagement programmes align with the organisation's wider commitments to long-term investment.</p>
Public policy engagement programmes	<p>Ensure that long-term investment-related issues are considered when designing and implementing public policy engagement programmes.</p>
Obtain organisational support for public policy engagement on long-term investment-related issues	<p>Establish a structured process that allows new policy issues to be proposed and which ensures that the importance of long-term investment-related issues is one of the prioritisation criteria.</p> <p>Ensure that decisions to proceed with public policy engagement include decisions on the resources to be allocated and the support to be provided by the individuals that lead public policy engagement.</p>
Report to beneficiaries	<p>Ensure transparency on policy engagement, implementation and success is shared with beneficiaries.¹⁴</p>

“Trade bodies play an important role – they can research the proposals in question, they can synthesise industry opinion and they can represent the industry effectively in meetings with policymakers.”

Seiji Kawazoe, Associate General Manager, Fiduciary Business Planning Department, Sumitomo Trust & Banking Company

¹² For an example, see www.fandc.com/documents/responsible-investment-public-policy/

¹³ See, for example, Caring for Climate (2013), Guide for Responsible Corporate Engagement in Climate Policy (UN Global Compact, UNFCCC and UNEP), <http://caringforclimate.org/workstreams/climate-policy-engagement/>

¹⁴ For an example, see <http://www.uss.co.uk/UssInvestments/ResponsibleInvestment/MarketWideInitiativesPublicPolicy/Pages/default.aspx>

CASE STUDY SUMMARY

SEC CLIMATE CHANGE, USA

In 2010, the US Securities and Exchange Commission (SEC) published binding interpretative guidance requiring companies to report on climate change-related risks and opportunities in their regular 10-K filings. The SEC decision marked the culmination of several years of intensive lobbying by Ceres, who first called for the inclusion of this information in 10-K filings in 2003. While there has been an increase in reporting on climate change, a 2014 report from Ceres concluded that implementation has been weak, with the information provided by most companies being insubstantial and largely superficial.

KEY LESSONS:

- The scale of investor support was an important signal to the SEC that climate change was a critical issue for investors.
- Regulatory bodies and other stakeholders often do not have deep knowledge of ESG issues. Developing their understanding on such issues was a key element of Ceres' engagement.

GRENELLE II, FRANCE

In 2009 and 2010, the French government held a consultation on how the social and environmental information provided by companies in their annual reports might be strengthened. While some long-term investors called for the adoption of mandatory indicators and for stronger assurance processes, these calls were outweighed by concerns expressed by other investors and companies about the burden of reporting. Article 225 is, however, recognised as an important step in strengthening the reporting requirements for French companies.

KEY LESSONS:

- Investors need to speak with a common voice if they are to have a real influence on policy.
- Domestic policy is hugely important in moving forward the international agenda. Article 225 has been critical in the development of the EU's Reporting Directive.

SOLVENCY II, EU

Solvency II was intended to consolidate relevant legislation and to bring legislation up to date with modern insurance practices. Following extensive preparatory work and consultation with national regulators, the insurance industry and other stakeholders, a legislative proposal was presented to the European Parliament in 2007. The final version of the Solvency II Directive was adopted in November 2009. This was subsequently amended to address some of the problems caused by volatile economic conditions. The Solvency II Directive is scheduled to come into effect on 1 January 2016.

KEY LESSONS:

- Policy can have unintended consequences. In this case, Solvency II may reduce insurance companies' willingness to invest in long-term infrastructure.
- Trade bodies have a critical role to play. On a major initiative such as Solvency II, policymakers can really only effectively engage with institutionalised stakeholders such as trade bodies, regulators or large organisations.

THE 5C CHECKLIST FOR LONG-TERM INVESTOR ENGAGEMENT IN PUBLIC POLICY

COMMIT:

Adopt a formal position statement on public policy engagement that explicitly addresses responsible investment issues and aligns with the organisation's broader commitments to long-term investment.

Allocate resources to public policy engagement on responsible investment-related issues.

CONSTRUCT:

Establish a structured process that promotes engagement in public policy issues.

Allocate responsibility for ensuring that public policy engagement aligns with organisational commitments to long-term investment.

Ensure that factors affecting long-term investment performance are part of the criteria used to prioritise public policy engagement.

STEWARDSHIP CODE, JAPAN

One of the core elements of the 'Abenomics' growth strategy for stimulating the Japanese economy was the development of a Stewardship Code which would encourage investors to play an active role in the governance of the companies in which they are invested. The Code was developed by a Council of Experts, which included representatives of the major Japanese investment trade bodies. The draft Code, which aligned with Japanese business norms and with relevant international standards such as the UK Stewardship Code, was issued for consultation in December 2013. The investment industry was supportive of the proposed Code. Since the final version was issued in February 2014, over 100 institutional investors have signed the Code.

KEY LESSONS:

- The active involvement of investors in designing the Code ensured that it reflected investors' interests.
- Overseas investment organisations have signed the Japanese Stewardship Code. This has been important in maintaining momentum and political support.

CRISA, SOUTH AFRICA

In 2009 and 2010, a number of institutional investors met to discuss the implementation of the King Code. They were concerned that investors would not monitor the Code's 'comply or explain' provisions. These investors encouraged the South African Institute of Directors to lead the development of the Code for Responsible Investing in South Africa, CRISA. A draft was published for comment in early 2011 and came into effect in February 2012. CRISA provides guidance on how institutional investors should carry out their investment activities and use their influence to promote good governance. Since CRISA was launched, there has been a significant increase in the level of collaboration on company engagement.

KEY LESSONS:

- The fact that CRISA was initiated by investors, that investors were involved in the design of the Code and that there was an open and inclusive consultative process were all important in ensuring that the Code was widely supported in the investment industry.
- It was important not to assume that that key individuals and organisations – including within government – would respond to the consultation. These individuals needed to be identified and proactively engaged.

“While historically, investors have behaved as future takers, we are seeing more behave as future makers. The long-term financial consequences of many critical policy issues are just too significant to ignore: engagement is a tool for risk management.”

Jane Ambachtsheer, Partner, Mercer Investments

CLARIFY:

Identify the key policy issues of concern to the organisation.

Recognise the expectations of policymakers.

Establish a rolling plan of action for achieving progress with these issues, both individually and collectively with other investors.

COLLABORATE:

Join and actively support relevant collaborative initiatives focusing on public policy.

Work with dedicated long-term investment coalitions at the national and international levels to pool resources and to achieve greater impact.

Ensure that traditional investor trade bodies incorporate responsible investment factors in their policy engagement, and that long-term investor voices are effectively represented in their governance.

COMMUNICATE:

Coordinate messages among responsible investors and wider financial groups.

Connect policy engagement with corporate engagement by calling on companies to be transparent in their lobbying positions, and by challenging company management when corporate positions, and those of their trade associations, run counter to long-term investor interests.

Report annually on the public policy engagement carried out, and use this as a platform for dialogue with beneficiaries.

ADDRESSING RESOURCE CONSTRAINTS THROUGH COLLABORATION

In practice, the majority of investors conduct public policy engagement in collaboration with others. This may be through formal, well-established domestic and international networks, or through smaller, informal groups of like-minded investors that come together to discuss a particular topic for a particular period of time.

Within the investment community, there are a number of well-organised collaborative initiatives focused on promoting long-term investment practices. Many of these have an explicit focus on public policy engagement.

“Regulatory bodies often do not have deep knowledge or expertise on ESG issues. Building their knowledge and capacity, and the capacity of other stakeholders, including politicians and their staff, is critical.”

Chris Miller, Partner, AJW Inc.

EXAMPLES OF INVESTOR COALITIONS: JOINING FORCES FOR RESPONSIBILITY

CLIMATE CHANGE

The Global Investor Coalition on Climate Change (GIC), the Investor Network on Climate Risk in USA (INCR), the Institutional Investors Group on Climate Change (IIGCC), the Investor Group on Climate Change in Australia / New Zealand (IGCC) and the Asia Investor Group on Climate Change (AIGCC), and the Climate Bonds Initiative.

CORPORATE GOVERNANCE

International Corporate Governance Network (ICGN), the Asian Corporate Governance Association (ACGA), the Brazilian Institute of Corporate Governance (IBGC), and the Canadian Coalition for Good Governance (CCGG).

CORPORATE DISCLOSURE

Carbon Disclosure Project (CDP), Carbon Tracker, the Asset Owners Disclosure Project (AODP), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), Sustainability Accounting Standards Board (SASB) and the Sustainable Stock Exchanges Initiative (SSE).

LONG-TERMISM

The Long-term Investing Club, Focusing Capital on the Long-Term (FCLT), and Cambridge Investment Leaders Group (ILG).

RESPONSIBLE INVESTMENT

United Nations-supported Principles for Responsible Investment (PRI), Network for Sustainable Financial Markets (NFSM), United Nations Environment Programme Finance Initiative (UNEP FI), Australian Council of Superannuation Investors (ACSI), Ceres and the Shareholder Association for Research and Education in Canada (SHARE).

GLOBAL SUSTAINABLE INVESTMENT ALLIANCE

National and regional sustainable and responsible investment forums, such as UK Sustainable Investment and Finance Association (UKSIF), the Association for Sustainable and Responsible Investment in Asia (ASRIA), European Sustainable Investment Forum (EuroSIF) and the US Forum for Sustainable and Responsible Investment (USSIF).

Collaborative engagement, which underpinned all five of the case studies presented in this report, offers a number of significant advantages:

- **Pooled resources:** Addressing the resource constraints faced by individual investors helps to avoid the duplication of effort, allows tasks and responsibilities to be shared, and offers smaller and resource-constrained investors the opportunity to lend their support to the collaboration process.
- **Unified voice:** A unified voice enhances power and legitimacy. Of particular importance is the potential for collaborative initiatives to create a platform for underrepresented voices, such as those of asset owners and smaller investment managers, to contribute to the policy process.
- **Strategic organisational structure:** Given that policy development and the implementation process often takes many years, collaborative groups can help achieve longevity.
- **Knowledge and skills:** This includes both the substance of the issue in question and the policy process in general.

Collaboration is not a panacea. It is important to ensure that collaborative initiatives do not simply become lowest common denominator initiatives, where the need to reach agreement means that the positions adopted are less stretching or less demanding than those that would have been adopted by organisations engaging with policymakers on their own.

BUILDING TRUSTED RELATIONSHIPS

A recurring message from across the case studies is that building trust between policymakers and investors is of critical importance to ensure that the investor voice is heard in policy debates. This is best done through face-to-face meetings. One policymaker, for example, expressed a clear preference for dealing with investors that are seen as credible and as having integrity, noting that this is generally developed through personal relationships over an extended period.

Personal relationships and access to policymakers are important to ensure that investors are given the opportunity to engage or contribute to policy debates at the correct point in the cycle. This is particularly the case in the early stages of the policy process, where it is not uncommon for policymakers to look for advice and suggestions from those organisations that they know and with which they have previously engaged.

Many of the policymakers interviewed expressed scepticism about investors' motivations. They commented that investors often invoke the needs and interests of beneficiaries, but then request policy interventions that are primarily for the investors' benefit and that take little account of the wider societal interests. The policymakers noted that this did not mean that they disregard the views and opinions of investors but, as with any stakeholder, they look closely at the views expressed and filter out those that clearly involve narrow self-interest.

Policymakers need to see that long-term investors' positions are in the wider public interest. Policymakers are keen to reach the ultimate stakeholders, the beneficiaries. Long-term investors need to show how their policy positions are linked to these stakeholders. Furthermore, when engaging with policymakers, long-term investors need to show how their arguments and positions align with wider public goals and needs.

“On a major process such as Solvency II, the reality is that policymakers can really only effectively engage with institutionalised stakeholders, trade bodies, regulators or large organisations.”

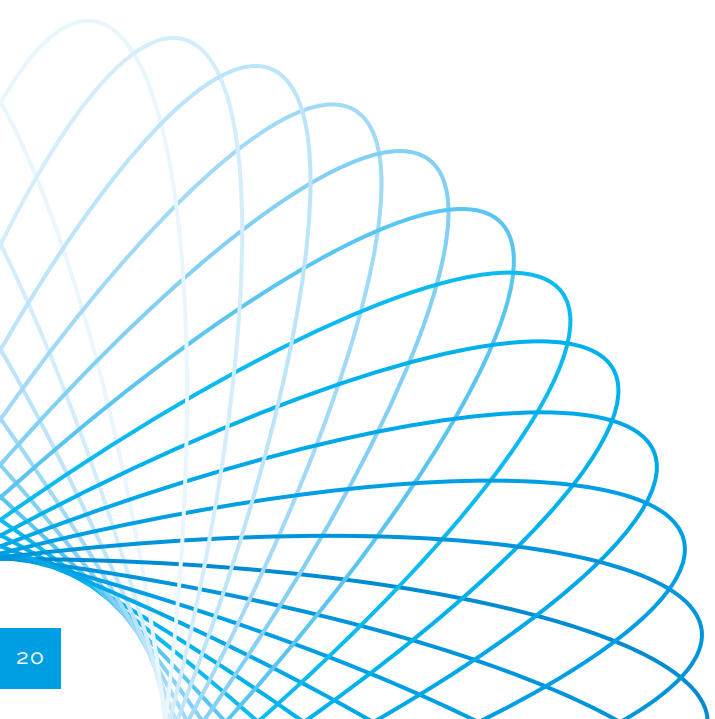
Professor Karel Van Hulle, former-Head of Unit Insurance and Pensions Financial Institutions, Internal Market Directorate-General, European Commission

The policymakers interviewed offered some practical suggestions concerning how investors could ensure that their views and suggestions are taken seriously to maximise the likelihood of policymakers acting on their suggestions:

- There should be a clear rationale for action. The issue in question must be both important and there should be a reasonable likelihood that policy action will be effective.
- The investor representative should be credible, holding relevant knowledge, evidence and expertise.
- Investors should recognise that policymakers must balance the needs and interests of different stakeholders. This may mean that the options preferred by investors would not be considered as acceptable or legitimate by other stakeholders. Of particular importance in this regard is recognising that economic efficiency is just one of the factors considered by policymakers.
- Investors should articulate the benefits in terms that are of interest to the policymaker in question. For example, one interviewee commented that politicians are very interested in initiatives that create jobs or that provide tangible benefits/projects – in other words, those that provide real economy-wide benefits, not just benefits to individual companies. Another commented that one of the core arguments in support of Grenelle II was that this would help to improve market functioning and stability, a core objective of the French government.
- Investors should be able to provide a detailed explanation of the impact on the beneficiaries they represent.
- Investors should be consistent in their messages and should be prepared to maintain their focus on the issue for the duration of the policy development process, which can often be over a number of years or parliamentary cycles.

“Politicians are very interested in initiatives that create jobs or provide tangible benefits (i.e. that provide wider economic benefits, not just benefits to individual companies). Policymakers are now more than ever interested in views and data that can be verified as independent and not just the arguments used in support of a particular company’s economic interests.”

Peter Skinner, MEP, 1994-2014



GUIDANCE FOR INVESTORS AND POLICYMAKERS

This report has highlighted the growing two-way interest from investors and policymakers in the shaping of frameworks that support the stability of financial markets as well as the long-term sustainability of social, environmental and economic systems.

This report has also shown that, where they are involved, long-term investors can play a key role in the delivery of important policy changes.

It has revealed the importance of sharing best practice internationally, and the valuable contribution that foreign investors can make to domestic policy design.

Perhaps most critically, it has shown that long-term investors need to do more to make their voices heard, to ensure that policy discussions take proper account of the full impacts on sustainability, on the financial sector, and on the wider economy.

If we are to scale up and maximise the contribution that long-term investors can make to the public policy process, both long-term investors and policymakers need to raise their game. Based on the materials presented in this report, we offer the following recommendations to investors and policymakers.

ACTION FOR INVESTORS:

LONG TERM INVESTORS SHOULD PRIORITISE PUBLIC POLICY ENGAGEMENT

- Commit resources to public policy engagement.
- Construct a strategic process for policy engagement.
- Clarify public policy positions.
- Collaborate on public policy engagement.
- Communicate to stakeholders regarding public policy engagement.

See page 16 for full details of the 5C checklist for long-term investor engagement in public policy.

ACTION FOR PRI:

THE PRI WILL SUPPORT COLLABORATIVE POLICY ENGAGEMENT¹⁵

The PRI has an important contribution to increase the number and improve the effectiveness of long-term investor engagement with policymakers. The PRI will:

- Encourage, educate and facilitate public policy engagement among signatories.
- Engage public policymakers on the topic of long-term investment.
- Expand regional public policy engagement.
- Enhance the PRI clearinghouse platform to facilitate collaborative public policy engagement.
- Express the views of investors within the United Nations alongside those of relevant constituent organisations, such as UNEP, UNEP FI, UNGC, UNCTAD, UNFCCC and others.

“I’m pleased to see the PRI coordinating the views of responsible investors in Europe, on the non-financial reporting directive and the Shareholder Rights Directive.”

Richard Howitt, MEP

“CCGG brought together investors from across Canada to work with policy makers at all levels on the important issue of majority voting. It took ten years, but we succeeded in having an impact on regulatory policy by being clear about the importance of the issue, pooling our resources and clout, and being persistent and consistent with our message.”

Catherine McCall, Director of Policy Engagement, Canadian Coalition for Good Governance

¹⁵ See the PRI's strategy plan for the next 3 years and the initiatives from the Policy & Research team at http://www.unpri.org/wp-content/uploads/PRI_Strategic-Plan_20141010_FINAL2.pdf

ACTION FOR POLICYMAKERS:

POLICYMAKERS NEED TO INVOLVE LONG-TERM INVESTORS

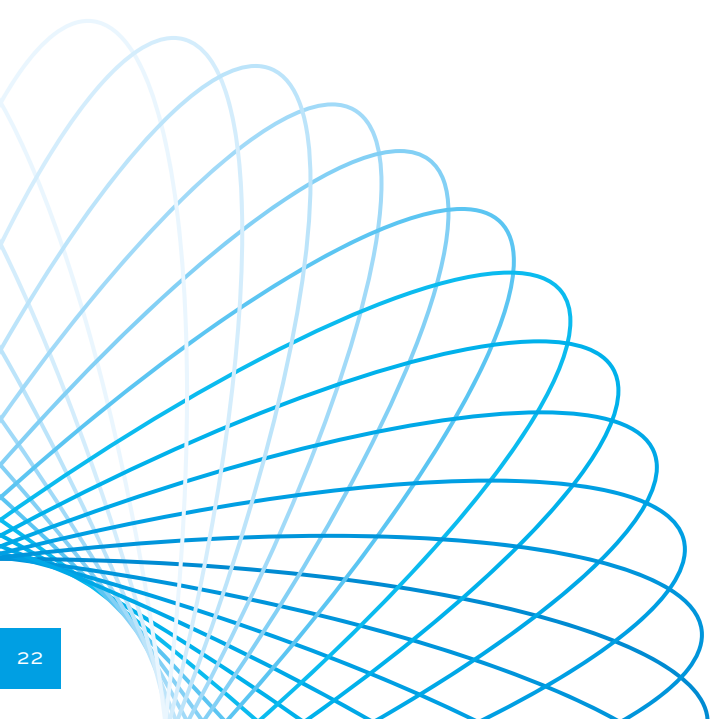
Policyholders need to create the conditions and incentives for long-term investors to contribute to policy discussions. This is not just a case of engaging with these investors when there is a specific policy issue that directly affects their interests, or when these investors are critical to the implementation of the policy. Such a transactional approach will, inevitably, lead to investors deciding that there is limited value in providing research or information to policymakers, and that there is limited value in playing a supportive role in wider policy debates.

Policyholders seeking to work with long-term investors need to:

- Understand the needs and interests of long-term investors and their end beneficiaries, and how these differ from those of other investors, banks and companies.
- Encourage investors and other financial sector organisations to clarify their approach to long-term sustainability issues in their policy positions and dialogue.
- Facilitate long-term investor input to policy discussions, both through reaching out to investors and through providing opportunities for investors to provide formal and informal feedback.
- Develop relationships with the key long-term investment organisations and their trade bodies.
- Demonstrate commitment to long-term investor engagement through, for example, ensuring that key individuals and organisations are properly represented on relevant working groups and advisory panels.

“It is crucial for policy makers and investors to work together. This must not be about lobbying. It must be about working together to be sure that our industry serves its clients and can deliver on its purpose of providing the capital which will deliver long-term prosperity.”

David Pitt-Watson, Co-Chair, UNEP Finance Initiative



APPENDIX 1: INTERVIEWEES AND CONTRIBUTORS

CASE STUDIES

The case studies were based on one hour long, structured interviews with the individuals listed below. The following subjects were covered:

- The origins and motivations for the legislation or policy measure.
- The engagement process, covering subjects such as how the engagement was initiated and organised, how the engagement proceeded and the information that investors provided.
- The influence of investors on the policy process.
- Wider reflections on the lessons learned, the strengths and weaknesses of investor engagement, the needs and interests of policymakers, key challenges and how these were overcome.

The interviews were conducted on the understanding that, unless explicitly indicated, the views and findings presented in this report would not be taken or presented as formal statements of any individual's position on responsible investment or the capital markets.

INTERVIEWEES:

- Deon Botha (Senior Corporate Governance Specialist, Public Investment Corporation, South Africa)
- Olivier Bonnet (Head of SRI, ERAFP, France)
- Jim Coburn (Senior Manager, Investor Programs, Ceres, USA)
- Philippe Desfossés (CEO, ERAFP, France)
- Robin Edme (Ministry of Ecology, Sustainable Development and Energy, France)
- Rosemary Hunter (Deputy Executive Officer, Financial Services Board, South Africa)
- Seiji Kawazoe (Associate General Manager, Sumitomo Trust and Banking Company, Japan)
- Nicholas Kitching (Head EMEA Regulatory Affairs, Swiss Re)
- Sonal Mahida (North American Network Manager, United Nations-supported Principles for Responsible Investment, USA)
- Christopher Miller (Partner, AJW, USA)
- Peter Skinner (Member of the European Parliament, 1994-2014 and European Parliament rapporteur on Solvency II in the Economic and Monetary Committee, 2002 – 2014)
- Stephane Voisin (Head of Sustainability Research & Responsible Investment, Kepler Chevreux, France)
- Karel Van Hulle (Internal Market Directorate-General, European Commission)
- Mr. Motoyuki Yufu (Director for Corporate Accounting and Disclosure Division, Financial Services Agency Japan)

APPENDIX 2: CASE STUDY: SEC CLIMATE GUIDANCE, USA

Investors have been at the forefront of efforts to encourage companies to report on their greenhouse gas emissions, and on the business risks and opportunities presented by climate change. This has been motivated by recognition that the physical impacts of climate change and the impact of regulatory measures directed at reducing greenhouse gas emissions will have significant financial implications for most companies and sectors of the economy.

In the United States, publicly traded companies are required to disclose material business risks to investors through regular filings (commonly called '10-K filings') with the Securities and Exchange Commission. In 2003, Ceres and INCR issued a 10-point action plan, one aim of which was to improve climate change related disclosures in these filings.

Ceres met with the SEC on a number of occasions in the years following the release of its 10-point plan, but made little progress. In 2007, a number of different events coincided to create a window of opportunity for action:

- New leadership at the SEC,
- Political changes in Congress,
- Increased public attention on climate change, and
- Increased investor interest in the risks and opportunities associated with climate change.

In September 2007, Ceres and the Environmental Defense Fund (EDF) submitted a detailed petition setting out why climate change is a financial risk, and why it is of interest to investors. The petition was signed by 18 investment organisations, including a number of state pension funds, with collective assets totalling \$1.5 trillion US dollars.

Further momentum was created when the New York State Attorney General issued subpoenas to five electricity utilities on inadequate climate change disclosures and when the Senate Banking Committee held a hearing on climate change disclosure.

In 2010, the SEC published binding interpretative guidance requiring companies to analyse climate change-related risks and opportunities. If material, the SEC required them to report in their annual 10-K filings on how climate change could potentially affect their businesses.

Since 2010, Ceres has monitored the SEC's implementation of the guidance and has produced annual reports tracking progress. In the period following the release of the SEC guidance, there was a jump of 10% in the number of companies providing disclosures on climate change related risks.

However, despite the SEC writing to a number of companies whose disclosure was not considered sufficient, implementation, to date, has been weak. In 2014, Ceres issued a report, *Cool Response: The SEC and Corporate Climate Change Reporting*¹⁶, analysing S&P 500 companies reporting on climate change. Ceres concluded that, for the majority of the companies, financial reporting on climate change is too brief and is largely superficial, concluding that most companies are failing to meet SEC requirements.

Ceres acknowledged that there are various reasons for this:

- A view among companies that climate change is not a material business risk,
- Lack of specialist climate change related expertise in the SEC,
- Personnel and funding limitations within the SEC,
- A perception that climate change is not a priority for the SEC, and
- Wider political debate in the US, where opposition to action on climate change has hardened significantly since the SEC issued its guidance in 2010.

“A number of factors contributed to the success of the Ceres/EDF petition: good, well-reasoned arguments, the scale of the investment support, the willingness of investors to participate in meetings when needed, Congressional pressure on the SEC to take action, and the perception that the administrative burden to companies was modest.”

Mindy Lubber, President, Ceres

¹⁶ <http://www.ceres.org/resources/reports/cool-response-the-sec-corporate-climate-change-reporting/>

CASE STUDY: GRENELLE II, FRANCE

Corporate reporting on ESG issues is essential to enable investors to analyse the implications for their investments, and to hold companies to account for their performance.

The French Loi sur les Nouvelles Régulations Economiques (NRE), introduced in 2001, required public companies to include information on the social and environmental consequences of their activities in their annual reports. This legislation played an important role in catalysing non-financial reporting by French companies; a 2007 analysis by the French Ministry for Ecology and Development concluded that 81% of companies had made some effort in terms of reporting. However, the legislation only applied to listed companies, who had significant flexibility in the data to be reported and the information did not have to be verified.

In 2009 and 2010, the French government conducted an extensive public consultation process on how these limitations might be addressed. This process informed the development of Articles 224 and 225 of the Grenelle II legislation. The Grenelle II Bill was passed in July 2010 and, in April 2012 the decree that implements Article 225 of Grenelle II was passed.

Article 225 requires companies to report on their commitments to sustainable development and on the environmental, social and societal impacts of their business activities and of their subsidiaries. Companies are also required to have this information verified by an independent, third-party organisation. The legislation applies to companies with more than 500 employees, including subsidiaries of foreign companies listed in France, and unlisted companies.

The French government engaged with French investors as part of its consultation process. The French Sustainable Investment Forum (FIR), representing the views of responsible investors, supported Article 225, arguing that these disclosures would enable investors to analyse company performance on the basis of consistent and comparable data. This would improve market functioning and stability, and help French companies be better prepared to deal with new regulations.

Despite this support, these responsible investors had relatively little influence on the final outcomes. There were three main reasons for this:

- The French investment community did not speak with a unified voice. Despite the arguments advanced by FIR, some investors expressed concerns about the burden of reporting and about the potential for revealing commercial secrets.
- The French government saw companies as the key stakeholders. Companies opposed the adoption of mandatory indicators for reporting, and argued that assurance processes should be less demanding than those required for the financial data included in the annual reports.

- Companies continued to argue their case even after the Grenelle II Bill was passed in 2012.

As a result, the final outcomes were less than responsible investors had desired. However, French investors do recognise Article 225 as an important step forward in terms of strengthening the reporting requirements for French companies.

KPMG's 2013 Survey of Corporate Responsibility Reporting suggests that 99% (up from 94% in 2011 and 59% in 2008) of large French companies now report on ESG topics, and that 76% of large French companies have this information assured, up from 60% in 2011.

“Domestic policy is hugely important in moving forward the international agenda. Individual countries can provide leadership and can also demonstrate what can be achieved.

For example, Article 225 has been critical in the development of the EU's Reporting Directive, which requires all large corporates to include environmental, social and governance data in their annual reports.

One of the key arguments for the introduction of the Directive was to create a level playing field for companies, with the European Commission explicitly pointing to France and Denmark as countries where these sorts of requirements had already been introduced.”

Stephane Voisin, Head of Sustainability Research and Responsible Investment, Kepler Cheuvreux

CASE STUDY: SOLVENCY II, EU

Strengthening financial sector regulation has been a priority in the wake of the global financial crisis. However, in addressing one set of policy problems, it is not uncommon to create other problems. The Solvency II Directive, which sought to strengthen risk management in the insurance sector, may actually increase the sector's focus on short-term financial performance and reduce its ability to invest in areas such as unlisted assets, infrastructure and private equity.

In the late 1990s, there was wide recognition that the insurance sector was lagging behind banking in terms of risk-based regulation. There was pressure to establish a new regulatory framework for the European insurance industry.

The need to modernise the regulatory framework received further impetus in the early 2000s following the market collapse post-Enron. The agenda was strongly supported by insurance companies, who wanted to be able to better manage their risks, and by regulators who wanted all risks (e.g. balance sheet, credit, market, operational) to be assessed and reported so they could get a better picture of the overall risk profile of the industry.

Solvency II was intended to consolidate relevant legislation and bring the legislation up to date with modern insurance practices. The Solvency II framework has three main pillars:

- Pillar 1 sets out the minimum capital requirements for insurers, i.e. the ability to withstand a 1-in-200 year event lasting for one year.
- Pillar 2 sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers.
- Pillar 3 focuses on disclosure and transparency requirements.

Following preparatory work and extensive consultation with regulators and stakeholders, a legislative proposal was presented to the European Parliament in 2007, and the final version of the Solvency II Directive was adopted in November 2009.

Insurance companies played an active role in the discussions surrounding Solvency II. Much of this was led by trade bodies, such as Insurance Europe, the Pan-European Insurance Forum and the Chief Risk Officers Forum. These trade bodies invested significant time in identifying priority issues and in developing a common agenda concerning these issues for the industry as a whole. This included the question of whether solvency capital would be calculated using a formula developed by regulators or whether the industry could use its internal models, and the specific amount of capital that needed to be held against liabilities.

The core negotiations for Solvency II occurred before the financial crisis. Following the financial crisis, the industry recognised the implications of market volatility and pressed for changes to reflect the nature of the risks and the

characteristics of the liabilities. In particular, the industry pressed for the legislation to reconcile the fact that assets were to be valued on a mark to market basis while liabilities were valued on a risk-free basis were considered.

This meant that insurance companies were exposed to market movements on assets but not on liabilities, which created problems in volatile economic conditions, and ignored the fact that insurance investors may not have needed to sell at these points in the economic cycle, thus reducing the incentive to invest in long-term assets.

Much of the work on the impact of solvency was facilitated via QIS (quantitative impact studies), a technical industry wide 'dry run' of the effect that the solvency methodology would have on capital requirements.

The insurance industry engaged intensively with the European Commission to introduce appropriate corrective mechanisms for this problem. In 2013, a compromise was agreed that addressed investor concerns by allowing them to use mark to market valuations for both their liabilities and their assets. Following an EU Parliament vote in March 2014, the Solvency II Directive was scheduled to come into effect on 1 January 2016.

Solvency II is a case study of how financial services can work effectively with policymakers to deliver the desired policy goals, in this case strengthening the industry's risk management processes in an economically effective manner.

However, it also highlights the risks of unintended consequences; in this case, the unintended consequence is that Solvency II may reduce insurance companies' willingness to invest in long-term infrastructure. This is because the standard risk-based approach in Solvency II results in longer term investments carrying higher capital charges.

These effects may be countered by the 2013 corrective mechanisms, which may see insurance companies focusing less on short-term market movements and more on long-term financial performance.

“The finalisation of Solvency II is not the end of the story. The industry will need to continue to monitor related legislative developments, for example the Commission's proposals on long term investment and understand their effects under Solvency II. This makes coordination even more important.”

Nicholas Kitching, Head EMEA Regulatory Affairs, Swiss Re

CASE STUDY: STEWARDSHIP CODE, JAPAN

Shinzō Abe was re-elected as Prime Minister of Japan in 2012. He was elected on the basis of a series of economic policies, known as 'Abenomics', directed at stimulating the Japanese economy. One element was the introduction of a Stewardship Code for Japanese investors, with the aim of promoting medium-to long-term sustainable corporate returns and investment in the Japanese equity market.

In June 2013, the Cabinet approved the Japan Revitalization Strategy, which included a commitment to drafting the Stewardship Code by the end of 2013. In August 2013, a Council of Experts was established to prepare the draft Code. Industry bodies included the Trust Companies Association of Japan, the Japan Investment Advisors Association and the Investment Trust Association.

The Code was developed with reference to Japanese business norms and to relevant international standards, particularly, the UK Stewardship Code, because of its emphasis on engagement and on long-term investment. The draft Code was issued for consultation in December 2013, and the final version of the Code was issued in February 2014.

This led to the proposed implementation date for the Code being delayed until 2015. The consultation process was led by the Financial Services Agency Japan (FSA), which consulted with the investment industry (trade associations, investment managers, asset owners and consultants). Investors were generally supportive of the proposed Code, although they emphasised that they needed time to develop their systems and processes.

The Code states that institutional investors should aim to "enhance the medium- to long-term return on investments for their clients and beneficiaries by improving and fostering investee companies' corporate value and sustainable growth through constructive engagement, or purposeful dialogue".¹⁷ While the Code pays relatively little attention to environmental and social issues, the Ito Review of Competitiveness and Incentives for Sustainable Growth, issued in August 2014, placed explicit emphasis on the importance of examining ESG factors in investment decision making.

The Code requires institutional investors to have clear policies on how they fulfil their stewardship responsibilities, on how they manage conflicts of interest and on how they vote their shareholdings. It also requires them to monitor investee companies, to support the sustainable growth of these companies, and to actively engage with these companies. Finally, institutional investors are expected to report on how they have implemented the Code.

In the specific context of Japan, perhaps the most significant innovations are that the Code is based on the

high level principles (rather than on hard and fast rules), and that investors are expected to adopt a 'comply or explain' approach to implementation. The FSA has encouraged industry organisations to work with these principles, rather than simply creating standard templates and checklists.

While it is too early to comment on the effectiveness of the Code, there are encouraging signs. A number of investors have commented that companies are more open to engagement, and there has been positive media coverage of the Code.

In June 2014, the FSA published the list of 127 institutional investors from Japan and overseas that had notified the FSA of their intention to accept the Code by the end of May 2014.

"The fact that a number of overseas organisations supported and subsequently signed the Japanese Stewardship Code was important to maintain momentum and political support."

Seiji Kawazoe, Associate General Manager, Fiduciary Business Planning Department, Sumitomo Trust & Banking Company

"Prime Minister Abe mentioned the Code at the WEF's annual meeting in Davos in January 2014, suggesting that it could form the basis for globally recognized approaches to stewardship."

Mr. Motoyuki Yufu, Director for Corporate Accounting and Disclosure Division, Financial Services Agency (FSA) Japan

¹⁷ www.fsa.go.jp/en/news/pub/o1.pdf

CASE STUDY: CRISA, SOUTH AFRICA

Many corporate governance and responsible investment codes rely on institutional investors to oversee the implementation of the code, and to take action in the event of non-compliance with the code. CRISA is, therefore, an important example of how oversight processes might be strengthened and made to work effectively. The Institute of Directors in Southern Africa (IoD) formally introduced the King Code of Governance Principles and the King Report on Governance (King III) in September 2009. Compliance with King III – which covers issues such as board structure and operation, directors' responsibilities, auditing, ethics and integrated reporting – is a requirement for companies listed on the Johannesburg Stock Exchange.

In 2009 and 2010, the Public Investment Corporation (PIC), the Government Employees Pension Fund (a public body governed by the Government Employees Pension Law of 1996, as amended) and other institutional investors met to informally discuss the implementation of the King Code. These organisations were concerned that investors, particularly asset owners, would not monitor the 'comply or explain' provisions of the King Code, and saw the need for a code to be adopted by investors that would set out the roles, responsibilities and expectations of investors in this area. In 2010, these investors approached the IoD with the idea of developing a Code. The IoD agreed to take the lead, establishing a committee called the Code for Responsible Investing in South Africa (CRISA) Committee. The committee included representation from the Association for Savings and Investment in South Africa (ASISA), individuals active in the responsible investment arena, individuals that had been involved with the development of the King Code, and regulators and business representatives.

A draft of the Code was published for comment in early 2011. Many of the investment managers were concerned about conflicts; for example, the implications of disclosing that they had voted against the management of a company in which they manage the pension fund. In response, the draft Code was modified to allow signatories not to disclose the specific details of their votes in these kinds of situations. However, the Code does require them to highlight the conflict. The final version was launched in July 2011, and came into effect on February 1, 2012. CRISA provides guidance on how institutional investors should carry out their investment activities and exercise their formal and informal rights as investors so as to promote sound governance.

The Code has five main elements:

- To incorporate sustainability considerations, including ESG issues, into their investment process as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.
- To demonstrate acceptance of ownership responsibilities in their investment arrangements and investment activities.
- To consider, where appropriate, a collaborative

approach to promote acceptance and implementation of the principles of CRISA, and other codes and standards applicable to institutional investors.

- To recognise the circumstances and relationships that have the potential to create conflicts of interest and to proactively manage these when they occur.
- To be transparent about the content of their policies, how the policies are implemented and how CRISA is applied, in order to enable stakeholders to make informed assessments.

While the application of CRISA is voluntary, institutional investors are expected to adopt the recommendations in CRISA and to report at least annually, on a 'comply or explain' basis, regarding ways in which they have implemented CRISA. Since CRISA was launched, there has been a significant increase in the level of collaboration. A 2013 survey commissioned by the CRISA Committee and conducted by Ernst & Young suggested that approximately 60% of a sample of 47 institutional investors and service providers had endorsed CRISA, but that smaller proportions (around 40% in each case) were reporting on their responsible investment policies, their voting policies and decisions, or on their engagement. Less than 20% of those surveyed were reporting on their management and control processes, such as how they included CRISA in mandates or contracts for service providers, or in their CRISA-related objectives and targets.

“It is important to ensure that the right stakeholders are involved in the development of codes and standards. The fact that CRISA was initiated by investors, that the Committee was representative of and credible with the investment industry and with key stakeholders and that there was such a consultative process were all critical to ensuring the relatively smooth process. Another important success factor was ensuring that key individuals and organisations – including within government – were identified and proactively engaged, rather than just assuming that they would respond to the consultation.”

Deon Botha, Senior Corporate Governance Specialist, Public Investment Corporation, South Africa

APPENDIX 3:

GLOSSARY

Asset owner:	This is a general term which includes non-corporate pension, superannuation and retirement funds, corporate pension funds, insurance companies, foundations and endowments, and sovereign wealth funds. ¹⁸
Beneficiaries:	Individual members of an asset owner.
Capital reserve:	Level of capital (money, or other assets), required by regulation, to hold against anticipated liabilities.
Corporate governance:	The system, structure and relationships through which various participants (chief executive officer, management, shareholders, employees) determine the direction, control and performance of corporations.
ESG:	Environmental, social and governance issues.
Institutional investors:	Organisations which invest pooled money on behalf of beneficiaries, normally with an expectation of financial return, for example, pension funds, sovereign wealth funds, mutual funds, insurance companies and investment managers.
Fiduciary Duty:	A legal duty to act solely in another party's interests.
FSA:	The Financial Services Agency Japan.
Investment consultants:	Advises institutional investors on investment strategy, including asset allocation and investment manager selection.
Investment manager:	This is a general term which includes asset managers and fund managers.
Listed:	A company whose shares are quoted on a stock exchange.
Mark to market:	A valuation of assets based on the most recent market price.
Mutual fund:	A professionally managed investment fund owned by shareholders who pool resources to diversify investments.
PRI signatories:	Asset owners, investment managers and financial service providers that have committed to the PRI's six principles.
Private equity:	An asset class of equity or debt in companies not listed on a stock exchange.
SEC:	Securities and Exchange Commission (US).
Solvency capital:	Amount of capital held by institutional investors to reduce risk of failing to meet liabilities.

¹⁸ See PRI reporting and assessment framework, 2014 - 2015: http://www.unpri.org/wp-content/uploads/2014-15_PRI_RF_01_OO.pdf

The Principles for Responsible Investment (PRI) Initiative

The PRI Initiative is a UN-supported international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

More information: www.unpri.org



The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org



UN Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

