

**Outcomes of the
Who Cares Wins Initiative
2004–2008**

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FUTURE PROOF?

**Embedding environmental, social and governance issues
in investment markets**

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Outcomes of the Who Cares Wins Initiative
2004–2008

Foreword by the sponsoring institutions

Who Cares Wins was launched in early 2004 as a joint initiative of the financial industry and the UN Global Compact, International Finance Corporation (IFC) and the Swiss Government. The aim was to support the financial industry's efforts to integrate environmental, social and governance (ESG) issues into mainstream investment decision-making and ownership practices through a series of high-level meetings with investment professionals.

At the heart of the Initiative lay the conviction that increased consideration of environmental, social and governance issues will ultimately lead to better investment decisions, create stronger and more resilient financial markets, and contribute to the sustainable development of societies.

The recent economic downturn has revealed the devastating effects of miscalculations. It has reinforced the necessity for the financial industry to more diligently manage their risks, including those related to environmental, social and governance issues. Among those is climate change, considered one of the most serious threats the global economy will have to face in the next century. A financial system that is too short-sighted and unaware of the dynamics of climate impacts will fail to avoid or reduce the risks posed by a climate-induced economic crisis that could easily be far greater than the credit-related crash of 2007–2008.

The positive message from the final report of this Initiative is that the industry has come a long way since 2004 in understanding the issues and developing the methodologies and tools for ESG integration. However it is clear that widespread implementation of these methodologies and tools has yet to occur throughout the financial industry, and will only be possible with the collaboration of all financial market actors.

Going forward, the engagement of asset owners and regulators is particularly sought to help create much-needed enabling frameworks and market demand for ESG-inclusive investments. Intelligent regulation is a necessary component of the growth of sustainable capital flows, which implies regulation that requires greater transparency on ESG integration from companies and investors and relies on markets to apply the most appropriate ESG integration strategies.

Implementation should also be driven by strong public-private partnerships, voluntary initiatives and principles-based approaches. Principles can offer both investors and companies guidance where legislation is lacking, and the chance to benefit from 'virtuous circles' of ESG leadership.

The Who Cares Wins Initiative is drawing to a close, but our dialogue and engagement with the financial industry continues unabated through other forums. We believe that this continued engagement will be particularly important for investments in emerging markets, where ESG integration is still an exception.

We strongly believe that better integration of ESG issues into investment markets is within reach, leading to more resilient and efficient markets and contributing to a more sustainable development of societies. IFC, the Swiss Government and the UN Global Compact urge all actors

involved in investment markets to consider and implement the recommendations set out at the end of the report.

Though the current turbulence in financial markets may tempt investors and companies to think of ESG issues as 'tomorrow's problem', we believe that urgent and wholehearted action is warranted not in spite of, but precisely because of the market dynamics observed in the past months.

ESG integration is about investors and companies taking a longer-term view, acknowledging the full spectrum of future risks and opportunities, and allocating capital as if they themselves were the beneficial owner. There can be no better way to restore public confidence in the markets and build a prosperous economic future.

Rachel Kyte

Vice President,
Business Advisory Services
*International Finance
Corporation*



Ambassador Thomas Greminger

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Schweizerische Eidgenossenschaft
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Commonly-used terms

EM Emerging market(s)
ESG Environmental, social and governance (issues)
WCW Who Cares Wins Initiative

Executive summary

This report summarises the strategic outcomes of the Who Cares Wins Initiative — a series of working conferences and financial industry consultations that took place between 2004 and 2008. The Initiative aimed to increase the industry's understanding of the risks and opportunities presented by environmental, social and governance (ESG) issues, and to improve their consideration in investment decision-making. In concluding four years of discussion with the industry, the report proposes a number of actions to further ESG integration and, ultimately, to set the investment system on a more sustainable, long-term footing.

The past years can be described as a period of intense experimentation and learning regarding the relevance of ESG issues for investments and their integration into investment decisions. The industry has considerably progressed since 2004: it is today a commonly-accepted fact that ESG issues can have a financial impact on single companies or entire sectors. The industry has also become more sophisticated in understanding when and where this impact is relevant. Leading analysts have developed the necessary techniques to integrate ESG issues into financial analysis — proving that ESG integration is absolutely within the reach of the analyst profession.

However, this know-how is not yet widely applied in the industry. Given the role of investors in assessing future economic developments, and the potential for many ESG issues to change significantly the course of our economies¹, this lack of uptake is surprising.

To understand better the impediments to a wider uptake of ESG information by the financial industry a systemic view is needed. The Who Cares Wins consultations looked in-depth at the relationships of key actors, including asset owners (pension funds and other institutional investors), asset managers, investment researchers and regulators. This report offers a set of key recommendations for each of the actors in order to improve and scale up ESG integration considerably.

The dynamic nature of the financial industry means that each actor is highly dependent on other actors. It also means that changes in the behaviour of key actors, such as the asset owners at the top of the chain, can rapidly unblock stalled situations and move the system to a new equilibrium.

In the coming years the financial industry has the opportunity to reap the gains of the good work done so far by applying it more widely to mainstream investment processes. If the industry does not seize this opportunity, it risks failing to account for important developments that are shaping the future of our economies. This in turn could create systemic risks for the financial industry and the economy at large. The positive message is that ESG integration currently represents an important source of competitive differentiation and value creation for financial institutions that make it part of their strategy.

However, the next phase of ESG integration will require the leadership of the CEOs and CIOs of financial institutions and implementation at all levels of their organisations, or it will not happen. Employees working on

Who Cares Wins was initiated by the UN Secretary-General's Global Compact Office in 2004 and endorsed by an alliance of financial institutions that collectively represent more than USD 6 trillion in assets. Who Cares Wins provided a platform for asset managers and investment researchers to engage with institutional asset owners, companies and other private and public actors on ESG issues. The principal setting for this engagement was a series of annual closed-door, invitation-only events for investment professionals. In-depth consultations with a number of leading industry practitioners preceded the drafting of this, the Initiative's final report.

¹ Climate change and its policy response being but one example

ESG integration must be given appropriate incentives, different actors must agree on ways to share the costs and benefits of developing new ESG-inclusive services, and institutions' strategies need to be communicated better to the market at large.

Progress in ESG integration

As mentioned, the level of awareness of ESG issues among mainstream professionals has greatly improved since the launch of Who Cares Wins, with new collaborative initiatives such as the Principles for Responsible Investment (PRI) facilitating the adoption of best practice. The development phase, characterised by experimentation and innovation in many areas, is now drawing to a close, leaving those institutions that have made a firm institutional commitment to the space with a springboard for scaling up ESG integration.

However, progress has not been uniform — environmental, social and governance issues have not been taken up by investors to equal extents. Nor have the various actors in the investment system moved forward in unison.

Asset owners (e.g. pension funds, insurance companies), at the head of the chain, have certainly improved their awareness of ESG issues, but their implementation efforts — investing in an ESG-inclusive manner

— have been disappointing. In contrast, active ownership activities, including the exercise of voting rights and engagement with companies, have made good progress since 2004.

"Having been involved in the investment industry for over 35 years, it is clear to me that ESG analysis is set to play an ever more important role in stock selection because it addresses key strategic issues for companies and economies. It is simply not possible to make good investment decisions in a world where corporate profitability increasingly depends on thriving in a world of growing scarcity of energy, water and skilled labour and effective and efficient corporate governance systems. ESG analysis can only become more important."

Jean-Pierre Hellebuyck
Director and Vice
Chairman, AXA
Investment Managers

Likewise the leading **consultants** have invested in researching what ESG issues mean for their clients, and have begun to show how ESG issues are built in to standard services such as investment strategy, asset allocation and manager selection. But the majority of the consultancy world is well behind the pace set by the few leaders.

The clearest progress made by **asset managers** has been in terms of sourcing ESG-inclusive investment research from service providers. On the other hand, it is much less clear how the research is actually being used by asset managers. Indeed, asset managers are candid about the challenge of integrating ESG information into their traditional frameworks.

In future, asset managers must provide a greater degree of transparency towards research providers and company management on the use of ESG data, and towards asset owners and consultants in terms of the objectives of their ESG-inclusive investment products and services. Further progress in asset management will also require clearer incentives for employees involved in ESG integration.

A big step forward has been made in the past years by academics and **investment researchers** in developing the analytical frameworks and demonstrating the rationale for ESG integration in investment research. Although the actual coverage of ESG by mainstream investment research has improved (from a low base), coverage remains patchy and is generally driven by specialist teams rather than by mainstream analysts. The key challenges ahead for researchers are insufficient incentive systems, the high cost of building up teams and tools, and the lack of comparable company data on ESG issues.

The emergence of new specialist ESG data providers is also a positive trend, but the leading credit rating agencies — a crucial actor in investment markets — are conspicuous by their absence from the debate on the materiality of ESG issues. The positive role played by a number of stock exchanges in improving the ESG disclosure of listed companies is a notable development.

Leading **companies** have advanced greatly in making ESG issues part of their strategy (arguably more rapidly than investors), and have shown that they are willing to engage in a sophisticated dialogue with investors on financially-material ESG issues. Nonetheless, the production of ESG data that are robust and comparable, and the integration of the most material issues into investor relations communications, remain areas of concern².

Who Cares Wins also looked at the role of **regulators and governments**. The message from WCW participants is that, given the complex and technical nature of ESG integration, governments should not play an active role at the micro level but should focus on defining the right boundary conditions for the system as a whole. This includes requiring greater transparency on ESG integration from companies and investors, supporting efforts to give a price to public environmental and social goods, and relying on markets to apply the most appropriate ESG integration strategies. Regulators can also support ESG integration by stating explicitly that they see no contradiction between a thoughtful consideration of material ESG issues and fiduciary responsibilities.

The role of professional bodies and qualifications in increasing the industry's awareness and knowledge and in better training young professionals in the field of ESG was repeatedly stressed throughout the WCW consultations. The more active role undertaken by the CFA Institute in this area provides an encouraging signal for the whole investment industry.

"The CalPERS Board and Investment Office are committed to integrating ESG issues into our asset management, consistent with our fiduciary duty to maximise risk-adjusted returns for our members. We have been a long-time corporate governance advocate for transparency in reporting, including reporting on environmental issues. Further, CalPERS is considering new opportunities to invest with managers who are targeting investments in publicly-held companies that have an advantage in adapting to, or mitigating, climate change and other environmental issues, in addition to managers whose processes involve screening out companies."

Anne Stausboll
Chief Executive Officer,
CalPERS

Enabling change in a complex system: 10 recommendations to kick-start the next phase in ESG integration in financial markets

To frame the recommendations that complete this report, a model for the interactions between different actors on ESG integration was developed. The concept of a simple, one-way chain, with requests issued by upstream clients to downstream providers, was considered an unsatisfactory description of the investment system.

The framework shown in the chart below takes a more dynamic, systems-orientated view of the interactions. When upstream participants request disruptive changes to the way the system works, they must accompany their requests with assurance (counter-requests) that their own actions will be transparent, and that risks taken will be reciprocated. This system of 'requests' and 'counter-requests' is set out below, and explained in more detail in the recommendations section that begins on page 30.

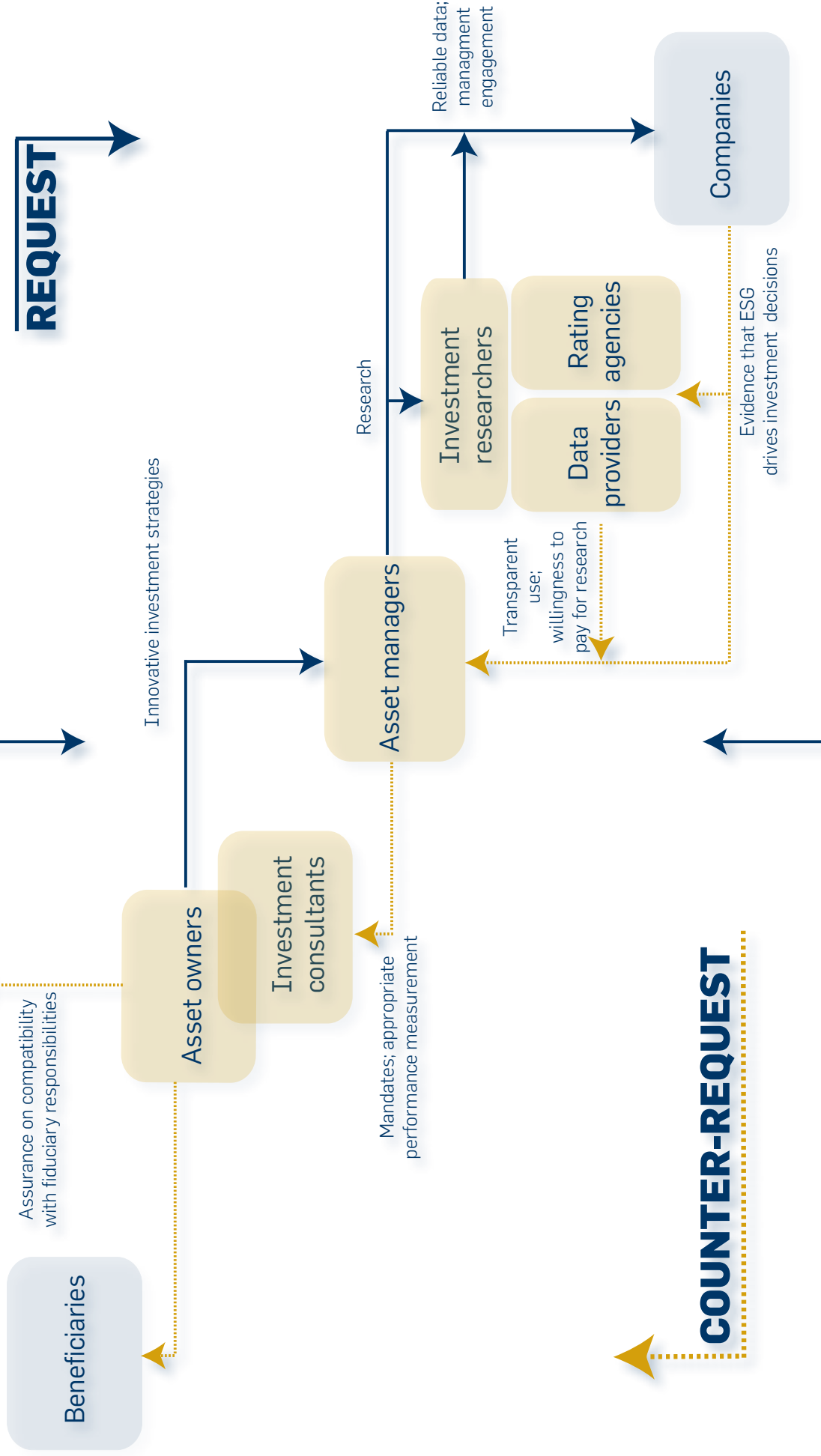
² These subjects were the focus of the 2006 Who Cares Wins event, 'Communicating ESG Value Drivers at the Company-Investor Interface'

Enabling change in a complex system

Regulators and governments, exchanges

Requirements for greater transparency

Internalisation of ESG costs



Academia, think tanks, supporting initiatives (e.g. PRI, ICGN)

Thought leadership

Groundwork research

Lower costs to entry through collaboration, dissemination of best practice

For example, when asset managers request improved ESG-inclusive research from service providers, they must show that the research will influence the way they spend their brokerage or research budgets, and that investment decision-making is influenced by the research

The strength of the discussions and consultations with industry professionals that took place during the WCW Initiative has been this focus on the dynamics of the investment system and on what is needed to unblock stalled situations.

Who Cares Wins aimed to support the financial industry's efforts to integrate ESG issues into mainstream investment decision-making and ownership practices. In the light of the 2007–2008 financial crisis the need to refocus the investment system on the long term and on a more holistic assessment of risk is more important than ever. The conclusions of the Who Cares Wins initiative — a roadmap to markets that are more 'future proof' — are captured by the following set of ten recommendations for different investment market actors:

1. **All investment actors:** mobilise top management. CEO / CIO leadership is needed to unblock stalled situations between different actors and agree on how to share the costs of further market-building efforts
2. **Regulators and governments:** require greater transparency on ESG performance / integration from companies and investors. Engage in an open dialogue with the financial industry on this issue, and support neutral platforms aimed at fostering that dialogue. 'Walk the talk' in terms of the way you invest your own capital. Help the industry's integration efforts by giving a price to public goods, thereby internalising external environmental and social costs
3. **Asset owners:** make ESG inclusion a specific criterion in new asset management mandates. Commit to evaluating ESG capabilities systematically when formulating mandates and selecting managers. Professional staff: increase the awareness and knowledge of trustees in this area
4. **Investment consultants:** develop and communicate a house view on the integration of ESG issues. Be explicit about how that position is reflected in your services (e.g. investment strategy, asset-liability management / asset allocation and manager selection)
5. **Asset managers (senior management):** lead ESG integration by communicating clear goals and providing appropriate incentives for employees and service providers (e.g. sell-side research). Involve human resources / compensation managers in your planning
6. **Asset managers:** pro-actively develop and distribute investment strategies and services that focus on ESG as a tool for improving risk-adjusted return. Design integrated methodologies³ for ESG that go beyond simple screening approaches
7. **Asset owners, asset managers and research providers:** enter a dialogue with companies to explain how ESG issues drive investment decision-making and to request improved reporting on ESG performance
8. **Asset owners, asset managers and research providers:** improve the quality and coverage of country-specific ESG research in emerging markets. Include ESG issues in regular company meetings and engagement activities. Consider collaborating with other investors in requiring minimum ESG disclosure standards from emerging markets legislators and exchanges
9. **Research providers:** leverage the knowledge of analysts covering industries with a high degree of ESG integration, and expand the quality and scope of ESG inclusive research to include other sectors, regions (including emerging and frontier markets) and asset classes
10. **Rating agencies:** improve and communicate your efforts to integrate ESG issues into rating methodologies

3 Methodologies that integrate ESG into the traditional fundamental analysis (profit and loss / cash flow modelling, cost of capital, multiples-based valuations, etc.) and into established investment processes

In order to plot a course that could be followed by institutions looking to scale up their ESG integration efforts, we present composites of the characteristics of asset owners and asset managers at early and advanced phases of integration. These composites can be found on pages 33 to 34.

To improve ESG integration in emerging markets investment (a special focus area of the WCW Initiative), the following key recommendations were formulated:

- Include ESG issues in regular company meetings and engagement activities
- Perform a systematic review of the ESG exposure of investments in emerging markets
- Consider collaborating with other investors in requiring minimum ESG disclosure standards from local legislators and exchanges
- Consider the potential for small allocations to frontier markets not only to deliver attractive returns but also to establish basic investability conditions (such as custody, efficient settlement services, etc.) and management awareness of material ESG issues

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David Russell
Universities Superannuation
Scheme (USS)

Dan Siddy
DELSUS

Raj Thamotheram
AXA Investment Managers

Roger Urwin
Watson Wyatt

Publications of the Who Cares Wins Initiative

- Who Cares Wins: Connecting Financial Markets to a Changing World (2004)
- Investing for Long-Term Value (2005)
- Communicating ESG Value Drivers at the Company-Investor Interface (2006)
- New Frontiers in Emerging Markets Investment (2007)
- Future proof? Embedding environmental, social and governance issues in investment markets (2009)

1. Introduction

The goal of the Who Cares Wins Initiative was to catalyse the integration of environmental, social and governance (ESG) issues into mainstream investment decision-making.

At the time of the Initiative's launch in 2004, 20 financial institutions with combined assets of over USD 6 trillion⁴ published a report entitled 'Who Cares Wins: Connecting Financial Markets to a Changing World'. The report contained a series of general recommendations, targeting different financial industry actors, that aimed to facilitate ESG uptake throughout the investment system.

Environmental, social and governance (ESG) issues

ESG issues relevant to investment decisions differ across companies, sectors and regions. The following are **examples** of issues with a broad range of impacts on companies and other issuers of securities:

Environmental issues:

- Climate change, water scarcity — related risks and opportunities
- Local environmental pollution and waste management
- New regulation expanding the boundaries of environmental product liability
- New markets for environmental services and environmentally-friendly products

Social issues:

- Workplace health and safety
- Knowledge and human capital management
- Labour and human rights issues within companies and their supply chains
- Government and community relations (notably where there are operations in developing countries)

Governance issues:

- Board structure and accountability
- Accounting and disclosure practices, transparency
- Executive compensation
- Management of corruption and bribery issues

⁴ Who Cares Wins endorsing institutions: ABN AMRO, Aviva, AXA Group, Banco do Brasil, Bank Sarasin, BNP Paribas, Calvert Group, China Minsheng Bank, CNP Assurances, Credit Suisse, Deutsche Bank, F&C Asset Management, Goldman Sachs, Henderson Global Investors, HSBC, Innovest, IFC, KLP, Mitsui Sumitomo Insurance, Morgan Stanley, RCM, UBS and Westpac

The ESG landscape has evolved greatly since that time. Substantial progress has been made through initiatives such as the Principles for Responsible Investment (PRI) and UNEP Finance Initiative, industry collaborations such as the Carbon Disclosure Project, the Enhanced Analytics Initiative (EAI) and the Marathon Club, and the innumerable efforts of institutions and individuals at all stages in the investment chain.

"ESG integration is challenging and not many asset owners have the resources to deal with it. However, I am impressed by a growing group who understand how delicately balanced and connected our financial system is, and how ESG will critically influence future outcomes. I think consultant research on ESG issues is a key enabler for more funds to see the tangible benefits of ESG integration."

Roger Urwin
Global Head of Investment
Consulting, Watson Wyatt

For their part, the sponsors of Who Cares Wins — the International Finance Corporation, the Federal Department of Foreign Affairs (Switzerland) and the UN Global Compact — hosted four closed-door events for investment professionals⁵. Each event considered a particular element of ESG mainstreaming, from the interface between investors and companies to the particular role of ESG issues in emerging markets investment. The events brought together asset owners, investment consultants, asset managers, service providers and policy makers, and were characterised by the frank, challenging dialogue between participants.

In concluding the Initiative in 2008 the sponsors aim to provide a platform for the next phase of ESG integration — scaling up current know-how in order to attain widespread integration of ESG issues into financial markets. As such, this report attempts to answer two questions:

1. *What progress has there been on mainstreaming ESG issues since the launch of Who Cares Wins in 2004?*
2. *Which actions will enable the next phase of ESG mainstreaming?*

Progress since 2004 was assessed against the framework set out at the launch of Who Cares Wins. In doing so we have not only summarised the outcomes of the four years of Who Cares Wins discussions, but also built on the excellent work already done in this space by various industry, academic, public sector and civil society initiatives⁶.

An instrumental component of the concluding phase was the consultation held with senior industry professionals in the summer of 2008. The experts consulted, who are listed on page 36, gave strategic insight into both the assessment of progress and future priorities for the industry. However, the conclusions and recommendations presented in this report are those of the authors alone.

⁵ The four events were: Who Cares Wins: Connecting Financial Markets to a Changing World (Zurich, 2004), Investing for Long-Term Value (Zurich, 2005), Communicating ESG Value Drivers at the Company-Investor Interface (Zurich, 2006) and New Frontiers in Emerging Markets Investment (Geneva, 2007)

⁶ Additional research sources included, inter alia, work by Ceres, the CFA Institute, The Conference Board, the European Centre for Corporate Engagement (ECCE), IFC, the International Corporate Governance Network (ICGN), the PRI, UNEP FI, and the World Economic Forum / AccountAbility

2. Progress in ESG integration

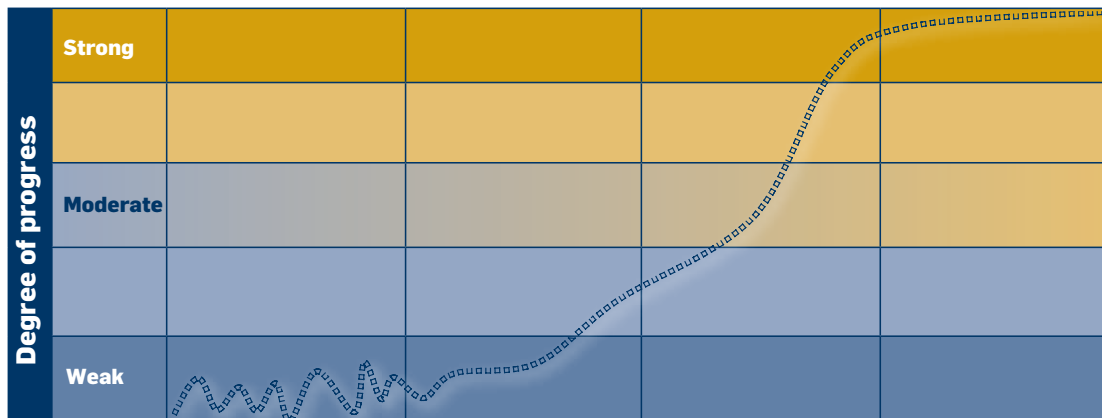
The first Who Cares Wins report, published in 2004, recommended action areas for each of the major actors in the investment chain. These recommendations were examined in depth in the course of the four Who Cares Wins events between 2004 and 2007. In 2008 we revisited these recommendations (in consultation with a number of industry experts) to test their validity and to measure the industry's progress against them.

In the expert consultation and this report we use a five-point scale to assess progress. The lowest grade used — 'weak' — indicates the existence of some knowledge sharing and commitments in principle, but that no practical implementation steps have been taken since the baseline was set in 2004. The upper limit of the scale — 'strong' — means that there has been widespread implementation by a majority of institutions, including clearly defined strategies, targets and implementation programmes. We also take strong to mean that no further focus on ESG integration is required from industry initiatives or other investment industry actors — ESG has become generally accepted as part of investment best practice in the area concerned.

Weak	Weak / moderate	Moderate	Moderate / strong	Strong
Some knowledge sharing and commitments in principle but no practical implementation steps			Widespread implementation by a majority of institutions, including clearly defined strategies, targets and implementation programmes	

By assessing the progress made by each actor relative to the original recommendations, we hope to plot the position of ESG integration on along the course shown below.

The phases of ESG integration towards mainstream acceptance are characterised by different activities and actors



Phase	1. Experimentation	2. Industry-wide innovation and learning	3. Institutional commitment and scaling up	4. Full Integration
Key actors	Pioneers, 'lone rangers'	Experts and leaders with varying degrees of institutional backing	CEOs, CIOs	All levels
Activities and 'symptoms'	Ad hoc initiatives by individuals	Specialist teams, focus on high ESG-exposure business and on certain product and client segments, learning through in-house and industry-wide platforms	ESG integration becomes part of the core strategy, scope of ESG integration rapidly expands to all types of relevant business activities, regions, asset classes and client types	ESG focus is integral part of core investment strategy and processes — generally accepted as best practice

Observations relating to the investment system as a whole

ESG integration has come a long way in the last four years. The level of consciousness of ESG issues among mainstream professionals has greatly improved — the majority of industry professionals that participated in Who Cares Wins consultations believe that the investment system is well on track for ESG issues becoming mainstream.

In terms of the phases of evolution mapped in the chart above, the investment system seems to be in the early stages of phase 3 — 'institutional commitment and scaling up'. That is to say in developed markets that the learning phase is drawing to a close, leaving those institutions that have made a firm institutional commitment to the space with a springboard for scaling up ESG integration.

However, progress has not been uniform — environmental, social and governance issues have not been taken up by investors to equal extents. In general, corporate governance is the concept that most easily captures mainstream minds. The understanding and integration of financially-material environmental issues has also advanced greatly in recent years, with a particular emphasis on the opportunities presented by responses to environmental challenges.

However, the response of investors to social issues, such as workplace health and safety, human rights and companies' stewardship of intellectual capital, has lagged.

As described in the following sections of this progress report, the actors have also progressed at different rates. In fact, there has been something of a transformation:

- In 2004 a number of asset owners expressed a strong belief in ESG as a value add, and challenged asset managers and research providers to take up these issues. Investment research was often seen as a blockage between increasingly enlightened ESG practices at the corporate level and uptake by investors
- By 2008 researchers and other service providers had made some of the biggest strides forward, begging difficult questions in terms of how asset managers are integrating ESG issues and whether asset owners were really writing ESG-inclusive mandates

As the innovation and learning phase comes to a close we stand at the brink of more systematic and profound changes to the role of ESG issues in investment. We cannot, however, expect this to happen without the sincere commitment of the industry's senior executives. Indeed, industry professionals repeatedly stressed the importance of the human resources aspects of mainstreaming, including:

- Leadership at the top (CEO support)
- Institutional commitment throughout a full market cycle — a five-year plan, not just a 'fair weather' approach
- The need for education and incentive systems at all levels
- A supportive corporate culture, coupled with self-confidence and the conviction that 'the ESG bet' will pay out over the long term

ESG mainstreaming requires both substance and intelligent communications. The pioneers of phases 1 and 2 should be conscious of the perceptions that they create in the investment community. For example, experts should check whether by constantly emphasising ESG as something special they have contributed to 'pigeonholing' the issues. Likewise, gaining traction with ESG sceptics will also involve being honest about situations when ESG issues are not material relative to other considerations.

The industry and its stakeholders should also be realistic in their time expectations, and acknowledge that large organisations have different speeds of change. ESG is, after all, unlikely to have a near-term, disruptive effect on the financial industry's business model in the way that, for example, hedge funds have. Rather it is about doing traditional investments better. ESG integration is therefore necessarily long term and adds value at the margin, making it understandable that change has sometimes been slow.

Asset owners and investment consultants

Asset owners

Action areas*		Assessment of progress 2004–2008**
1.	Consider ESG issues in formulation of mandates / selection of managers / in-house management	Weak
2.	Implement active ownership strategies inclusive of ESG issues	Moderate

* As defined by the original Who Cares Wins report in 2004

** For an explanation of the scale please see the beginning of the section on progress on ESG integration

Industry professionals that participated in the Who Cares Wins consultations commented that the awareness of asset owners of ESG issues has improved more than expected⁷, but that the level of implementation — investing in an ESG-inclusive manner — was underwhelming. Given asset owners' position at the top of the investment chain, a move to a higher level of implementation of ESG commitments will be a major boost to ESG integration throughout the system.

In contrast, individual and collaborative active ownership activities (engagement with companies, other issuers and regulators on ESG issues, exercise of voting rights, etc.) have made good progress since 2004.

Although a number of large asset owners, such as the Environment Agency (England and Wales) Pension Fund and the Fonds de réserve pour les retraites (FRR) in France, have issued asset management mandates that explicitly require ESG integration, these have been the exception, rather than the rule. Moreover, action in this area has been dominated by institutional asset owners whose beneficiaries are either public sector employees or broad groups of citizens / tax payers (e.g. pension reserve funds). Despite theoretical work on long-term, ESG-inclusive mandates carried out by Hewitt / the Universities Superannuation Scheme (USS), the Marathon Club, and others, most of the signals sent out by owners are not 'asset backed'.

Asset managers that participated in WCW consultations noted that they:

- Do not see the ESG-inclusive mandates
- Doubt whether ESG capabilities genuinely have an influence in the selection of external managers
- Find it hard to get constructive feedback from asset owners on what managers are doing on integration, reporting, etc.

The lack of concrete action does not necessarily indicate a lack of sincerity on the part of asset owners. It may rather be that many simply lack the governance and human resources to implement their commitments to ESG. It is perhaps no coincidence that many of the most

⁷ It is less clear what is happening outside the group of PRI signatories. In addition, corporate pension funds are conspicuously absent from the debate, with the exception of a few large company defined-benefit schemes (which have been active in the PRI)

robust ESG actions have come from large asset owners such as ABP (and their manager APG Investments), the BT Pension Scheme and FRR, where strong governance systems and experienced teams are present.

Asset managers urged owners to 'make real' their commitments to ESG by explicitly mandating managers to integrate the issues, and by formalising the role of ESG capabilities in the manager selection process.

More positively, the use of active ownership approaches to ESG has increased notably among asset owners. Initiatives such as the PRI Clearinghouse⁸ and specialist engagement service providers have allowed asset owners (and asset managers) to pool resources, amplify their voice and reduce costs⁹. ESG-specific engagements through the PRI, the CDP, etc., are just a component of a larger trend of asset owners making greater use of their formal and informal ownership rights.

According to industry professionals the obstacles that asset owners most frequently encounter are entrenched beliefs and misconceptions about ESG, and limited empirical evidence around ESG as a value-adding strategy. However, the number of asset owners that believe there is a conflict between ESG integration and fiduciary (or equivalent) duties has reduced considerably in number.

Another obstacle to more decisive action by asset owners is the ability of their own resources and governance structures to support ESG integration. Any discussion of an asset owner 'taking on' ESG needs to be accompanied by an evaluation of the governance and time budgets available in-house. i.e. is the owner apt to manage ESG issues himself, or should it be outsourced to service providers?

Smaller asset owners often have inadequate governance to deal with the complexity of ESG. Moreover, the incentives for the fiduciaries of asset owners of all sizes to adopt apparently risky, new approaches are low. Industry professionals pointed to the importance of investment consultants guiding their clients through ESG integration (a role that is rarely actively played).

However, an 'enabling environment' will not be created solely by improved owner governance and leadership from consultants. In some cases asset owners require stronger statements by beneficiaries and regulators confirming that ESG integration is entirely consistent with their responsibilities.

The Who Cares Wins consultations also reminded us of the need to consider the role of asset owners other than pension funds. Pension funds are often seen as the panacea for all market ills, whereas in reality other large asset owners such as insurance companies, sovereign funds and private wealth must also be part of the discussion. These other owners may have at least as great an interest in long-term, ESG-inclusive strategies as pension funds.

⁸ Other important collaborative initiatives in this space include the Carbon Disclosure Project (CDP), the International Corporate Governance Network (ICGN) and the Institutional Investors Group on Climate Change (IIGCC). Please also refer to page 38 of the appendices for a more complete list of initiatives

⁹ It should, however, be noted that the advantages of outsourced engagement services can sometimes be accompanied by the disadvantage that the signal sent to companies may be weaker than if the asset owner or manager was dealing with the company directly

The clear message left by the Who Cares Wins Initiative is that without the sincere engagement of asset owners of all descriptions the 'scaling up' phase of ESG integration will not happen. The time has come for asset owners to turn their stated commitments to ESG into concrete interactions with their service providers. This report proposes such a step in the recommendations on page 32.

Investment consultants

Action areas		Assessment of progress 2004–2008
1.	Consider ESG issues in formulation of mandates / selection of managers / in-house management	Weak

A discussion of the importance of asset owners to ESG integration should clearly also acknowledge the gate-keeping role of consultants. However, many investment consultants have made little effort to understand how ESG issues can enhance the services they offer asset owners¹⁰.

There are, however, exceptions — investment consultants such as Mercer and Watson Wyatt have allocated significant resources to ESG issues.

The journey for consultants begins by developing and communicating a house view on the integration of ESG issues. Once the policy has been established, the challenge is to how systematise the inclusion of ESG in standard services such as formulating investment strategies and selecting managers to implement those strategies.

As part of the latter, industry professionals invited consultants to put lower weights on managers' recent track records, and greater weights on the ability of managers to deal with emerging issues, including ESG.

The leading consultants have begun to rate managers in their databases in terms of ESG capabilities (not only for the benefit of clients with an expressed interest in ESG). However, much like investment research, until such time as ESG becomes a fixed component of the standard manager evaluation model, claims that ESG issues can be material to all investors will appear incongruous.

Consultants should also lead smaller asset owners through these difficult issues, proactively proposing solutions that are appropriate for the owner's governance budget and in-house capacity.

¹⁰ Standard investment consultancy tasks include investment strategy, asset allocation / asset-liability modelling and manager selection / monitoring

Asset managers

Action areas		Assessment of progress 2004–2008
1.	Request and reward ESG research from sell-side / independent research	Weak / moderate
2.	Integrate material ESG issues into investment processes	Weak / moderate
3.	Incentivise employees in charge of ESG integration	Weak
4.	Proactively offer ESG inclusive investment products and services	Weak / moderate

Some of the strongest progress in the asset management community has been in terms of sourcing ESG-inclusive investment research from service providers. On the other hand, other actors in the investment system have doubts about how that research is used within asset managers, and about the robustness some of the current range of ESG-inclusive asset management strategies. Asset managers themselves also cautioned that incentive systems within their organisations were often not aligned with the long-term goals of ESG integration.

The Enhanced Analytics Initiative (EAI) has been an important force in signalling the desire of asset managers to see investment research on the full range of risks and opportunities to which they are exposed. The call from the asset manager members of the EAI has been unambiguous, and backed by commercial incentives for their service providers. The response to this call by research providers is discussed on page 23.

However, the absolute levels of progress in the broader asset management community are still low. Few asset managers are requesting and rewarding ESG research (even among PRI signatories), and sometimes even those who are making requests send contradictory signals to research providers. The market for ESG-inclusive research requires both broader international reach and greater 'liquidity'. The responsibility is with the buyers to send appropriate signals.

A common complaint from the sell side of this market is that it is unclear how the research is actually being used by asset managers. Managers ask for integrated research, but is there evidence for reciprocal integration efforts on the buy side, beyond high-level commitments and self-assessment of progress? Market participants suspect that there is a large gap between policy and implementation at asset managers. It may be that asset management CEOs make public commitments (such as signing the PRI) without consulting the CIO and other key personnel on the structures that need to be put in place to implement the commitment.

The message sent by research providers is that requests for enhanced research must be accompanied not only by commercial incentives, but also by clarity on how managers use the research, and more broadly how ESG policies translate into integration into asset management products and services (in all asset classes).

Once again we see that the concept of a simple, one-way chain, with requests issued by up-

"Taking into account financially-material ESG issues improves the quality of investment decisions. It also makes the investment system as a whole more 'future proof' and ultimately may help to avoid heavy-handed regulatory interventions."

Burkhard Varnholt
Chief Investment Officer,
Bank Sarasin

stream clients to downstream providers, provides an unsatisfactory description of the investment system. When upstream participants request disruptive changes to the way the system works, they must accompany their requests with assurance that their own actions will be transparent, and that risks taken will be reciprocated.

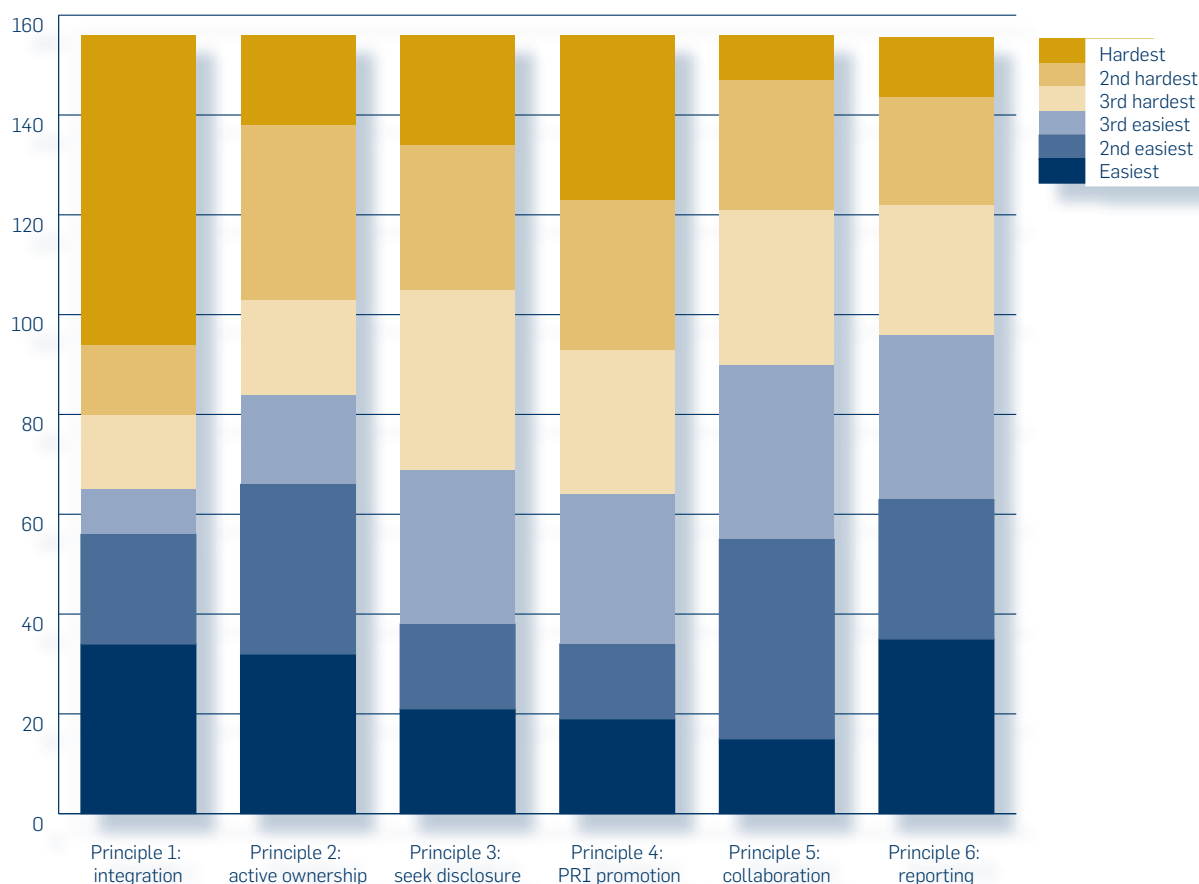
This requirement for an 'enabling environment' applies equally to the direct interaction between asset managers and company management. In order to enable the disclosure by companies on key ESG issues, and management engagement at the highest levels of investee companies, asset managers must be clear about the influence that ESG information has on their investment decision-making.

However, integration of ESG into orthodox investment frameworks is a real challenge for many asset managers, as is shown in the chart below.

PRI signatories find integration of ESG into investment decision-making the hardest part of their commitment

Ranking of principles from most difficult to implement to least difficult to implement (Q117)

Source: *Principles for Responsible Investment, PRI Report on Progress 2008*



The lack of consistency in ESG data and research may explain some of these difficulties. However, asset managers in countries such as Australia have advanced their ESG integration efforts, despite the paucity of research on that market.

In contrast to integration, engagement with companies, other issuers and regulators on behalf of asset owners can be a powerful way for managers to embrace ESG, and is often the least threatening change for mainstream professionals to make. However, in the long term this could be counterproductive, if engagement creates a smokescreen that obscures less impressive efforts on the integration front.

From the point of view of asset owners and their consultants, the transparency of asset management products is currently a problem. There is often a gap between how a product is marketed and what it actually does. Many asset managers also try to serve traditional SRI investors and financially-driven investors with the same strategy. Owners feel that this bundling of clients is unlikely to deliver satisfactory outcomes over the long term.

Finally, the gap between policy and implementation also manifests itself in terms of the incentives for rank and file buy-side researchers and portfolio managers to embrace ESG. The onus is clearly on senior management to communicate clear goals and provide strong incentives for employees.

For asset managers that give clear guidance to companies and research providers on how ESG information is used, that develop ESG-inclusive strategies that are transparent about their objectives, and that align the incentives for employees and service providers with their policies, ESG provides a great business opportunity.

Indeed, industry professionals were surprised that few large asset management houses were using ESG as a differentiator. So far this role has been left to niche asset managers.

Investment researchers, data providers and rating agencies

Action areas		Assessment of progress 2004–2008
1.	Develop the investment framework and rationale for ESG integration	Moderate / strong
2.	Integrate ESG issues into mainstream research, widen sector coverage	Weak / moderate
3.	Widen coverage of emerging markets	Weak / moderate

A big step forward has been made in the past years by academics and investment researchers in developing the analytical frameworks and demonstrating the rationale for ESG integration in investment research. Leading sell-side research institutions have published comprehensive methodologies for ESG integration and have demonstrated that quantifying financial impacts of ESG issues, in spite of their often uncertain and long-term character, is absolutely within the reach of the analysts' profession. This is one of the most important legacies of the 'innovation and learning' phase and an important basis on which the next phase ('institutional commitment and scaling up') can build.

Likewise, in terms of the actual coverage of ESG issues in mainstream investment research, the industry has made important strides from a low

"There is an increasing recognition of the need to include the analysis of ESG factors in order to more completely fulfil this duty [to act in the best interests of clients and ultimate beneficiaries]."

CFA Institute

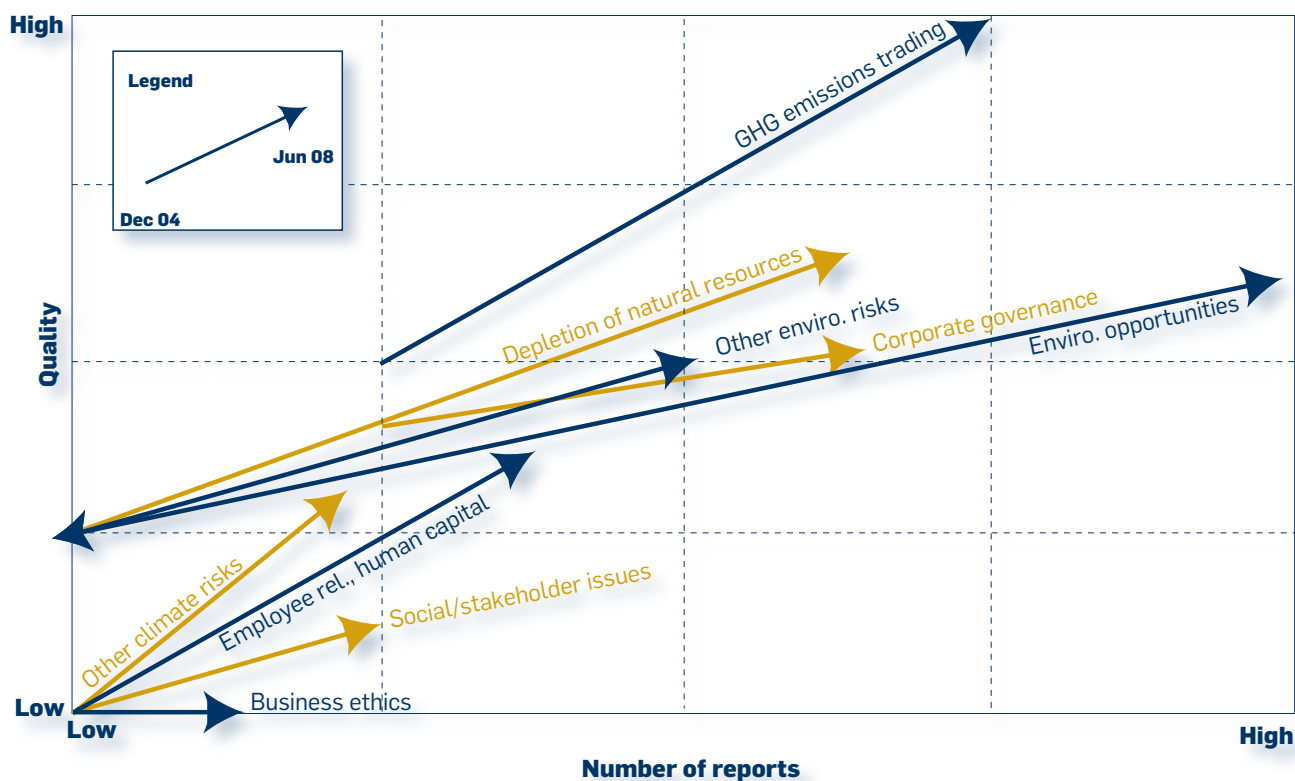
base. Initiatives such as the Enhanced Analytics Initiative have observed strong growth in the number of ESG inclusive reports and in the coverage of relevant sectors and regions by sell-side and independent research institutions. However, coverage remains patchy and at times opportunistic, and is generally driven by specialist teams rather than by mainstream analysts.

The emergence of new ESG data providers is also notable, and signals a positive trend toward a greater specialisation and efficiency in this still young market. On the other hand, it is disappointing to note that the leading credit rating agencies — a crucial actor in investment markets — have not progressed in terms of providing more transparency in relation to the integration of ESG issues into their methodologies.

The industry professionals that participated in WCW consultations stressed the need to differentiate between E, S and G in assessing progress in investment research, and between Europe and other regions. Coverage of environmental issues is often strong, with many of the large research providers having tackled a wide range of environmental themes. However, research into social value drivers is distinctly lagging, and research on corporate governance is patchy relative to its perceived importance (see chart below). Likewise, coverage of certain markets (notably the US, but also Japan, the emerging markets and Australia¹¹) has been poor.

Coverage of different ESG issues has advanced at different paces

Source: Enhanced Analytics Initiative, December 2008



Participants in WCW consultations noted that none of the leading global research institutions has committed to making ESG an integral component of all their house models. Such a commitment would be a breakthrough moment, with many of the other large institutions following

11 Interest in ESG has been high among asset owners in Australia

the leader in quick succession. Participants also suggested that gaps in the research agenda present ideal opportunities for academics and investment researchers to collaborate¹². For example:

- More work needs to be done not just on micro issues for companies but also on the impact of ESG issues on long-term macro drivers and asset allocation
- Fixed income / credit research was also seen as a crucial gap. There is a lot of focus on sell-side equity research, but it has been very hard to engage sell-side fixed income researchers and the big three rating agencies, even on the most widely-accepted corporate governance issues

The main obstacles for better ESG integration mentioned during WCW consultations were insufficient incentive systems for analysts¹³, the high cost of building up the new research offer (versus relatively low demand from clients), and the lack of comparable company data on ESG issues.

The first point calls for more leadership by senior management, the second for a fair split of costs and benefits between users and producers of the research.

In terms of better data availability, voluntary standards such as the Global Reporting Initiative and the services of specialist data providers have led to certain improvements. However, several participants in WCW consultations were convinced that this is not enough and that governments should mandate minimum ESG disclosure standards for companies in order to improve data availability.

Regulators, exchanges, professional bodies, etc.

Action areas		Assessment of progress 2004–2008
1.	Require minimum degree of disclosure / accountability from companies	Moderate
2.	Establish that ESG integration and fiduciary obligations are compatible	Moderate
3.	Incorporate ESG issues in professional curricula and support knowledge and awareness building in the industry	Weak / moderate

The 2004 Who Cares Wins report mentions that “regulatory frameworks should require a minimum degree of disclosure and accountability on ESG issues from companies, as this will support [ESG integration into] financial analysis. The formulation of specific standards should, on the other hand, rely on market-driven voluntary initiatives.”. Since then, through the efforts undertaken by several exchanges¹⁴ and voluntary initiatives (such as the Global Reporting Initiative and the Carbon Disclosure Project), disclosure levels and the comparability of ESG data have improved. But the battle on ESG performance disclosure is not yet won, and some invest-

12 Platforms for collaborations between academics and industry practitioners already exist, such as the Mistra Sustainable Investment Research Platform and the new PRI / ECCE Academic Network

13 The ‘bundled’ commissions model by which most research is remunerated is an important component of this obstacle

14 A number of exchanges have introduced minimal ESG disclosure standards as part of their listing particulars. The World Federation of Exchanges has been active in this space

ment professionals called for regulators to maintain the pressure on companies and consider mandating minimum disclosure standards.

In the coming years, not only companies but also financial institutions, especially pivotal players such as the large credit rating agencies, should improve disclosure of their ESG integration efforts¹⁵. Regulators can play an important role here by supporting voluntary initiatives and neutral platforms through which the financial sector can report on ESG integration efforts.

Overall, the message from the WCW consultations is that, given the complex and technical nature of ESG integration, governments should not play an active role at the micro level but should focus more on defining the right 'boundary conditions' for the system as a whole. E.g. sending price signals to companies and the financial sector by putting a price on public goods such as clean air and water.

When Who Cares Wins started, many investors were uncertain as to whether ESG integration was compatible with their fiduciary responsibilities. The publication of a Freshfields Bruckhaus Deringer / UNEP FI study on this issue¹⁶, and the debate that has taken place within the industry since then, have made it clear that integration of material ESG issues is not only compatible with but may be a requirement of fiduciary responsibility.

In practice, however, many fiduciaries are still confused on this point. Regulators could support ESG integration by communicating explicitly to the industry that they see no contradiction between a thoughtful consideration of material ESG issues and fiduciary responsibilities.

It should also be remembered that governments also own large pools of financial and other assets. Participants at WCW consultations stressed that government investors and multi-lateral agencies should 'walk the talk' when it comes to investing their own capital in a more ESG-inclusive way. This would not only add to the pool of ESG-inclusive assets, but also send important signals in terms of governments' long-term support of the industry's ESG integration efforts.

The role of professional bodies and curricula in increasing the industry's awareness and knowledge and in better training young professionals in the field of ESG was repeatedly stressed throughout the WCW Initiative. Several initiatives by professional bodies have been undertaken in the course of the past years but a lot still remains to be done to counter the prevailing scepticism. The recent more active role undertaken by the CFA Institute in this area is very encouraging in this respect.

15 While respecting the proprietary nature of the rating agencies' methodologies

16 Freshfields Bruckhaus Deringer / UNEP Finance Initiative: A legal framework for the integration of environmental, social and governance issues into institutional investment, October 2005

3. A focus on emerging markets investment

The role of ESG issues in emerging markets investment was a particular area of focus for Who Cares Wins¹⁷. This section summarises key findings and specific recommendations in this area.

Industry professionals that participated in WCW consultations noted that the investment case for considering ESG issues in EM investments is on average stronger than in the case of developed market investments.

Departures from ESG best-practice tend to be larger in the worst-case EM companies (compared with worst-case developed market companies) and a relative lack of oversight by regulators and gatekeepers such as analysts and institutional investors results in weaker investor protection and ultimately higher agency costs.

Participants also remarked that ESG issues in EM can have a profound impact not only at the micro but also at the macro level (including the impact on long-term growth rates of issues such as political stability, governance, corruption, education levels and public health).

An important insight is that emerging markets should not be viewed monolithically by investors — country specificity and contextualisation are crucial. In addition, international investors have a tendency of focussing on downside mitigation when considering ESG issues, without spending time on the upside potential of ESG integration.

Interestingly, perceptions about which ESG issues are most financially material often differ between international and local emerging markets investors. Local investors often point to social and governance issues as being most relevant, at least in the short term, whereas the focus of international investors tends to be on environmental issues¹⁸. Governance issues are generally of high relevance in the EM context. This is particularly true in the case of the many EM companies controlled by governments and families.

WCW participants highlighted the fact that there has not been much progress in the past years in terms of asset owners¹⁹ allocating more capital to ESG-inclusive EM investment strategies. This was seen as a major impediment for better ESG integration throughout the industry. Participants also stressed the fact that international investors should be more aware of their central role in establishing high standards of disclosure and ESG practice and should consider investing capital not only to established EM but also to frontier markets²⁰.

"Nowhere are issues such as air pollution, water scarcity and social exclusion as tangible as in emerging markets. Enlightened investors will not only see the risks but also the huge opportunities presented by responsibly engaging in these frontier market opportunities."

Hendrik du Toit
Chief Executive Officer,
Investec Asset Management

¹⁷ The Who Cares Wins event in Geneva in July 2007 was dedicated to this subject

¹⁸ The chart on page 29 illustrates that the ESG questions that investors most frequently pose to EM companies are on environmental performance and governance

¹⁹ Including multilateral financing institutions

²⁰ Countries whose markets are in the tier below emerging markets in terms of investability are generally classified as 'frontier markets'

The lack of ESG research on EM companies was seen as one of the reasons for asset owners' caution in this area. This creates an impasse where research providers are not willing to bear the cost of developing an expensive ESG research service without a stronger commitment by asset owners. To unblock this impasse, further support from public institutions acknowledging the 'public good' character of this research may be needed²¹.

Participants also signalled the paradox of developed markets asset managers that have a strong ESG pedigree in their home markets do not apply ESG strategies to their EM investments.

Direct engagement with companies and with regulators and exchanges is a key enabler of further mainstreaming of ESG in EM. Leading companies and exchanges²² in EM have often been very responsive to international investors' interest in ESG issues, as was noted during WCW consultations.

In terms of engaging with regulators in EMs, concert party rules can sometimes inhibit collaboration between investors. Using investors with appropriate local knowledge as a coordinator and third-party engagement services are both viable alternative mechanisms in emerging markets.

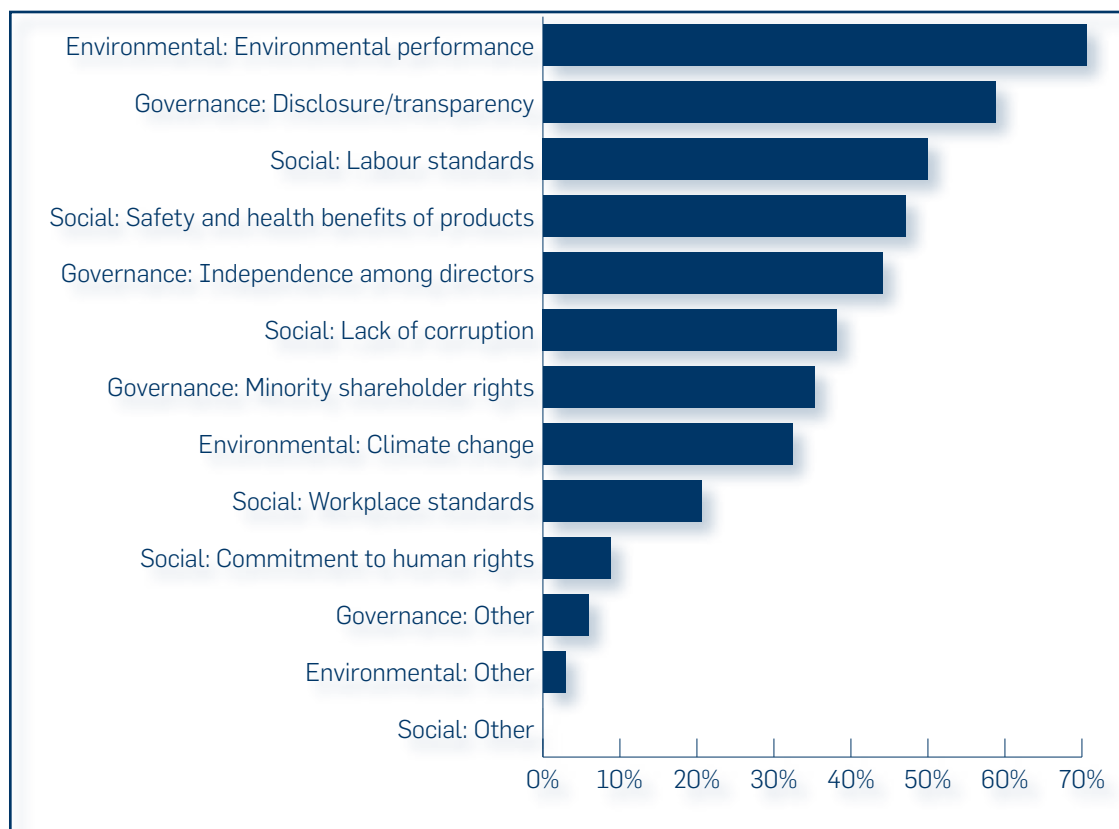
It was also noted that ESG-inclusive indices for EM can be a valuable awareness-raising tool for both companies and investors. They also serve as a basis for developing investment products, both active and passive.

21 An example is IFC's grant competition for better ESG investment research in emerging markets. IFC has also commissioned a survey of EM asset managers' ESG capabilities and worked with industry partners on ESG-inclusive strategies for EM

22 The World Federation of Exchanges and single stock exchanges such as the JSE Securities Exchange (South Africa) and the São Paulo Stock Exchange (BOVESPA) have been active in this regard

Perceptions of the importance of different ESG issues vary — in the chart below EM companies described the issues that investors raised most frequently

Source: IFC / Economist Intelligence Unit survey, 2007



The inputs received during WCW consultations lead to the following key recommendations for investors seeking to improve the integration of ESG issues in their EM investments:

- Include ESG issues in regular company meetings and engagement activities
- Perform a systematic review of the ESG exposure of investments in emerging markets. Take into account the fact that ESG issues in EM can also affect global investment portfolios through macroeconomic effects and the increasing operational exposure of non-EM-domiciled companies to EM. Not only equity investments, but also other asset classes (fixed income, infrastructure, project finance, real estate, etc.) are potentially exposed
- Consider collaborating with other investors in requiring minimum ESG disclosure standards from EM regulators and exchanges²³
- Consider the potential for small allocations to frontier markets not only to deliver attractive returns but also to establish basic investability conditions (such as custody, efficient settlement services, etc.) and management awareness of material ESG issues

²³ Examples include ASrIA's engagement with the Hong Kong Stock Exchange on IPO listing particulars, the efforts of the Carbon Disclosure Project (CDP) to improve carbon disclosure in India and Brazil, and Calvert's initiative to improve ESG disclosure in EM

4. Ten recommendations to accelerate ESG integration

The experts we consulted were asked to help to formulate a limited set of strategic recommendations for key actors (mainly asset owners, asset managers and investment researchers). We attempted to answer the question, "What needs to happen for ESG integration to become widespread in the course of a 3-4 yr time horizon?"

We targeted recommendations for the industry and related actors that are actionable (not purely aspirational) and economically rational. In formulating these recommendations we have also tried to stress the 'systems' nature of the challenges that ESG mainstreaming will face, which we set out on the following page.

We emphasise the systems view because we believe that the concept of a simple, one-way flow of demands from asset owners at the head of the investment chain down through their agents does not reflect the complexities of the interactions in the investment system.

The model shown in the following chart takes a more dynamic, systems-orientated view of the interactions. When upstream participants request disruptive changes to the way the system works (BLUE arrows in the chart), they must accompany their requests with assurance (counter-requests) that the changes they make themselves will be transparent, and that risks taken will be reciprocated (GOLD arrows in the chart).

For example, requests from asset owners for ESG-inclusive investment strategies must be accompanied by awards of mandates that make the asset manager's ESG capabilities a formal component of the manager selection process. The mandate must also give the manager comfort that the performance criteria are suitable for the type of strategy being requested (e.g. by using longer-term, rolling performance measures).

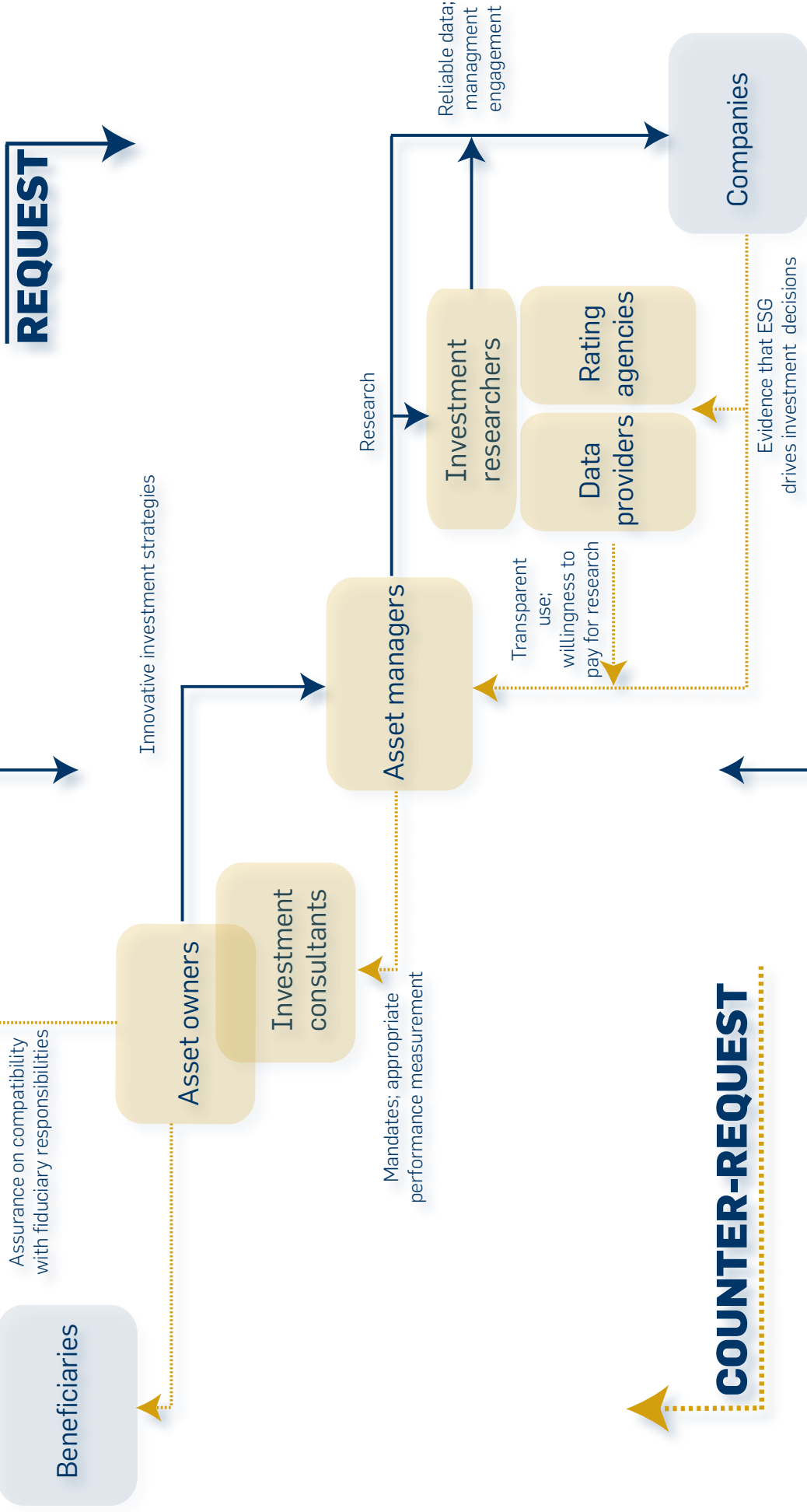
Likewise, when asset managers request improved ESG-inclusive research from service providers, they must show that the research will influence the way they spend their brokerage or research budgets, and that investment decision-making is influenced by the research.

Enabling change in a complex system

Regulators and governments, exchanges

Requirements for greater transparency

Internalisation of ESG costs



Academia, think tanks, supporting initiatives (e.g. PRI, ICGN)

Thought leadership

Groundwork research

Lower costs to entry through collaboration, dissemination of best practice

For example, when asset managers request improved ESG-inclusive research from service providers, they must show that the research will influence the way they spend their brokerage or research budgets, and that investment decision-making is influenced by the research

Recommendations

The strength of the discussions with industry professionals that took place during the WCW Initiative has been the systems view and the focus on what is needed to unblock stalled situations and kick-start wide-spread integration of ESG issues into investment markets. The conclusions of this process are described in the following set of ten recommendations for different investment market actors:

1. **All investment actors:** mobilise top management. CEO / CIO leadership is needed to unblock stalled situations between different actors and agree on how to share the costs of further market-building efforts
2. **Regulators and governments:** require greater transparency on ESG performance / integration from companies and investors. Engage in an open dialogue with the financial industry on this issue, and support neutral platforms aimed at fostering that dialogue. 'Walk the talk' in terms of the way you invest your own capital. Help the industry's integration efforts by giving a price to public goods, thereby internalising external environmental and social costs
3. **Asset owners:** make ESG inclusion a specific criterion in new asset management mandates. Commit to evaluating ESG capabilities systematically when formulating mandates and selecting managers. Professional staff: increase the awareness and knowledge of trustees in this area
4. **Investment consultants:** develop and communicate a house view on the integration of ESG issues. Be explicit about how that position is reflected in your services (e.g. investment strategy, asset-liability management / asset allocation and manager selection)
5. **Asset managers (senior management):** lead ESG integration by communicating clear goals and providing appropriate incentives for employees and service providers (e.g. sell-side research). Involve human resources / compensation managers in your planning
6. **Asset managers:** pro-actively develop and distribute investment strategies and services that focus on ESG as a tool for improving risk-adjusted return. Design integrated methodologies²⁴ for ESG that go beyond simple screening approaches
7. **Asset owners, asset managers and research providers:** enter a dialogue with companies to explain how ESG issues drive investment decision-making and to request improved reporting on ESG performance
8. **Asset owners, asset managers and research providers:** improve the quality and coverage of country-specific ESG research in emerging markets. Include ESG issues in regular company meetings and engagement activities. Consider collaborating with other investors in requiring minimum ESG disclosure standards from emerging markets legislators and exchanges
9. **Research providers:** leverage the knowledge of analysts covering industries with a high degree of ESG integration, and expand the quality and scope of ESG inclusive research to include other sectors, regions (including emerging and frontier markets) and asset classes
10. **Rating agencies:** improve and communicate your efforts to integrate ESG issues into rating methodologies

In order to plot a course that could be followed by institutions looking to scale up their ESG integration efforts, we present composites of the characteristics of asset owners and asset managers at early and advanced phases of integration. These composites are based on observations of the practices at leading institutions around the world²⁵.

²⁴ Methodologies that integrate ESG into the traditional fundamental analysis (profit and loss / cash flow modelling, cost of capital, multiples-based valuations, etc.) and into established investment processes

²⁵ The asset owners and managers on which the composites are based include ABP / APG Investments, AXA, Bank Sarasin, BNP Paribas, Colonial First State, Dexia, the Environment Agency (England and Wales) Pension Fund, F&C, FRR, Generation, Hermes, HESTA, I.D.E.A.M, Insight Investment, PGGM, PREVI, Robeco, SAM, USS and VicSuper

Asset owner institution (external asset management) — initial phase

- A coordinator is in charge of monitoring and coordinating overall ESG integration efforts
- The initial focus is on listed equities
- Trustees and senior management have participated in a half-day strategy workshop on ESG issues and their importance for the fund's investments (e.g. with input from a guest speaker) and have clarified the institution's position in the field
- Investment consultants are asked to provide guidance in the area (e.g. to advise on how ESG issues are best included in asset allocation, manager selection, etc.)
- Managers' capability to integrate material ESG issues is taken into account in manager selection processes
- In interviews or annual reviews, managers are challenged to express their views on the materiality of emerging ESG issues (e.g. climate change) and how they are taken into account
- An external source of ESG research is used to monitor the 'ESG quality' of the portfolio and challenge external managers to provide additional information, e.g. in the case of low or rapidly decreasing ESG quality of certain portfolio positions
- Collaboration with other investors and participation in relevant forums is used to improve knowledge in the area

Asset owner institution (external asset management) — advanced

- In an extensive consultation with its beneficiaries, the fund has assessed their preferences with regard to ESG integration (beside integration, this can also lead to certain issues being excluded from the portfolio, e.g. on the basis of normative ethical concerns)
- The fund has issued a policy stating that its goal is to integrate systematically all financially material ESG issues. Objectives, targets and progress on targets are communicated publicly
- The focus of integration includes all relevant asset classes, e.g. public and private equity, fixed income, commodities, real estate, etc.
- Managers' capability to integrate material ESG issues receives a high weighting in manager selection processes
- Managers' efforts to integrate ESG issues are reviewed annually
- Mandates are specified in a way that is compatible with ESG integration, e.g. performance measures take into account the more long-term nature of some ESG value drivers
- Clear incentives for key personnel in charge of ESG integration are in place
- Investment / risk committees or other functions in charge of strategic investment decisions are required to review asset classes, industries, securities, etc., that have been flagged as being 'high risk' from an ESG point of view
- The fund's skills in providing superior returns based on ESG integration are actively marketed to beneficiaries; they become part of the institution's value proposition to its clients
- Knowledge about material ESG issues is used in a coordinated way across several functions, e.g. in voting, engaging with companies and investment decision-making

Source: onValues

Asset management institution — initial phase

- A coordinator is in charge of monitoring and coordinating overall ESG integration efforts
- The initial focus is on listed equities
- A member of senior management is responsible for these efforts
- The coordinator has assessed and selected external sources of ESG research; these are made available to portfolio managers and analysts throughout the company
- Senior management has participated in a half-day strategy workshop on ESG issues and their importance for asset management (e.g. with input from a guest speaker)
- An internal working group, including portfolio managers and analysts from sector teams with a high exposure to ESG and some prior experience in integration (e.g. utilities, autos, energy), meets regularly to support the coordinator in developing simple tools and knowledge that can be shared throughout the organisation
- All portfolio managers and analysts have participated in an initial workshop on ESG integration. Thereafter, ESG integration is an agenda item at team meetings (e.g. sector teams, product teams, specialist research teams) at least twice a year
- External (and internal) research is used to flag issues, industries, companies that might be particularly exposed to emerging ESG issues. These issues and their expected financial impact are discussed on a regular basis in team meetings and committees responsible for overseeing investment decisions

Asset management institution — advanced

- The manager has issued a public policy stating that its goal is to systematically integrate all financially material ESG issues; objectives, targets and progress on targets are communicated publicly
- Integration applies to all relevant asset classes, e.g. public and private equity, fixed income, commodities, real estate, etc.
- For each asset class, a methodology to systematically and quantitatively consider material ESG information in asset allocation, risk management and security selection is defined and used by all investment managers and analysts. The policy balances institution-wide consistency and managers' and analysts' freedom to adapt to specific situations
- Clear incentives for key personnel in charge of ESG integration are in place. This implies regularly assessing the performance of portfolio managers and key analysts in terms of their successful identification and consideration of material ESG issues
- Internal sources of ESG research increasingly replace external sources
- Investment / risk committees or other functions in charge of strategic investment decisions are required to review asset classes, industries, securities, etc., that have been flagged as being 'high risk' from an ESG point of view
- The institution's skills in providing superior returns based on ESG integration are actively marketed to clients; they become part of the institution's value proposition to clients

Source: onValues

Appendices

Background, expert consultation

The expert consultations that took place in the mid-2008 had two specific goals:

1. Assess the state of play
 - Experts were asked for their views on the progress made so far in terms of ESG integration in the industry (focussing on the period 2004–2008). This included reviewing and prioritising obstacles to integration
2. Make recommendations aimed at furthering the integration of ESG (3-4 year horizon)
 - Experts were asked to help to formulate a limited set of strategic recommendations for key actors (mainly asset managers, investment researchers and asset owners). We targeted recommendations that are be actionable (not purely aspirational) and economically rational

Furthermore, the second expert consultation, which took place in August 2008, brought together professionals with particular know-how in emerging markets investment. In addition to the goals above, we asked these experts to check that the conclusions reached by the 2007 WCW event in Geneva²⁶ were still valid.

Experts were supplied with a 'straw man' document in advance of the call. The document included onValues' tentative assessments of the progress made by the industry (relative to the action areas set out by the Who Cares Wins baseline assessment in 2004) and recommendations for further action.

The sponsors are indebted to the following individuals and institutions, who participated in the expert consultations and reviewed the final report. Participants were selected on the basis of their individual expertise, and spoke in a personal capacity (comments were made under the Chatham House Rule). However, the conclusions and recommendations presented in this report are those of the authors alone.

²⁶ New Frontiers in Emerging Markets Investment, Geneva, July 2007

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Goals and chronology of the WCW Initiative

In June 2004 a group of 20 financial institutions with combined assets of over USD 6 trillion published and publicly endorsed a report entitled 'Who Cares Wins: Connecting Financial Markets to a Changing World'²⁷. Facilitated by the UN Global Compact, the focus of the report was a series of recommendations, targeting different financial sector actors, which taken together seek to address the central issue of integrating environmental, social and governance (ESG) issues into mainstream investment decision-making and ownership practices.

Although the focus was on integration of ESG into asset management and investment research, the role of asset owners and other actors in promoting that integration was explicitly treated by the events.

The key characteristics of Who Cares Wins are as follows:

- The core constituency is the middle of the investment chain: asset managers and the investment research community
- However, Who Cares Wins also provides a platform for asset managers and investment researchers to engage not only with their peers, but also with companies, institutional asset owners and other private and public actors in the investment system
- The principal setting for this engagement is an annual closed-door, invitation-only event for investment professionals (four events took place in Switzerland in 2004–2007)
- The public bodies that host Who Cares Wins aim to create a neutral and protected space for frank dialogue between financial professionals on the challenges of integrating ESG issues into investment processes

Who Cares Wins chronology

- January 2004: UN Secretary-General Kofi Annan writes to the CEOs of the world's leading financial institutions to invite them to participate in the Initiative
- June 2004: initial Who Cares Wins event and report — Who Cares Wins: Connecting Financial Markets to a Changing World (Zurich)
- 2005: event and report — Investing for Long-Term Value (Zurich)
- May 2006: a delegation from Who Cares Wins endorsing institutions meets the directors of the CFA Institute to discuss ESG integration
- 2006: event and report — Communicating ESG Value Drivers at the Company-Investor Interface (Zurich)
- 2007: event and report — New Frontiers in Emerging Markets Investment (Geneva)
- January 2009: release of Who Cares Wins' concluding recommendations

²⁷ Who Cares Wins endorsing institutions: ABN AMRO, Aviva, AXA Group, Banco do Brasil, Bank Sarasin, BNP Paribas, Calvert Group, China Minsheng Bank, CNP Assurances, Credit Suisse, Deutsche Bank, F&C, Goldman Sachs, Henderson, HSBC, Innovest, IFC, KLP, Mitsui Sumitomo Insurance, Morgan Stanley, RCM, UBS and Westpac

Selected organisations and initiatives addressing ESG integration for investors

- AccountAbility
- Carbon Disclosure Project (CDP)
- Ceres
- CFA Institute
- European Centre for Corporate Engagement (ECCE)
- Global Reporting Initiative (GRI)
- Institutional Investors Group on Climate Change (IIGCC)
- International Corporate Governance Network (ICGN)
- International Finance Corporation (IFC)
- Principles for Responsible Investment (UNEP Finance Initiative / UN Global Compact)
- The Conference Board
- UNEP Finance Initiative
- UN Global Compact
- Who Cares Wins (International Finance Corporation (IFC) / Federal Department of Foreign Affairs (Switzerland) / UN Global Compact)
- World Economic Forum

Assessment of progress by investment actors

Asset Owners

Action areas *		Notable initiatives	Developments 2004–2008	Key obstacles / challenges (in decreasing order of importance)	Assessment of progress 2004–2008**
1.	Consider ESG issues in formulation of mandates / selection of managers / in-house management	PRI, Marathon Club, USS / Hewitt collaboration, etc.	PRI announces that its signatories now own / manage assets in excess of USD 14 trillion; several US and European PFs (but mostly of a public nature) launch ESG mandates	<ul style="list-style-type: none"> • ESG integration requires sophisticated governance / strong beliefs (limited trustee know-how is a problem) • Need for demonstrable compliance leads to trustees preferring prevailing approaches • Doubts about the investment case, scepticism from consultants • Questions around compatibility with fiduciary obligations 	Weak
2.	Implement active ownership strategies inclusive of ESG issues	PRI, ICGN, IIGCC / INCR, CDP, Marathon Club, etc	PRI Engagement Clearing-house launched supporting knowledge sharing and collaboration on active ownership strategies	[Not explicitly discussed at WCW events]	Moderate

* As defined by the original Who Cares Wins report in 2004

** For an explanation of the scale please see the beginning of the section on progress on ESG integration

Investment consultants

Action areas		Notable initiatives	Developments 2004–2008	Key obstacles / challenges (in decreasing order of importance)	Assessment of progress 2004–2008
1.	Consider ESG issues in formulation of mandates / selection of managers / in-house management	PRI, Marathon Club, USS / Hewitt collaboration, etc.	May 2008: Mercer announces that it will include a set of ESG questions in its assessment of all managers	<ul style="list-style-type: none"> • Consultants' belief that this could divert asset owners' attention away from other issues seen as more important 	Weak

Asset managers

Action areas		Notable initiatives	Developments 2004–2008	Key obstacles / challenges (in decreasing order of importance)	Assessment of progress 2004–2008
1.	Request and reward ESG research from sell-side / independent research	EAI, UNEP FI, etc.	EAI founded — currently 30 members representing EUR 2 trillion in assets; UNEP FI 'Materiality' reports	• Lack of specific incentive systems (e.g. due to bundled commissions)	Weak / moderate
2.	Implement active ownership strategies inclusive of ESG issues	UNEP FI, PRI, etc.	PRI Clearinghouse launched supporting knowledge sharing and collaboration on ESG integration	• Leadership by senior management	Weak / moderate
3.	Incentivise employees in charge of ESG integration			• Leadership by senior management	Weak
4.	Proactively offer ESG inclusive investment products and services		Surge in the offer of ESG themed funds, indices and structured products (in terms of financially-focussed products, the base was low)	<ul style="list-style-type: none"> • Limited client demand (in part due to lack of attractive products for institutional investors covering all asset classes) • Multitude of concepts leading to confusion ((S)RI, ethical investments, ESG themes, etc.) • ESG not yet seen as a big opportunity, managers opt for opportunistic approach which in turn weakens client demand 	Weak / moderate

Investment researchers, data providers and rating agencies

Action areas		Notable initiatives	Developments 2004–2008	Key obstacles / challenges (in decreasing order of importance)	Assessment of progress 2004–2008
1.	Develop the investment framework and rationale for ESG integration	EFFAS, New York Society of Security Analysts (NYSSA), etc., and academic programmes supported by Mistra, PRI / ECCE	Several sell-side research organisations publish investment frameworks for ESG integration (e.g. Citigroup, Goldman Sachs, Société Générale); industry surveys (e.g. from Mercer) and academic programmes underpin the investment case	<ul style="list-style-type: none"> • ESG has not been a major focus of leading thinkers / researchers so far • Few young professionals have learned the basics of ESG integration during their professional education 	Moderate / strong
2.	Integrate ESG issues into mainstream research, widen sector coverage	EAI.	The Enhanced Analytics Initiative reports a substantial increase in the quality and quantity of ESG-inclusive research	<ul style="list-style-type: none"> • Lack of awareness and skills in the industry • Limited client demand • Missing incentives for analysts • Lack of comparable company data 	Weak / moderate
3.	Widen coverage of emerging markets	ASrIA, IFC	WCW07 focuses on ESG integration into emerging markets investments; ASrIA publishes several sector and theme reports; IFC launches a grant program to enhance ESG research in EM, S&P ESG India Index launched. Similar indices developed in Brazil (BOVESPA) and South Africa (JSE)	<ul style="list-style-type: none"> • High cost vs. low demand from clients • Need to contextualise / establish local research teams (costly) • Missing incentives for analysts • Lack of comparable company data 	Weak / moderate

Regulators, exchanges, professional bodies, etc.

Action areas		Notable initiatives	Developments 2004–2008	Key obstacles / challenges (in decreasing order of importance)	Assessment of progress 2004–2008
1.	Require minimum degree of disclosure / accountability from companies	GRI, UNCTAD, UN Global Compact	Several countries introduce frameworks that encourage ESG disclosure (without mandating it); data providers and companies are moderately active in improving quality of ESG data	<ul style="list-style-type: none"> • Diverging opinions among investors, lack of a clear position / demand vis-à-vis regulators • Compared to other financial crisis zones, not a very high priority for regulators • Strong differences in terms of ESG disclosure needs between regions and jurisdictions 	Moderate
2.	Establish that ESG integration and fiduciary obligations are compatible	EAI.	UNEP FI / Freshfields Bruckhaus Deringer study published end of 2005 asserts that ESG inclusion is compatible with and may be required by fiduciary duty	<ul style="list-style-type: none"> • Cannot happen overnight because prevailing beliefs need to be changed • Strong differences between regions and jurisdictions 	Moderate
3.	Incorporate ESG issues in professional curricula and support knowledge and awareness building in the industry	EFFAS, Beyond Grey Pinstripes (Aspen Institute / World Resources Institute), Principles for Responsible Management Education (PRME), etc	A WCW delegation meets the CFA Institute in 2006; partial integration of ESG issues in CFA professional courses; several EFFAS publications related to ESG issues; July 2008: NYSSA to host the global launch of 'ESG Factors at Listed Companies: A Manual for Investors', published by the CFA Institute Centre for Financial Market Integrity	<ul style="list-style-type: none"> • Lack of leadership from flagship curricula • Prevailing beliefs in the industry 	Weak / moderate

Institutions that participated in Who Cares Wins 2004—2008

The sponsors are indebted to the following institutions, which participated in the Initiative between 2004 and 2008.

ABB	Credit Suisse
ABN AMRO	Daimler
AccountAbility	DELSUS
AHV Ausgleichsfonds / Fonds de Compensation AVS	Det Norske Veritas (DNV)
APG Investments	Deutsche Bank
ASrIA	Dexia
ASSET4	DnB NOR
Atlantic Trust	Dresdner Kleinwort
Aviva Investors	ECOFACT
AXA	Eco-Frontier
Banco do Brasil	Economist Intelligence Unit
Bank Sarasin & Co.	EIRIS
Bank Vontobel	Environmental Finance
BankInvest Gruppen	equinet Institutional Services
BASF	Erste Bank Group
BHP Bruggen und Partner	Ethos
BNP Paribas	Eurizon Capital
BOVESPA (São Paulo Stock Exchange)	F&C Asset Management
BT Group	F. Hoffmann-La Roche
CA Cheuvreux	Federal Department of Foreign Affairs (Switzerland)
Caisse des Dépôts et Consignations (CDC)	Fonds de réserve pour les retraites (FRR)
California Public Employees' Retirement System (CalPERS)	Forma Futura Invest
Calvert Group	Forum For The Future
Center for Corporate Responsibility and Sustainability (CCRS)	Generation Investment Management
Centre Info	GES Investment Services
China Minsheng Bank	Global Reporting Initiative
Citigroup	Goldman Sachs
ClearBridge Advisors	GovernanceMetrics International
CLSA	Groupama
CNP Assurances	Grupo BBVA
Colonial First State Group	Henderson Global Investors
Columbia University, Graduate School of Business	Hermes Pensions Management
Comité syndical national de retraite Bâtiment	Holcim
ConSer Invest	HSBC
CPP Investment Board	ING
Crédit Agricole	Innovest Strategic Value Advisors
	Inspire AS
	International Finance Corporation (IFC)
	Investec
	KLD Research & Analytics

Kommunal Landspensjonskasse (KLP)
Lehman Brothers
Lombard Odier Darier Hentsch
London Bridge Capital
London Stock Exchange
Mercer
Mistra
Mitsubishi UFJ Trust and Banking Corporation
Mitsui Sumitomo Insurance
Morgan Stanley
Nestlé
New York City Employees' Retirement System (NYCERS)
New Zealand Superannuation Fund
Norges Bank Investment Management (NBIM)
Oddo Securities
oekom research
onValues
OTP Fund Management
PGGM
Pictet & Cie
PREVI
RCM
responsAbility
Rio Tinto
RiskMetrics Group
Rothschild
Royal Dutch Shell
SAM Sustainable Asset Management
SIX Group
SNS REAAL
Société Générale
SRI World Group
Standard & Poor's
State Street Global Advisors (SSgA)
SustainAbility
Swedbank Robur
Swiss Re
Swiss State Secretariat for Economic Affairs (SECO)
The Conference Board
The Nathan Cummings Foundation
Trucost
UBS

UN Global Compact
UN Secretariat for the Principles for Responsible Investment
UNEP Finance Initiative
United Nations Office at Geneva (UNOG)
Universities Superannuation Scheme (USS)
University of California Berkeley, Haas School of Business
Watson Wyatt
WestLB
Westpac
World Federation of Exchanges
World Resources Institute
Zürcher Kantonalbank

