INVESTING FOR SUSTAINABLE DEVELOPMENT?

A review of investment principles – trends and impacts

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SHAPING SUSTAINABLE MARKETS

just economics

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Shaping Sustainable Markets is the new flagship research project for the Sustainable Markets Group at IIED.

Can markets be 'governed' to better benefit people and planet? This project explores the individual and combined impact of market governance mechanisms on sustainable development to find out what works where and why. Some of these mechanisms are well established. Others are innovative ideas yet to be tested in the real world.

We want to improve and broaden understanding of how market governance mechanisms can be designed and used to secure livelihoods and protect environments. Find out more about our work at http://shapingsustainablemarkets.iied.org.

We welcome your comments on this publication or other aspects of Shaping Sustainable Markets. Please contact emma.blackmore@iied.org.

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About the author
Just Economics is a research company that uses interdisciplinary research techniques to address economic injustice and achieve progressive and sustainable change. See www.justeconomics.co.uk for more information.

ACRONYMS AND ABBREVIATIONS

AUM	assets under management
BAT	best available technology
BCBS	Basel Committee on Banking Supervision
BCS	Broad Community Support
EIA	Environmental Impact Assessment
EIB	European Investment Bank
EITI	Extractive Industries Transparency Initiative
EPFI	Equator Principle Financing Institution
ESG	environmental, social and governance (issues)
ESIA	Environmental and Social Impact Assessment
ESRD	Environmental and Social Review Document
ESRP	Environmental and Social Review Procedure
FDI	foreign direct investment
FI	financial institution
IFC	International Finance Corporation
ILO	International Labour Organization
IM	investment manager
IP	investment principle
MNC	multinational company
OECD	Organisation for Economic Co-operation and Development
PPS	Policy and Performance Standard
PRI	Principles for Responsible Investment (UN)
PS	Performance Standard
SRI	socially responsible investment
TRIM	Trade Related Investment Measure (WTO)
UNEP	United Nations Environment Programme

GLOSSARY

BCBS. (Basel Committee on Banking Supervision) provides a forum for regular cooperation on banking supervisory matters, with the aim of enhancing understanding of key supervisory issues and improving the quality of banking supervision worldwide. The Committee is best known for its international standards on capital adequacy, the Core Principles for Effective Banking Supervision, and the Concordat on cross-border banking supervision.

Covenants. Under the *Equator Principles*, borrowers commit (or make a 'covenant') to certain actions. If the borrower fails to undertake these actions, it is in breach of the covenant, and the bank can take corrective action, up to and including cancelling the loan and demanding immediate repayment.

Engagement. An approach to *socially responsible investment (SRI)* in which the investor (either directly or through a specialist intermediary) works with a company's senior management to influence performance on environmental, social and governance (ESG) issues. In this approach, SRI investors hold the same portfolio as orthodox investors in the same sector, but attempt to use their influence as shareholders – including their voting rights – to affect behaviour.

Institutional investor. An investor, such as a pension fund, insurance company or bank, which generally has substantial assets and experience in investments, and pools and invests capital on behalf of corporations or private individuals.

Investment manager. A person or organisation that makes investments on behalf of clients.

Negative screening. An approach to *SRI*, in which investors remove particular types of company (such as those concerned with tobacco, arms or alcohol), or individual companies, from their investable universe.

Portfolio investor. A person or institution that holds: (a) fixed-interest securities such as government or corporate bonds, and/or (b) equities such as company shares of up to 10 per cent of the ordinary shares or voting power in a company. Examples are *institutional investors* (defined above) and retail investors, which are either individual investors or asset management funds open to the general public.

Positive screening. An *SRI* approach in which investors include only, or give a disproportionately high weight to, particular types of company (such as renewable energy companies) or individual companies in their investable universe.

Private equity. Finance invested by private equity funds in companies that are not publicly traded on a stock exchange, or invested in publicly traded companies in order to make them private companies.

Socially responsible investment (SRI). SRI includes considerations beyond the purely commercial when making investment decisions. Typically, this relates to one or more environmental, social or governance (ESG) factors. The range of SRI strategies include *engagement*, *negative screening* and *positive screening*. While some SRI funds may be prepared to accept a lower financial return to achieve ESG objectives, the dominant approach is to pursue these ends while simultaneously seeking to achieve market-level (or higher) financial returns.

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SUMMARY

How can investors be encouraged to consider more than purely commercial and short-term gains? Several different sets of investment principles now exist, aiming to incorporate social, environmental and governance criteria into investment decisions. These principles have growing numbers of signatories, and are used in various contexts, and for various reasons, from improving reputation to minimising risks and improving long-term prospects. Yet the impact of these principles on sustainable development remains unproven.

This paper aims to take a first step in assessing the content, take-up, implementation and impact of investment principles. We focus on the UN Principles for Responsible Investment (PRI), the Equator Principles, the Environmental and Social Principles of the European Investment Bank (EIB), and the OECD Declaration on International Investment and Multinational Enterprises.

These principles vary according to: the nature of their source organisation (public or private); their force (voluntary or mandatory); geographical application (global, regional or national); institutional scope (for all institutions, or only a particular type such as banks); and range of issues (applying to all investments or a specific sector). Most of the principles (with the exception of the EIB's) explain what should *not* be done, rather than what should.

The principles differ in the extent to which they include environmental criteria, and according to the type of investment concerned. For example, the Equator Principles focus on project finance and so emphasise local community consultation and participation far more than do the UN PRI, which are used for arm's-length investments.

Many of the principles' commitments are qualified with terms such as 'where appropriate' or 'as far as possible'. This means that their integration of environmental, social and governance criteria is limited to the level of aspiration rather than requirement. This weak commitment is exacerbated by the vague language used in most sets of principles.

A lack of guidance and/or precedent in implementing investment principles further leaves them open to interpretation. Until all investors sign up to a common set of investment principles there is a commercial incentive for current signatories to adhere to the principles by meeting only their minimum requirements, to avoid competitive disadvantage. Some principles, such as the UN PRI, allow scope for lax interpretation.

It is easier for some actors than others to abide by investment principles. An entity such as the European Investment Bank (backed by resources from the European Union), can secure a lower financial rate of return in order to promote positive outcomes in terms of sustainable development. By contrast, a bank answerable to shareholders must seek to maximise returns and the dividends it pays, or risk losing business.

Information on the implementation of investment principles is often difficult to access and lacking in transparency. This makes it very hard for outsiders to hold signatory investors to account for their performance. Smaller asset managers find it more difficult to implement investment principles, citing lack of resources as a key issue. For some fund types, notably pooled and passive funds, it is impossible to apply investment principles at all because the managers have no direct control over the ultimate investment decisions. There are also few incentives for investors for good performance on environmental, social and governance issues.

The available evidence suggests that investment principles are having a limited impact on sustainable-development outcomes. Investors will not compromise high returns on investments for improved sustainable-development outcomes. Furthermore, fiduciary responsibility prevents many investing institutions from sacrificing financial returns for other considerations.

The main impact of investment principles may be to encourage attempts to mitigate the worst effects of investments, rather than to prevent damaging investments in the first place. Some investors do take decisions that have positive sustainable-development implications. However, it is not clear that they do so because of adherence to investment principles – rather, they act because of a business case. Profitable investments with positive sustainable-development impacts will continue to occur and may even grow – but they would presumably continue to do so in the absence of investment principles.

In general, all these principles appear to be encouraging minor alterations to investment decisions, within commercial constraints, rather than altering the underlying basis of decision-making. Consequently, the potential for investment principles to support sustainable development is not yet being realised. Therefore, we call for better monitoring and measurement of the impact of investment principles, as well as a better understanding of the broader institutional changes required to support them. With such improvements, the next generation of investment principles should be more ambitious and more powerful in bringing about investment that supports, rather than undermines, sustainable development.

FOREWORD

The 2008 financial crisis saw all eyes turning to bankers and investors. The recession posed

fundamental questions about the role of investors in society – both in terms of the investments they make and the manner in which they use their influence to ensure that the positive poverty reduction and development impacts of their activities are maximised and the negative impacts are minimised.

(Fiestas *et al.*, 2010: 5).

Meanwhile, and more positively, the role of markets and the private sector in contributing to sustainable development has been increasingly asserted in recent years. Where the 1992 Earth Summit assumed that government plans and international conventions would be the primary drivers of sustainable development, there is now a stronger realisation that attention must be given to the long-term finance flows needed to cut out bad production, promote good production, and shape infrastructure choices. For developing countries in particular, investment has now come under the spotlight, partly driven by the shifting emphasis from aid to trade: the scale of investment flows far outweighs that of aid – a trend set to continue.

Thus, finding ways to enhance the benefits and reduce the negative impacts of investment for development is essential. Hitherto, issues of sustainable development have had little traction in the investment world, except where they can be directly and clearly linked with risk to investors and their returns. Sustainable development is complicated, usually involving a series of trade-offs that are viewed as needing to be balanced against investors' fiduciary responsibilities.

Consequently, various sets of investment principles have been promulgated, aiming to incorporate non-commercial factors – such as social, environmental and governance criteria – into investment decisions. The idea is that using investment principles potentially offers investors a more straightforward means of understanding and incorporating non-commercial factors into their decisions.

This paper reviews the design, use, implementation and impact of investment principles. It forms part of the Shaping Sustainable Markets research series, which seeks to understand the use and impact of market governance mechanisms[1] in shaping markets' contributions to sustainable development. Ultimately, we want to understand how market governance mechanisms can be better designed and implemented, to improve their impact on sustainable development.

This paper is the first comprehensive exploration of the state and value of a range of investment principles. The difficulty of obtaining credible evidence of the impact of these principles on society and the environment has made it challenging to make definitive statements about their impact to date, particularly because there is very little independent literature on, and analysis, of impact. *Shaping Sustainable Markets* will continue to track information about impact over time. However, we are able to offer valuable insights into the design and implementation of investment principles. The vague language used in most principles makes it too easy for investors to incorporate social, environmental and governance criteria only where these do not conflict with commercial considerations. This research suggests that investors will not compromise high returns for investments with negative impacts on sustainable development.

There are many barriers to uptake of investment principles

The role of investment principles thus far may have been to encourage attempts to mitigate the worst effects of such investments, rather than to prevent damaging investments occurring in the first place.

At present, it is clearly far easier for some players than others to abide by investment principles. An entity such as the European Investment Bank (backed by resources from the European Union), can secure a lower rate of return in order to promote positive sustainable development outcomes. Similarly ethical investors – the number of which are growing – have been explicitly tasked with integrating non-commercial principles into investment decisions and can accept a lower rate of return on their investments. By contrast, a bank answerable to shareholders must seek to maximise returns and the dividends they can pay, or risk losing business. Similarly, institutional investors manage other people's money and are judged on their performance (in terms of financial returns) relative to other asset managers. In the latter cases, the investing institutions are simply not in a position to sacrifice returns for other considerations, even if they wished to.

To ensure competitive equity between signatories to investment principles, it is important for as many institutions as possible to adopt the same principles. At present, there are many barriers to uptake – such as the costs of implementation, the difficulty in applying principles to some asset classes (such as passive and pooled funds, where investors are more 'removed' from their investments), a lack of internal incentives and staff training to encourage implementation of the principles, and a lack of resources. Further, a lack of transparency and disclosure in the application of some sets of principles makes it very hard for outsiders to hold signatory investors to account.

We urgently need more research on how to overcome the barriers to investment principles, as well as information about their impact and their relative effectiveness. A potentially fruitful area for further research is improved understanding of the kind of 'green economy' enabling conditions and institutional change necessary to incentivise the incorporation of social, environmental and governance concerns in investment decisions.

Emma Blackmore, Series Editor
Shaping Sustainable Markets, IIED

INTRODUCTION

The purpose of this review is to assess trends in the production, implementation and impact of investment principles, with a particular focus on international development and environmental objectives. The review considers the potential of investment principles to influence sustainable development outcomes, and makes some early recommendations on how to enhance this potential.

What are 'investment principles', for the purposes of this review? The *Farlax Financial Dictionary* (2009) defines 'investment' as:

The act of placing capital into a project or business with the intent of making a profit on the initial placing of capital. An investment may involve the extension of a loan or line of credit, which entitles one to repayment with interest, or it may involve buying an ownership stake in a business, with the hope that the business will become profitable. Investing may also involve buying a particular asset with the intent to resell it later for a higher price.

According to this definition, the only principle that influences investment decisions would be whether or not the financial capital employed is likely to yield a profit, with the most attractive investment being simply that which will yield the greatest profit.

The 'investment principles' explored in this review are any set of factors beyond the purely commercial that may guide, influence or regulate investment decisions. We are concerned with market-level investment principles that address environmental, social and governance objectives (ESG) in addition to making a positive financial return, and that potentially contribute to the achievement of sustainable development.[2] Investments guided by such principles seek to create positive impacts in these areas, and/or to avoid negative impacts. We are particularly interested in investment principles that affect emerging and developing economies because of their relevance to sustainable development more broadly.

The idea of investing to achieve both commercial and non-commercial ends has a long history. As far back as 1760 John Wesley, the founder of Methodism, argued in *The Use of Money* that investors should seek the best returns for their investments, but should commit their capital only to activities that 'did not hurt our neighbour in body or soul'. Here, we see the roots of what is today known as socially responsible investment (SRI).

In modern times, the value and proportion of investments classified as 'socially responsible' have grown considerably, as illustrated in Figure I.1. In 2002, the SRI sector had assets valued at more than US$2.5 trillion globally, although this represented only 7 per cent of total global assets under management. By 2008, the value of global SRI funds had risen to around US$7.5 trillion, equivalent to around 12 per cent of total global assets under management (EuroSif, 2008).

In the 1990s, the early years of the modern SRI sector, the United States was by far the largest source of funds. As recently as 2002, 84 per cent of total funds were American. Since then, however, Europe has become the largest source of SRI managed funds, with 53 per cent in 2008, compared to 39 per cent from the US. The other big difference between 2002 and 2008 is the growing importance of Asia. From zero funds under management at the start of the period, Asia's market share had reached 8 per cent of total SRI funds by 2008, equivalent to more than $500 billion (EuroSif, 2008). Despite the recent financial crisis, SRI growth looks set to continue.

Despite the financial crisis, socially responsible investment looks set to continue

FIGURE I.1. GROWTH OF GLOBAL SRI ASSETS AND SRI MARKET SHARE, 2002–2008

Source: EuroSif (2008)

For example, financial commentators predict that, by 2015, up to a third of all global investment assets will be managed according to some form of SRI principles.[3]

Socially responsible investment can involve a set of 'investment principles', as considered in this paper, although there are also other strategies for SRI.[4] While SRI principles are very close to our definition of investment principles, they are not included in the bulk of the analysis contained in this review, because they are not 'market-wide'. That is, they generally pertain only to a particular investment fund.

Interestingly, SRI funds also invest less in developing (or emerging) economies than do funds from the mainstream sector. Within Europe, allocation to emerging markets is just 7 per cent of total portfolios, the bulk of which comes from Scandinavia and the Netherlands. Within the US, a similar picture emerges, with 'international' or 'global' funds being overwhelmingly invested in other developed countries, primarily in Europe and Japan. Little of this investment goes to developing, as opposed to emerging, countries in part because of the preoccupation of SRI investors with their own countries, but in part also because of a prevalent 'screening-out' approach. Particularly in the US, many sectors – and even countries – are screened out of investment portfolios. Whether in relation to labour or environmental standards or to human rights, many investments in developing countries fail to meet these standards and so are excluded from the universe of possible investments.

Despite this, there are clearly strong overlaps between SRI and investment principles focused on sustainable development. Recent years have seen a series of attempts to adapt aspects of the SRI approach to investment more generally, particularly in relation to enhancing human development and environmental outcomes in developing countries. Perhaps the most high-profile and ambitious of these is the UN's Principles for Responsible Investment (PRI) (Appendix 1). These are six principles designed by the investment community in partnership with the UNEP Finance Initiative and the UN Global Compact, to encourage incorporation of ESG issues into investment decisions.

However, as detailed in Section 1, there are many other sets of investment principles. Some of these, like the PRI, are universalist in nature, while others relate to particular types of investors, or to particular sectors or locations. Despite these differences, they all have one thing in common: each set of principles aims to encourage investors to incorporate factors beyond the purely financial into their decision-making process, with the aim of altering the pattern of investments or their implementation and monitoring. In short, they are designed to change behaviour by encouraging investors to do things that they would not do otherwise.

This paper is based on a review of existing literature. It explores the content, uptake, implementation and impact of investment principles. Section 1 describes the range of investment principles in use today, and Section 2 discusses how these principles are implemented. Section 3 considers what we know about the impact of these different sets of principles. The *conclusions and recommendations* assesses the current and potential impact of these principles on outcomes for sustainable development.

ONE.
A CATEGORISATION OF INVESTMENT PRINCIPLES

There are at least five dimensions along which sets of investment principles (IP) can be organised. These include:

1 The nature of the **promulgating body** – public or private.

2 The **force of the principles** – voluntary or mandatory.

3 The **geographical application** – global, regional or national.

4 The **institutional scope** – for all investors, or focused upon a particular type of institution such as banks, for example.

5 The **range of issues**, with all investments in developing/emerging economies at one end of the spectrum (that is, universal range), and investments in specified sectors at the other end.

In this section, we examine a wide range of investment principles in three categories: public, globally applicable principles; national-level (public and private) principles; and sector-specific principles.

PUBLIC AND PRIVATE GLOBALLY APPLICABLE INVESTMENT PRINCIPLES

The Principles for Responsible Investment

The UN's Principles for Responsible Investment (PRI) is probably the most well known set of investment principles being promoted and used today. The PRI are 'public' in that they have been promulgated by a group of public institutions (UNEP's Finance Initiative and the UN Global Compact), although this has been done in conjunction with a group of 20 leading institutional investors – the PRI Investor Group.

The PRI are 'voluntary' in that they are non-binding, and are aimed at institutional investors, specifically institutional portfolio investors. A version of the PRI has also been adapted for the private equity sector, so that the PRI cover both public and private equity markets.[5] The PRI scheme is global in scope and universal in terms of sector. Signatories commit to incorporate environmental, social and governance (ESG) principles into all their investment decisions, regardless of asset class or location.

By the end of 2010 the PRI had more than 800 signatories from 45 countries, representing US$22 trillion of assets under management, – just over a quarter of all conventionally managed[6] financial assets. The PRI consist of six principles, through which signatories make the following headline commitments:

1 We will incorporate ESG issues into investment analysis and decision-making processes.

2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.

Under each of these headlines, the PRI text includes suggestions for 'possible actions' (see Appendix 1).

BOX 1.1: DEFINING PROJECT FINANCE

The Basel Committee on Banking Supervision defines project finance as:

a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements. In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. The borrower is usually an SPE (Special Purpose Entity) that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project's cash flow and on the collateral value of the project's assets.

(BCBS, 2005: 53)

The PRI are quite vague: for example, the commitment to 'incorporate ESG issues into investment analysis and decision-making processes' could be interpreted in numerous ways. This could mean using environmental or social criteria to seek out investments (positive screening), or it might mean using the criteria to preclude investments (negative screening). Alternatively, it might simply mean investors supporting better ESG outcomes in companies in which they invest (engagement), or that companies with the best ESG performance in a particular sector are targeted (the so-called 'best in class').

As noted in the Introduction, around 12 per cent of global assets are managed according to SRI-type principles. This share is expected to grow significantly, perhaps reaching 30 per cent by 2015. This seems broadly in line with the current reach of the PRI, suggesting that there is considerable overlap between PRI signatories and existing SRI investors.

The Equator Principles

The best-known set of principles applied to the banking sector is the Equator Principles, based on the International Finance Corporation (IFC)[7] performance standards on social and environmental sustainability. Unlike the PRI, the Equator Principles are 'private' in that they are promulgated by a group of banks.[8] They also differ from the PRI in that they apply only to particular parts of banks' activities – project finance contracts (Box 1.1) with a value greater than US$10 million, rather than all investments made by an institutional investor. The Equator Principles are global in application, and voluntary in that banks can choose whether or not to sign up to them.

In 2010, the Equator Principles had been adopted by 68 banking institutions (representing 75 per cent of large-scale project finance or $53 billion of the $75 billion invested in 2008). The Equator Principles are grouped into 10 categories, as follows:

1. **Review and Categorisation.** This requires Equator Principle Financing Institutions (EPFIs) to categorise projects (A, B or C) according to the size of their potential environmental and social impacts and risks.[9]
2. **Social and Environmental Assessment.** For projects categorised as higher risk (A or B), the borrower must conduct a Social and Environmental Assessment and propose mitigation and management measures. The EPFI undertakes a due diligence exercise to ensure this is done satisfactorily.
3. **Applicable Social and Environmental Standards.** For projects in non-OECD countries, the Assessment should conform to the applicable IFC Performance Standards and the applicable Industry Specific EHS Guidelines. For high-income country projects, the Assessment would be expected to exceed this, with the benchmark being compliance with national-level standards in the country concerned.
4. **Action Plan and Management System.** An Action Plan to implement and manage the mitigation measures set out in the assessment is prepared by the borrower, for all Category A and B projects in non-high-income countries.
5. **Consultation and Disclosure.** All Category A (and Category B where appropriate) projects located in non-high-income countries require a process of structured and culturally appropriate consultation to have been undertaken with communities affected. Where significant adverse impacts are likely, 'free, prior and informed consultation'[10] and participation is required, and the project must address the concerns of these communities.
6. **Grievance Mechanism.** The process of consultation, disclosure and community engagement must continue throughout the project, and a grievance mechanism (of a scale appropriate to the risk of the project) must be established.
7. **Independent Review.** For Category A (and some Category B) projects, an independent social or environmental expert not directly associated with the borrower should review the Assessment, Action Plan and consultation process in order to assess Equator Principle compliance.
8. **Covenants.** For Category A and B projects, the borrower will covenant[11] to: a) comply with all relevant host country social and environmental laws, regulations and permits; b) comply with the Action Plan during the construction and operation of the project; c) provide periodic reports (at least annually) in a format agreed; and d) decommission the facilities, where 'applicable and appropriate', in accordance with an agreed decommissioning plan.
9. **Independent Monitoring and Reporting.** All Category A (and some Category B) projects, require the appointment of an independent environmental and/or social expert to verify its monitoring information.
10. **EPFI Reporting.** Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience.

(Equator Principles, 2006)

The Equator Principles are more specific than the PRI, which in part reflects the more focused nature of their scope – project-finance funding from banks, primarily in developing countries – and that they were based on the IFC's performance standards. The PRI by contrast aim to cover all institutional investor activity across all asset classes and locations.

As the Equator Principles are largely geared towards project finance in developing and emerging economies, their potential social and environmental impacts are more significant, particularly as public equity markets are small in many low-income countries. (In Section 2 of this report, we consider how the Equator Principles are implemented in practice).

Environmental and Social Principles of the European Investment Bank

An example of a public but mandatory set of investment principles is those promulgated by the European Investment Bank (EIB), whose Environmental and Social Principles and Standards (P&S) are based on EU environmental law. These P&Ss apply to all projects in which the EIB is an investor, and also inform the EIB's lending objectives, in which climate-change, biodiversity and ecosystems considerations are priorities: 'the ability of the Bank to contribute positively in these respects is an important element of the non-financial value that it brings to the project it is financing' (EIB, 2009).

There are three EIB Environmental and Social Principles, as follows:

1. **The integration principle** (Article 6). This requires that environmental considerations be appropriately weighted in all aspects of EIB work, including through the transparent development and implementation of its corporate strategy, operational plans, objectives and targets, and sector lending policies, as well as in the projects it finances.
2. **The principle of aiming at a high level of environmental protection** (Article 95 (3) and Article 174 (2)). In practice, this 'high level' is achieved through: a) the application of the precautionary principle; b) the taking of preventative action; c) that environmental damage should be rectified at source; and d) that the polluter should pay.
3. **To maximise social well-being.** The EIB seeks to increase social benefits (and reduce social costs) in all of its projects, and will not finance any projects with significant social costs. The Bank takes a rights-based approach based on the principles of the Charter of Fundamental Rights of the European Union (the 'Charter'), and the UN Universal Declaration of Human Rights, including involuntary resettlement, indigenous people and other vulnerable groups, ILO core labour standards and occupational and community health and safety principles (EIB, 2009).

There are three EIB Standards, as follows:

1 **Emission standards.** Projects are required to eliminate or minimise pollution arising directly or indirectly from their activities. The Bank requires its promoters to apply point-source-specific emission standards according to the IPPC Directive, based on 'best available technology' (BAT).

2 **Ambient standards.** These relate to accumulated pollution in air, water and soils. The standards are determined by the requirements of EU Directives.

3 **Procedural standards.** These are management and administrative requirements, which draw upon a number of EU Directives, including the sector Framework Directives, the IPPC Directive, the Environmental Liability Directive and Directives related to the Aarhus Convention (EIB, 2009).

The EIB applies these standards (based on EU law) stringently when operating within the European Union. For other countries (such as developing countries), the EIB requires that:

… all projects comply with national legislation, including international conventions ratified by the host country, as well as EU standards. Where EU standards are more stringent than national standards the higher EU standards are required, if practical and feasible. The EIB recognises that for a variety of reasons, including institutional capacity, technological capability, availability of investment funds and consumer ability and willingness to pay, for a particular project the immediate achievement of EU requirements may not be practical and in some cases may not be desirable. When the case arises, it is incumbent on the promoter to provide an acceptable justification to the Bank for a deviation from EU standards, within the framework of the environmental and social principles and standards set out in the Statement. In such cases, provision should be made for a phased approach to higher standards.

(EIB, 2009: 16)

The EIB also adheres to other sets of principles and codes of practice in particular areas such as the recommendations of the World Commission on Dams, the Extractive Industry Review, and the Extractive Industry Transparency Initiative, as well as internationally recognised certification schemes such as those of the Forest Stewardship Council.

On the social side, the EIB bases its approach on the Charter of the Fundamental Rights of the European Union and does not finance projects located in countries declared 'off-limits' by the European Council for EU financing for violations of human rights. The EIB's approach to consultation is comparable to that of the Equator Principles.

The OECD Declaration on International Investment and Multinational Enterprises[12]

The EIB's Principles and Standards are mandatory rather than voluntary as they apply where the Bank is the primary or co-investor. The EIB can therefore insist that its Principles and Standards are followed as a condition of making the investment. By contrast, the OECD's Declaration on International Investment and Multinational Enterprises is more like the PRI and Equator Principles in that it is public and global in scope, but voluntary. The OECD Declaration (hereafter 'Guidelines') pertains to foreign direct investment (FDI) made by multinational companies (MNCs).

The OECD Guidelines apply in 42 countries, which are the source of the majority of global FDI flows (OECD, 2000).[13] The governments of these countries commit to promote the implementation of the Guidelines by enterprises operating in or from their territory.

The OECD Guidelines include the following 'General Policies' (OECD, 2000: 11):

1. Contribute to economic, social and environmental progress with a view to achieving sustainable development.
2. Respect the human rights of those affected by their activities consistent with the host government's international obligations and commitments.
3. Encourage local capacity building through close cooperation with the local community, including business interests, as well as developing the enterprise's activities in domestic and foreign markets, consistent with the need for sound commercial practice.
4. Encourage human capital formation, in particular by creating employment opportunities and facilitating training opportunities for employees.
5. Refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation, financial incentives, or other issues.
6. Support and uphold good corporate governance principles and develop and apply good corporate governance practices.
7. Develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the societies in which they operate.
8. Promote employee awareness of, and compliance with, company policies through appropriate dissemination of these policies, including through training programmes.
9. Refrain from discriminatory or disciplinary action against employees who make bona fide reports to management or, as appropriate, to the competent public authorities, on practices that contravene the law, the Guidelines or the enterprise's policies.
10. Encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the Guidelines.
11. Abstain from any improper involvement in local political activities.

The OECD Guidelines also contain information on disclosure, the tenor of which is reflected in the following:

Enterprises should apply high quality standards for disclosure, accounting, and audit. Enterprises are also encouraged to apply high quality standards for non-financial information including environmental and social reporting where they exist. The standards or policies under which both financial and nonfinancial information are compiled and published should be reported.

(OECD, 2000: 12)

As with the PRI, however, the Guidelines are rather vague and could be interpreted in a variety of ways, and with a highly variable degree of stringency. The tenth principle, for example, requires corporate conduct 'compatible' with the Guidelines 'where practicable'. Clearly, different investors and companies are likely to differ considerably on what is 'practicable', and may consider a variety of forms of corporate conduct to be 'compatible' with the OECD approach.

Similarities and differences: comparison of global principles

The four sets of principles that we have considered within this subsection have a number of similarities, as well as some important differences. All are global in scope, rather than pertaining to a particular geographical area. All combine environmental and social/economic/governance objectives. As well as encouraging environmentally sustainable development, all four sets of principles also reference:

- human rights
- labour rights
- the need to abide by local laws
- best practice in corporate governance
- anti-corruption
- encouraging local economic development.

There is less commonality between the principles in terms of environmental criteria. This partly reflects the lack of environmental emphasis within the OECD Guidelines. The PRI have a more comprehensive approach to environmental issues, with a suggestion to integrate metrics of environmental impact into decision-making. The Equator Principles take this a step further, requiring detailed environmental impact assessments and mitigation plans to be completed before a project proceeds.

The Equator Principles place much greater emphasis on local community consultation and participation than do the PRI. This might reflect the differences between 'arm's-length' portfolio investors and the types of activity funded through project finance.

In terms of wording, the EIB takes the most positive stance – stating what investors should do. The other principles tend to focus on what should *not* be done. Another key difference between the EIB and other sets of principles is the qualification of commitments. The commitments in the non-EIB principles are more likely to be qualified with terms like 'as far as possible', or 'where appropriate'. While PRI investors are urged to 'integrate ESG issues into decision-making', Equator Principles adherents are urged to 'mitigate negative environmental impacts' and MNCs 'to refrain from improper involvement in local politics', this is only up to a point.

How do these principles affect decision-making?

In general, all these principles appear to be making the best of things within commercial constraints rather than altering the underlying basis of decision-making. That is, the principles aim to minimise the harm, and maximise the social and environmental benefits, of investments that were going to take place anyway. Given that these investments are intended to maximise returns (regardless of whether they actually do or not), there is no reason to assume that they would be of intrinsic environmental benefit, which perhaps explains why many are focused on mitigating damage.

Similarly, on the social side, there is no straightforward connection between good rates of pay and high labour standards and profitability. In many instances, the opposite will be true. In some – though not all – cases, these principles therefore seem designed to restrain investors (whether institutional, banks or MNCs) from acting in ways that may be in their commercial interest, at least in the near term.

Some investors take decisions that have positive sustainable-development implications, but it is not clear that they do so because of adherence to investment principles. Investors of this type are likely to see a business case for investing in this way (for example, as in the long-term growth of the

‘Global’ investment principles do not alter the underlying basis of decision-making

green-technology sector) and are therefore able to subscribe to principles that do not alter the way they invest, but may provide some reputational benefit. Others may have less interest in investments of this form, but still wish to obtain the reputational benefits mentioned. Here, there may be some willingness to refrain from overtly negative investments, but only to the extent that the impact on returns is minimal.

Profitable investments with a positive sustainable-development component will continue to occur and even grow, but they would presumably do so regardless of the existence of investment principles that encourage them. Alternatively, the appeal of investments with neutral sustainable-development implications is likely to be unaffected, while those with negative impacts will be less appealing, depending on the level of potential return. Therefore, if there are two potential investments offering similar levels of return, but one has a neutral and one a negative impact on sustainable development, adherence to investment principles of the type described may make an investor more likely to shun the option associated with a negative impact.

What is less likely, however, is to see the same outcome when the two possible investments have different prospective rates of return. Where an investment may have a negative impact on sustainable development, but is potentially much more lucrative than one with a neutral impact, it does not seem likely that adherence to a set of principles would make an investor accept the lower return. All the evidence suggests that SRI investors, for example, do not make lower returns than mainstream investors. Indeed, this fact is usually stressed strongly in marketing materials from the industry. High-yielding investments associated with negative outcomes for sustainable development are still being made – and will continue to be. The role of investment principles, therefore, may be to encourage attempts to mitigate the worst effects, rather than prevent such investments occurring in the first place.

Ostensibly, the EIB takes a different approach, seeking proactively to ‘maximise social well-being’ through its investments. The EIB is also explicit about taking decisions on considerations beyond the purely commercial: ‘the ability of the Bank to contribute positively in these respects is an important element of the non-financial value that it brings to the project it is financing’. It is thus not a matter of tempering the commercial imperative, or reducing the negative social and environmental impact that might result from an exclusive focus on profit. Positive impacts should, in theory at least, be built in from the outset.

This, of course, is what the PRI are trying to do by getting signatories to commit to ‘integrate ESG factors’ into the core of their decision-making. However, a key distinction is that the EIB is not a private company, and so can balance commercial considerations with other factors. For commercial institutions, particularly those operating in a highly competitive environment, this is a far more difficult task. Indeed, for institutional investors, aiming for such a balance could be construed as breaching their fiduciary responsibility to maximise returns for their members.

Balancing financial and ESG concerns

There are areas where financial and ESG concerns do not conflict. Investing in ‘clean-tech’, for example, is both environmentally positive and likely to be highly profitable in the long term. Global investment in renewable energy, particularly wind and solar, has grown six-fold in as many years, from $35 billion in 2004 to $200 billion in 2010 (Pew, 2010). The same cannot be said of many other sectors, from the extractive industries to aluminium smelting, for example. On the social side, there is a reputational risk to being exposed as financing 'sweatshops' or child labour, but little commercial incentive to go beyond the minimum requirements. To do so obviously increases costs and so is likely to reduce profitability and therefore the return on any investment.

It is important for as many institutions as possible to adopt common investment principles. If all institutional investors sign up to the PRI (or all banks to the Equator Principles), then the competitive disadvantage of incurring higher costs is addressed, since everyone faces the same costs. A problem with the PRI – as opposed to the more specific Equator Principles – is that, even after institutions sign up, they may have a commercial incentive to interpret the principles in as lax a way as possible because this may bring commercial benefit in a competitive environment. The vagueness of the PRI allows the scope for this.

The EIB does not face commercial pressures of this nature, or does so to a lesser extent. It needs to make a positive return, but not necessarily to maximise this return, and it is backed by the resources of the European Union rather than by shareholders or pension funds, for example, which aim to maximise their own returns. Commercial banks are answerable to their shareholders, and seek to maximise returns and dividends they can pay. Similarly, institutional investors manage other people's money and are judged on the returns they generate relative to that of other asset managers. In either case, the institutions are simply not in a position to sacrifice returns for other considerations, even if they wished to.

NATIONAL-LEVEL PUBLIC AND PRIVATE PRINCIPLES OF INVESTMENT

In this section we briefly review principles established at the national level. Given the large number of such initiatives, it is not possible to give details of each example. Instead, we have organised the national sets of principles into broad categories, and provided comprehensive lists in Appendices 2–8.

First, there are national-level institutions that have the capacity to set investment principles or codes of standards. For example, numerous regulatory agencies or accountancy bodies have broad ESG requirements relating to business and investment activity within their jurisdictions (Appendix 2).

Similarly, many national stock exchanges require companies listing on them, and investors trading on them, to subscribe to certain minimum standards (Appendix 3). A more focused offshoot of this are exchanges that specifically focus on social and/or environmental standards, such as the Dow Jones Sustainability Index in New York or the FTSE4Good Index in London (Appendix 4).

The focus of these initiatives depends on their origin. For example, the emphasis given to corporate governance by stock exchanges reflects the need to maintain the integrity of investments, and particularly to uphold the rights of investors, especially minority investors. Accountancy bodies are similarly focused on maintaining the integrity of published accounts, while regulatory bodies seek to uphold general levels of trust in investing in their jurisdiction.

Dedicated indices perform a rather different function. They are a market response to demand from investors – particularly the SRI investors profiled above – for a means of assessing the ESG performance of companies. By being included on such an index, a company may qualify for SRI investors' 'universe' of permissible investments, and so may be able to access this growing pool of capital.

Whether this affects behaviour is likely to be determined by whether inclusion on a dedicated index provides access to capital where there was previously a lack (unlikely), or if it provides this capital at a lower cost (unproven) or on better terms. It is possible that SRI investors may take a longer-term view of investments – that is, they may be more likely than investors overall to 'buy and hold'.[14]

The demand for the rating and ranking of companies in relation to ESG is undoubted, however, and this is the source of another approach to the setting of investment principles – investment managers and ultimate investors. A number of private investment managers, and investors such as pension funds, have formed groups promulgating or supporting ESG-related investment principles (Appendix 5). There is a clear commercial aspect to this. Because adhering to ESG principles may reduce financial returns, investors have a strong incentive to encourage their competitors to follow the same principles, thereby creating a level playing-field.

Pension funds are also an interesting category. They are often the largest institutional investors in a country, and many are publicly owned (for example, the pension fund of government departments) (see Appendix 6). Pension funds – particularly those of a public or semi-public nature – are in an unenviable position. Like any investor, they face competitive pressures to maximise returns relative to their peers. However, to a greater or lesser extent they also face pressures to behave responsibly and sustainably, which may be contrary to maximising returns.

A similarly interesting category, particularly on environmental matters, is the insurance sector. Like pension funds, insurance companies are often one of the largest forms of institutional investor in developed countries. Given their focus on assessing long-term risks, they have also been engaged in environmental issues from an early stage, particularly with regard to better understanding long-term risks. Insurance companies have a stronger incentive than most to assess these risks accurately, since the premiums they charge should be calibrated to cover any possible future payments – they need to know what their liabilities might be (Appendix 7).

Of all the forms of institutions considered, insurance companies face the clearest commercial incentives to invest responsibly, since their long-term profitability is dependent upon their ability to minimise liability payments relative to premiums. If negative impacts on sustainable development result in economic liabilities over the longer term, insurance companies will have to pay.

Appendix 8 gives examples of guidelines or principles produced by economic, trade or foreign ministries, which completes this listing of national-level initiatives that promulgate principles of investment or corporate behaviour, or lay down minimum standards, or promote best practice. Although such bodies are not subject to the same commercial pressures as are private investment institutions, they still face strong incentives to maximise 'returns' for the state. There is also an issue of competition – if the trade ministry from one country wishes to apply stringent social and environmental standards to the activities of its private investors, but other countries do not do the same, investors from that country could be forced to avoid certain profitable activities when their counterparts from other countries do not. It is not difficult to imagine the intensive lobbying of the trade ministry for a relaxation of rules to restore a level playing field that would be likely to result.

The national-level lists in Appendices 2–8 are very long, and overwhelmingly focused on high- and middle-income countries. This is not surprising, since these are the countries from which most investment flows and multinational companies originate. Why are there so few national-level initiatives from lower-income countries requiring investors or companies to conform to particular ESG principles? The simple answer is that these countries are generally not able to insist on principles of this form. More often, there is competition between low-income countries to attract investment of various forms, with inducements – such as tax holidays – being the norm, rather than insistence on principles of behaviour.[15]

This does not mean that low-income countries can do nothing. Local content requirements – where investors/MNCs are required to secure specified inputs from domestic suppliers – may have fallen foul of the WTO's Trade Related Investment Measures (TRIMs), but are still actively used, particularly in the oil, gas and mining sectors. However, such investments are not readily transferable from one state to another – a country either does or does not have oil and gas reserves. Consequently, the relative negotiating position of governments with desired resources is far stronger than when the investments could be made in any developing country.

Some countries hold stronger positions more generally. China, for example, is able to insist upon stringent requirements for those wishing to invest in the national economy, as investors have very strong incentives to gain access to the Chinese domestic market. In the high-speed rail (HSR) sector, for example, China required investors from developed countries, such as Siemens, to partner with domestic firms and agree to meaningful technology transfer. As a result, Chinese manufacturing advanced rapidly, and is now a major producer of HSR technologies, serving the domestic economy, which has laid more high-speed rail lines than the rest of the world combined over the past 10 years.

This can be seen as a straightforward issue of supply and demand in many ways. The supply of potential investors in China exceeds the demand within the country for investment, empowering the national authorities. In most developing countries, however, the demand for international investment is greater than the supply of potential investors, giving the power to the investors.

Some of the principles considered so far, particularly the Equator Principles and OECD Guidelines on Multinational Investment, aim to address the potentially negative impacts of the 'race to the bottom', by ensuring minimum acceptable social and environmental standards. However, the vagueness of the OECD Guidelines (and PRI) contrasts with the relative specificity of the Equator Principles. Investors generally have a commercial incentive to do the minimum permissible (regardless of any countervailing pressures), in any 'non-commercial' area such as the environmental or social. Where countries are competing for international investment flows, the positive impact of any investment, in terms of social and environmental outcomes, is likely to be lower when principles are relatively vague.

SECTORALLY FOCUSED INVESTMENT PRINCIPLES

There are numerous sets of codes and standards for particular economic sectors that relate to sustainable development but are not investment specific. In most instances, these apply to the processes of production, but may have some relevance from an investment perspective. For example, the World Bank and International Finance Corporation (IFC) have developed detailed sets of principles on a sectoral basis. These are not specifically related to investment but do provide guidelines for IFC financing.

Where sector-specific codes and standards have a clear link with investment, we will cover them in this subsection. Where the link is more tenuous, however, they will remain outside the scope of this review.[16] This subsection looks at the IFC standards, the Finance Initiative of the UN Environment Programme, and the Extractive Industries Transparency Initiative.

IFC Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information

The IFC Performance Standards (PSs) were promulgated in 2006 and have the following scope:

The International Finance Corporation (IFC) applies the Performance Standards to manage social and environmental risks and impacts and to enhance development opportunities in its private sector financing in its member countries eligible for financing. The Performance Standards may also be applied by other financial institutions electing to apply them to projects in emerging markets. Together, the eight Performance Standards establish standards that the client is to meet throughout the life of an investment by IFC or other relevant financial institution.

(IFC, 2006a: i)

Thus, the PSs apply to the standard IFC project finance activities, but also to their third-party management of financial assets. Designed to be implemented at each stage of the project cycle, the eight standards cover the following areas:

1 Social and Environmental Assessment and Management System

PS1 is procedural in nature but concerns the practical implementation of the Standards. The focus is on developing appropriate and effective management systems so that social and environmental issues resulting from a project are assessed, mitigated and addressed: a) before a project begins, b) during the lifetime of the project, and c) after the project is completed.

For the IFC, the objectives of PS1 are:

- 'To identify and assess social and environment impacts, both adverse and beneficial, in the project's area of influence
- To avoid, or where avoidance is not possible, minimise, mitigate, or compensate for adverse impacts on workers, affected communities, and the environment
- To ensure that affected communities are appropriately engaged on issues that could potentially affect them
- To promote improved social and environment performance of companies through the effective use of management systems'. (IFC, 2006a: 1)

Under PS1 projects, clients are required to:

- establish a Social and Environmental Management System
- conduct an integrated Social and Environmental Assessment of the potential risks and impacts of the project, including consultation with affected communities

- design and implement a Management Programme to eliminate or minimise these risks, which should be codified into an 'Action Plan' where specific measures are required
- ensure that the Organisational Capacity to implement the Management Programme is in place
- undertake appropriate Training of relevant staff
- ensure meaningful Community Engagement occurs throughout the life-cycle of the project, based on disclosure of pertinent information and consultation with affected communities ('For projects with significant adverse impacts on affected communities, the consultation process will ensure their free, prior and informed consultation and facilitate their informed participation' (IFC, 2006a: 4). The client is also required to implement an effective grievance mechanism, on a scale appropriate to the scale of the potential impacts)
- establish an effective Monitoring framework as part of its overall Management system
- provide timely and complete Reporting on the implementation of the Action Plan.

2 Labour and Working Conditions
PS2 focuses on establishing the rights of workers and is 'guided by' international conventions negotiated through the International Labour Organization (ILO) and the (UN).[17] The objectives are:

- 'To establish, maintain and improve the worker–management relationship
- To promote the fair treatment, non-discrimination and equal opportunity of workers, and compliance with national labour and employment laws
- To protect the workforce by addressing child labour and forced labour
- To promote safe and healthy working conditions, and to protect and promote the health of workers' (IFC, 2006a: 7).

3 Pollution Prevention and Abatement
PS3 seeks to ensure that the most effective pollution prevention and abatement techniques and technologies are employed in all projects, 'as far as their use is technically and financially feasible and cost-effective in the context of a project that relies on commercially available skills and resources' (IFC, 2006a: 11).

PS3 has the following objectives:

- 'To avoid or minimize adverse impacts on human health and the environment by avoiding or minimizing pollution from project activities
- To promote the reduction of emissions that contribute to climate change' (IFC, 2006a: 11).

4 Community Health, Safety and Security
PS4 seeks:

- 'To avoid or minimize risks to and impacts on the health and safety of the local community during the project life cycle from both routine and non-routine circumstances
- To ensure that the safeguarding of personnel and property is carried out in a legitimate manner that avoids or minimizes risks to the community's safety and security' (IFC, 2006a: 15).

5 Land Acquisition and Involuntary Resettlement
Under PS5, the IFC defines involuntary resettlement as follows:

Involuntary resettlement refers both to physical displacement (relocation or loss of shelter) and to economic displacement (loss of assets or access to assets that leads to loss of income sources or means of livelihood) as a result of project-related land acquisition. Resettlement is considered involuntary when affected individuals or communities do not have the right to refuse land acquisition that results in displacement. This occurs in cases of: (i) lawful expropriation or restrictions on land use based on eminent domain; and (ii) negotiated settlements in which the buyer can resort to expropriation or impose legal restrictions on land use if negotiations with the seller fail.

(IFC, 2006b: 18)

Specifically, the objectives are:

- 'To avoid or at least minimize involuntary resettlement wherever feasible by exploring alternative project designs
- To mitigate adverse social and economic impacts from land acquisition or restrictions on affected persons' use of land by: (i) providing compensation for loss of assets at replacement cost; and (ii) ensuring that resettlement activities are implemented with appropriate disclosure of information, consultation, and the informed participation of those affected
- To improve or at least restore the livelihoods and standards of living of displaced persons
- To improve living conditions among displaced persons through provision of adequate housing with security of tenure at resettlement sites' (IFC, 2006a: 18).

6 Biodiversity Conservation and Sustainable Natural Resource Management

PS6 is drawn from the Convention on Biological Diversity and addresses means through which clients can prevent or reduce threats to biodiversity resulting from their operations. The objectives are:

- 'To protect and conserve biodiversity
- To promote the sustainable management and use of natural resources through the adoption of practices that integrate conservation needs and development priorities' (IFC, 2006a: 25).

7 Indigenous Peoples

PS7 seeks to safeguard the rights of indigenous peoples, while also allowing them to benefit from projects where this is in accordance with their wishes for economic development. Specific objectives are:

- 'To ensure that the development process fosters full respect for the dignity, human rights, aspirations, cultures and natural resource-based livelihoods of Indigenous Peoples
- To avoid adverse impacts of projects on communities of Indigenous Peoples, or when avoidance is not feasible, to minimise, mitigate, or compensate for such impacts, and to provide opportunities for development benefits, in a culturally appropriate manner
- To establish and maintain an ongoing relationship with the Indigenous Peoples affected by a project throughout the life of the project
- To foster good faith negotiation with and informed participation of Indigenous Peoples when projects are to be located on traditional or customary lands under use by the Indigenous Peoples

- To respect and preserve the culture, knowledge and practices of Indigenous Peoples' (IFC, 2006a: 28).

8 Cultural Heritage
The final standard, PS8, is concerned with preserving cultural heritage, for 'current and future generations'. Specifically:

- 'To protect cultural heritage from the adverse impacts of project activities and support its preservation
- To promote the equitable sharing of benefits from the use of cultural heritage in business activities' (IFC, 2006a: 32).

The IFC's Disclosure Policy was developed separately from the PS in 2006. The guiding principles of the policy are:

'Taking into account its roles and responsibilities, IFC makes available information concerning its activities that would enable its clients, partners and stakeholders (including affected communities), and other interested members of the public, to understand better, and to engage in informed discussion about, IFC's business activities, the overall development and other impacts of its activities, and its contribution to development … There is a presumption in favor of disclosure with respect to the information described … above, absent a compelling reason not to disclose such information'

(IFC, 2006c: 2).

Areas where disclosure may not occur are as follows (IFC, 2006a: 2–3):

- 'Consistent with the practice of commercial banks and of most public sector financial institutions (for their private sector investments), IFC does not disclose to the public financial, business, proprietary or other non-public information provided to IFC by its clients or other third parties. To do so would be contrary to the legitimate expectations of its clients, who need to be able to disclose to IFC detailed information without fear of compromising the confidentiality of their projects or other proprietary information in a highly competitive marketplace.'
- 'IFC does not disclose any documents, memoranda, or other communications that are exchanged with member countries, with other organizations and agencies, or with or between members of IFC's Board of Directors (or the advisers and staff of IFC's Board members), where these relate to the exchange of ideas between these groups, or to the deliberative or decision-making process of IFC, its member countries, its Board of Directors or other organizations, agencies or entities with whom IFC cooperates.'
- 'IFC does not disclose any internal documents, memoranda, or other communications that are issued by or between members of IFC's Board of Directors, the advisers and staff of IFC's Board members, members of IFC management, IFC staff, or IFC's consultants, attorneys, or agents.'
- 'In limited circumstances, IFC may delay the disclosure of certain information that it would otherwise make publicly available because of market conditions or timing requirements.'
- 'IFC does not disclose information if such disclosure would violate applicable law'.
- 'IFC does not disclose information relating to arrangements for preserving the safety and security of individuals working with, or for, IFC or to arrangements related to its corporate records and information systems'.

The best known set of principles in the mining sector is the Extractive Industries Transparency Initiative

UNEP Finance Initiative

The United Nations Environment Programme (UNEP) Finance Initiative, of which the PRI is an offshoot, has a number of work strands in sector-specific areas. These include: climate change, property,[18] human rights, biodiversity,[19] conflict, and water. All of these focus on awareness-raising and the need to channel sustainable finance into key sectors such as water, rather than the promulgation of investment principles.

An example of sectoral private principles: the EITI

The most well known set of principles in the mining sector is that set out under the Extractive Industries Transparency Initiative (EITI). The EITI Principles were first promulgated in 2003, with the final Validation methodology being released four years later in 2007 (EITI, 2011a). The EITI Principles (which represent the shared position of the signatories) are as follows:

1. We share a belief that the prudent use of natural resource wealth should be an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction, but if not managed properly, can create negative economic and social impacts.
2. We affirm that management of natural resource wealth for the benefit of a country's citizens is in the domain of sovereign governments to be exercised in the interests of their national development.
3. We recognise that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent.
4. We recognise that a public understanding of government revenues and expenditure over time could help public debate and inform choice of appropriate and realistic options for sustainable development.
5. We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.
6. We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws.
7. We recognise the enhanced environment for domestic and foreign direct investment that financial transparency may bring.
8. We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure.
9. We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business.
10. We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use.
11. We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.
12. In seeking solutions, we believe that all stakeholders have important and relevant contributions to make – including governments and their agencies, extractive industry companies, service companies, multilateral organisations, financial organisations, investors, and non-governmental organisations.

The EITI is a broad coalition of governments, companies, investors, civil society groups and international organisations, which promotes revenue transparency in the extractive industries at local level. The EITI could be considered not strictly a private-sector grouping but rather a hybrid public–NGO–private coalition. As well as the Principles listed above, the EITI publishes sets of Criteria,[20] Validation and Policy that countries need to adhere to in order to be EITI compliant. To date, just five countries[21] are EITI compliant, with a further 27[22] being 'candidates' (EITI, 2011c).

We have seen that there is a vast range of initiatives related to investment, which are promulgated by official bodies (such as the UN or IFC), governments and regulatory agencies, private companies, NGOs and different combinations of these actors (see table below for a summary). There is clearly no shortage of activity on investment principles. The next section analyses the implementation of these principles.

There is no shortage of activity on investment principles. But what about their implementation and impact?

TABLE 1.1 SUMMARY OF INVESTMENT PRINCIPLES AND THEIR KEY CRITERIA

	NATURE OF PROMULGATING BODY *Public/private*	FORCE OF PRINCIPLES *Voluntary/ mandatory*	GEOGRAPHIC APPLICATION *Global/regional/ national*	INSTITUTIONAL SCOPE *All investors or institutionally specific?*	RANGE OF ISSUES *Universal or sector specific?*
UN PRI	Public	Voluntary	Global	All investors	Universal
EQUATOR PRINCIPLES	Private	Voluntary	Global	Project finance, but can be applied more broadly	Universal
EIB ENVIRONMENTAL AND SOCIAL PRINCIPLES	Public	Mandatory	Global	All projects where EIB is an investor. Also informs its lending decisions	Universal
OECD GUIDELINES	Public	Voluntary	Global	Foreign direct investment made by MNCs	Universal
IFC PERFORMANCE STANDARDS	Private	Mandatory for IFC Voluntary to other financial institutions that wish to use them	Global	IFC Project finance and the IFC's 3rd-party management of financial assets. Can be applied to others who wish to use them.	Sector specific
EITI	Public/NGO/ private	Voluntary	Global	All investors	Sector specific – mining

TWO.
THE IMPLEMENTATION OF INVESTMENT PRINCIPLES

In this section, we focus on implementation of four of the most important sets of principles – the PRI, the Equator Principles, the OECD Guidelines, and the IFC Performance Standards – and explore how they are implemented. Implementation is an important consideration because it shapes uptake, and therefore impact, of investment principles.

PRINCIPLES OF RESPONSIBLE INVESTMENT (PRI)

As discussed in Section 1, the PRI have more than 800 signatories from 45 countries, representing US$22 trillion of assets under management, or a little over a quarter of all conventionally managed financial assets. What does this mean in practice, however?

The first implementation step of the PRI is described as the creation of an organisation-wide policy that shapes operational activities (see UN PRI, 2010). The PRI reports that around 90 per cent of signatories now have such a policy in place in relation to ESG issues. However: 'putting internal management processes in place that fulfil this policy, is a more difficult step. Only a minority of signatories said they had these processes in place to a large extent across their entire portfolio' (UN PRI, 2010: 9).

Examples of such processes include:

- benchmark tools that compare all companies in a particular sector on a particular ESG issue
- requests for proposals that include ESG criteria
- models to put financial values on ESG data
- staff training modules and key performance indicators that cover sustainability as well as financial issues.

Small funds – defined by the PRI as signatories with less than US$2bn under management – represent 30 per cent of the PRI signatory base. The major obstacle to implementation for these funds is a lack of resources. Small funds face different challenges from their larger peers – they often have only one staff member, if any, dedicated to ESG issues, pay a relatively high price for ESG research and can have limited influence if they engage alone with investee companies (UNPRI, 2010). Only 33 per cent of small asset owners and small mainstream investment managers have the capacity to implement 'responsible investment processes' to a large extent. Small dedicated socially responsible investment funds find it easier to implement these processes, however.

For larger funds, the biggest obstacle is applying ESG processes across all asset classes in which they are engaged. By 2010, around half of PRI signatories had implemented these processes to a large extent in developed country equity markets, but only 10–30 per cent of signatories reported that this held true for all other asset classes. For the PRI, however, this is not necessarily a problem: 'The Principles have always been intended to be aspirational and not a prescriptive set of rules, and are to be applied as appropriate within each asset class and investment approach' (UN PRI, 2011: 5).

A large proportion of PRI signatories stress that they have undertaken the staff training required, but the PRI Verification process, which checks the self-reporting of signatories, warns that this may be open to interpretation. Much of this training is informal in nature, and includes attendance at conferences, for example, rather than targeted ESG training in the institution itself. An indication that PRI signatories are not necessarily prioritising ESG issues is that very few provide incentives for ‘good’ performance in these areas. Of mainstream signatories, only a small proportion – less than 30 per cent – incentivise performance on ESG issues.

Around 20 per cent of PRI assets under management are managed passively, and each investor signatory typically holds 31 per cent of their assets in passive funds. This means that investors buy long-only index funds (such as the FTSE 100) and do not actively select to buy or sell stocks in particular companies. In such circumstances, incorporating ESG considerations into investment decisions (as described under Principle 1 of the PRI) is obviously not possible. The PRI does not regard this as a problem in itself:

If a signatory indicates that assets are passively managed, the relevant Principle 1 questions on active management and ESG integration into stock selection disappear from the survey and are not counted. Passive managers can rest assured that the PRI is entirely compatible with their strategy, even if there is no consideration of ESG factors in the portfolio construction process.

(UN PRI, 2011: 5)

Passive investors thus implement PRI through two routes, which fall under Principle 2 of the PRI: voting in accordance with ESG factors, and ‘engaging’ with companies to improve their ESG performance. One factor which complicates this, however, is that a reasonable proportion of such assets are held in ‘pooled funds’, where asset managers combine the investments from a large number of individual institutions that wish to track the same index. The resultant economies of scale reduce costs significantly – hence the attraction – but one consequence is that it is more difficult for each institution to vote on their shares individually, and is impossible in some jurisdictions.

Some investors, particularly those most committed to ESG issues, have expressed some frustration at this. For example, the UK Environment Agency Pension fund insists on voting on core environmental issues where possible, but is keen for its options to be expanded. The PRI responds:

To expand the process to cover all votes would have its limitations, not least administrative. There could also be restrictions in certain countries that will not allow pro-rata voting. However we do not believe this goal is beyond the capacity of modern fund management and/or technology. Currently our investment manager is able to offer the service of pro-rata voting on UK pooled equities but there is growing demand, particularly from smaller funds, for this function to be available across all markets. We believe this will be an area of product development in the medium-term [sic] as responsible asset owners want to exercise their shareholder rights to ensure their long term [sic] interests.

(UN PRI, 2011: 7)

Nevertheless, the ability to exercise a vote does not necessarily mean that the vote will be cast in any particular direction. There is a long-standing tendency of major investors to vote with the board, even where ESG motions are tabled by other shareholders. For example, Northern Trust Global Investments – a US manager with assets of $679bn – describes its approach as follows:

Our current proxy voting guidelines provide that we generally support the position of a company’s board of directors when voting shareholder initiated social and environmental proposals. This position is grounded on the belief that in most cases a company’s management group and elected directors are best positioned to make corporate decisions on these sorts of proposals.

(UN PRI, 2011: 7)

Lack of resources is the greatest obstacle to smaller funds implementing the PRI

The evidence on PRI implementation would thus appear to support the points made in Section 1:

- SRI-type investors are the most committed to fully incorporating ESG practice, but it is probable that they would do this regardless of the PRI.
- Mainstream investors have yet to implement the PRI in such a way that their investment decisions are strongly influenced.
- The PRI may encourage some signatory investors to engage more on ESG issues, and to vote accordingly, but other investors may not be influenced.
- There is no sense that mainstream investors are prepared to sacrifice returns in order to uphold the PRI. Indeed, they may be prevented from doing so by fiduciary responsibilities even if they did wish to.

THE EQUATOR PRINCIPLES

As discussed in Section 1, there is extensive and detailed guidance on how signatory banks should implement the Equator Principles, including how banks should incorporate the Principles into loan documentation (Equator Principles, undated). Similarly, borrowers are required to commit to particular actions (covenants), or risk the withdrawal of loans.

It is not clear what this means in practice, however. To what extent has the behaviour of banks actually changed? A key problem is a lack of transparency. While some banks have adopted the Equator Principles across their whole portfolio (that is, beyond only project finance), and are relatively transparent,[23] there is no requirement on signatories to be transparent. This voluntarist approach is problematic. Banks adopting the Principles stringently are also those likely to be the most transparent. Conversely, the activities of those with a less impressive record are likely to be far more opaque.

Some NGO observers have asked whether the introduction of the Equator Principles has led to a reduction in bad practice, in terms of environmentally and socially damaging projects:

Today we find ourselves continuing to campaign against the very same projects that we expected the Principles to prevent or significantly improve: supersized dams blocking life-supporting rivers, driving thousands of people from their submerged villages and lands; huge mining projects scarring entire mountains and polluting rivers and seas with their waste; oil and gas pipelines carrying their toxic load straight through devastated forests and threatening marine sanctuaries; coal power plants belching out millions of tons of greenhouse gases into our already fatigued atmosphere; enormous paper mills with insatiable appetites that devour the last wilderness areas, etc. Much to our disappointment, the Equator Principles allow for all of these disgraces to proceed, only now in an 'Equator compliant' mode.

(BankTrack, 2010: 2)

Again, the core problem here is identified as the lack of transparency:

The current Equator Principles oblige EPFIs to meet an extremely lenient set of reporting criteria, but these do not allow external observers to judge the quality and progress of a bank's implementation. The reporting criteria also allow for a long grace period during which it is impossible for external observers to determine what an adopting bank has put in place to deliver on its commitment to the Principles.

(BankTrack, 2010: 3)

As with the PRI, therefore, it seems that adoption of the Equator Principles is not generally preventing damaging projects. Negative outcomes may be reduced, but this is not the same as preventing them altogether.

OECD GUIDELINES

The process of implementation of the OECD Guidelines starts with the governments of signatory countries, who 'agree to promote their implementation by enterprises operating in or from their territory' (OECD, 2011b). Central to this process are the National Contact Points (NCPs), a part of the relevant government given responsibility for disseminating information and 'encouraging' observance of the Guidelines:

The NCP gathers information on national experiences with the Guidelines, handles enquiries, discusses matters related to the Guidelines and assists in solving problems that may arise in this connection. When issues arise concerning implementation of the Guidelines in relation to specific instances of business conduct, the NCP is expected to help resolve them.

(OECD, 2011a)

Clearly, therefore, the extent to which the Guidelines are implemented in any given country, and the strictness with which they are adhered to, is primarily determined by the strength and effectiveness of the NCP. While recognising that different countries will want to deal with these issues in different ways, the OECD stresses the need for NCPs to operate in a way that is visible, accessible, transparent and accountable.

NCPs are held to account in four ways: by the democratic process of their own country; by their peers, in the annual meeting of the National Contact Points; by the OECD Investment Committee, and through the advisory committees of business (BIAC) and labour (TUAC), and NGOs (OECD Watch).

The importance of not having just national accountability is in preventing a race to the bottom, where OECD country governments do not wish to put their companies at a competitive disadvantage by interpreting the Guidelines too severely. In turn, the importance of having a layer of accountability additional to the peer-review process – particularly with regard to OECD Watch – is to prevent signatory governments implementing the Guidelines in the most minimal way possible, particularly where they may be facing competitive pressures from non-OECD countries.

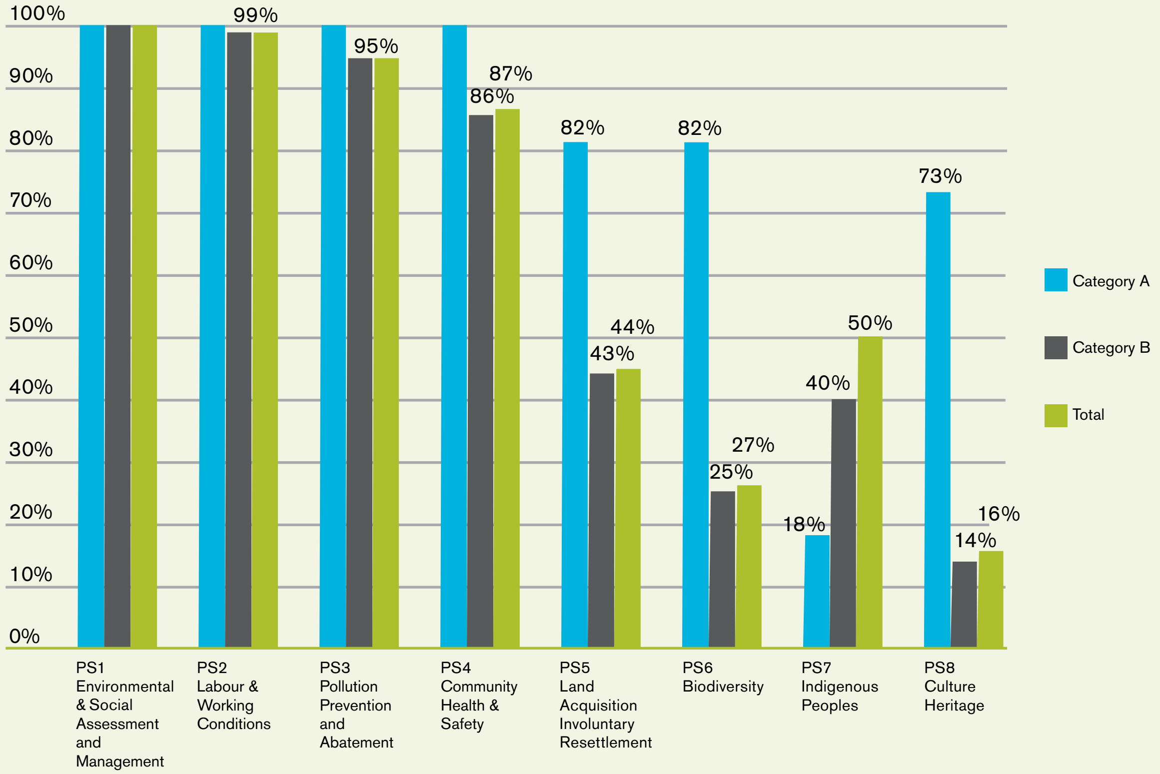
Implementation of the OECD guidelines is determined by the strength and effectiveness of the National Contact Point

IFC PERFORMANCE STANDARDS

As described in Section 1, the IFC Performance Standards (PSs) are intended to be implemented by clients throughout the life-cycle of all projects. In the first stage, potential projects are vetted under the Environmental and Social Review Procedure (ESRP) and approved (or rejected) by the Board on the basis of the client's Assessment and Action Plans. Each project is accorded a risk category, and individual PSs are either 'triggered' or not depending on their relevance.

Figure 2.1 gives a breakdown of the extent to which each Standard was triggered in projects from 2006 to 2009. Standards 1–4 have been triggered in most or all projects, while the other four Standards have been considered relevant far less frequently, particular PS7, which relates to indigenous peoples.

FIGURE 2.1 TRIGGERING OF THE IFC PERFORMANCE STANDARDS, 2006–2009



Source: IFC (2009)

Complying with the IFC's standards is comparatively expensive

In 2009, the IFC reviewed the implementation of its Performance Standards and Disclosure Policy from inception in 2006, and noted that by 2009 a quarter of all IFC projects were compliant with the Performance Standards. The aim of the review was to:

- 'Assess the efficiency and effectiveness with which this new policy framework is being implemented
- Assess the impacts of this policy framework on IFC, the projects IFC finances, IFC clients, as well as impacts on market practice
- Describe the proposed process for reviewing and updating the PS [performance standards] and DP [disclosure policy], and lay out in broad terms the emerging agenda that is likely to form the core of the review-and-update process' (IFC, 2009: 2).

To these ends the IFC undertook an internal consultation process with key departments, gathered feedback from external experts, and also conducted a client survey to get a sense of implementation costs. Of particular interest to IFC was whether clients found the implementation of the Policy and Performance Standards (PPS) to be excessively expensive; and the review concluded that this was not the case. However, 60 per cent of clients reported that the cost of compliance was higher than the average costs of meeting social and environmental requirements for their sector. But only 21 per cent said that this would negatively affect their decisions on whether to work with the IFC in future. Box 2.1 summarises the key findings of the review for each of the Performance Standards.

BOX 2.1 THEMES AND TOPICS EMERGING FROM PS IMPLEMENTATION EXPERIENCE

POLICY

- Further clarify the approach to project categorisation
- Better document the E&S review process of FIs
- Clarify the BCS requirements and explore the BCS timeline

PS1

- Provide further clarity of the E&S management plan, programme and system
- Include guidance on Emergency Preparedness Plans in the management system
- Clarify further when and to what extent to examine supply chains
- Expand the scope of community engagement on issues such as water
- Elaborate on Social and Environmental Management System requirements for FIs

PS2

- Provide additional reference on working conditions, such as application to non-employees, and living-condition requirements
- Consider expanding retrenchment requirements to cover labour brokers and extend the client's grievance mechanism to non-employee workers
- Require that employers disclose safety and other information to their workers

PS3

- Review requirements on GHG emissions, climate-change-related matters, and energy efficiency
- Clarify the role of the *EHS guidelines*
- Highlight the importance of water-conversation measures

PS4

- Clarify when a Health Impact Assessment might be most appropriate

PS5

- Examine the requirement for security of tenure

PS6

- Clarify supply chain requirements
- Clarify the actions required when dealing with natural habitats
- Clarify the definition of critical habitat

PS7

- Provide guidance on the technical judgement needed to prepare an IP

PS8

- Clarify the definition of internationally recognised heritage

Source: IFC (2009)

On disclosure, the IFC concluded that this remains 'an issue'. Although minimum requirements (in line with the Disclosure Policy) are being met, the approach is to rely on clients themselves to disclose project-specific information. Clearly, the extent to which this occurs varies widely from client to client, such that:

The result is that stakeholders must often look both to the IFC and to clients to piece together a picture of the project, whom it affects, the expected development outcomes, how the project is being implemented, and whether the IFC achieved the developmental goals and outcomes for the project.

(IFC, 2009: v)

The concept of Broad Community Support (BCS) for a project is central to the IFC Standards approach. Feedback from the 2009 review, however, stressed the need for this to be seen as an evolving process, where BCS needs to be maintained throughout the life of the project rather than assuming that BCS will automatically continue where it existed in the early stages.

Comments from developing country civil society groups[24] on the IFC review report, also stressed the issue of community support, arguing that 'consent' rather than 'consultation' should not be restricted to PS7 (Indigenous Peoples), but adopted more broadly (for all stakeholder groups) (CSO, 2010).

Civil society groups also highlighted the following concerns about implementation of the IFC Principles (CSO, 2010):

- Though the IFC recognises that the implementation of BCS needs to be improved, there is no roadmap offered for how this could or should be done.
- The IFC's review acknowledges that ESIAs [Environmental and Social Impact Assessments] are difficult to implement for IFC clients and EPFIs – therefore the implementation of ESIAs needs to be reviewed, as does the PS5 provision for economic displacement, which is weakly implemented.
- There is a greater need for disclosure of project implementation/completion documentation, which should extend to Environmental and Social Review Documents (ESRDs) and related documents.

The IFC committed to a number of reforms in light of the review, and is clearly making efforts to improve its performance on these issues. As with the other sets of principles reviewed, however, there is a clear tension between commercial and developmental – particularly environmental – objectives.

Implementation of the Performance Standards incurs increased costs for clients, with some suggesting that this could affect their willingness to work with the IFC in future. Going further, for example, insisting on 'consent' rather than 'consultation' beyond indigenous people, would clearly add to these tensions.

Like the Equator Principles, the IFC Standards have more 'bite' than, say, the PRI, but even here this is significantly tempered by commercial pressures. This is made very clear in IFC documents, where rather ambitious objectives are generally qualified by such phrases, as 'where feasible' or 'where commercially viable'.

THREE. WHAT DO WE KNOW ABOUT IMPACT?

Despite the huge range and scope of the various sets of investment principles, there is very little information about their impact. By 'impact' we mean improved social and/or environmental outcomes resulting from the investment that would not have occurred in the absence of the principles. This impact can be either positive (with good social or environmental outcomes) or negative (with less-bad outcomes than would otherwise have occurred).

This raises both conceptual and practical difficulties. First, there is the absence of a direct counterfactual: we are interested in the extent to which outcomes (and behaviours) have been changed by the adoption of a particular set of principles, but we have no way of knowing what would have happened in their absence.

> The number of third-party assessments of the impact of investment principles is surprisingly limited

At the heart of this issue is a problem of asymmetric information – the only party that can really answer this question is the investor itself. Clearly, the investor may have very strong incentives to avoid answering, or to answer in a partial or misleading way.

Second, even if these major conceptual issues could be overcome, there is the problem of measurement and its comparability. Investors have an incentive to exaggerate their social and environmental credentials, and the weight they give to these factors when taking decisions. It is therefore not enough to take an investor's or company's own impact assessment as evidence; we need to look for third-party assessments. As we shall see, there have been some of these, but they are far more limited than might be expected. There has also been no attempt to compare across the range of principles to assess relative impact – for example, does signing up to the PRI influence behaviour in a more positive way than, say, adhering to the Equator Principles?

Third, there is perhaps the most fundamental question: are these the right principles in the first place, or might a different approach lead to better social and environmental outcomes? Keeping these three points in mind, this section now briefly reviews currently knowledge about the impact of investment principles.

THE PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

As we have seen, the PRI have rapidly built market share among institutional investors, with signatories now accounting for around a quarter of all assets under management, or $22 trillion. The main – indeed almost the only – evidence we have on PRI impact is from the self-assessments[25] of signatories,[26] the location and types of which are shown in Table 3.1.

TABLE 3.1 LOCATIONS OF PRI SIGNATORIES

COUNTRY/ COUNTRIES	TOTAL SIGNATORIES	ASSET OWNERS	INVESTMENT MANAGERS
USA	31	11	20
Canada	12	4	8
UK	36	14	22
Netherlands	21	12	9
France	13	3	10
Scandinavia	25	21	4
Switzerland	16	3	13
Australia/New Zealand	56	30	26
Brazil	20	16	4
South Africa	13	1	12
Japan	11	3	8

Source: UN PRI (2009: 1)

According to the PRI *Report on Progress* (UN PRI, 2009), self-assessment scores by signatories from Asia Pacific and emerging markets were lower than those recorded by signatories from Europe and North America. Self-assessment scores from North American signatories on average slightly exceeded those of the much larger number of European signatories. UK asset owners recorded higher scores than peers from other regions on four of the six principles, albeit narrowly in some cases. Investment managers from the US and UK recorded generally strong results across the principles, as did the small number of investment managers from Canada and France.

All regions, with exception of Brazil, had a relatively high median score in active ownership, with the larger regions (UK and US), scoring higher on Principle 5 (working together) than the other regions, which scored higher on Principle 2 (individual active ownership). Activities in which the regions achieved relatively low median scores were promotion and reporting of responsible-investment activities.

From a regional perspective, groups of signatories in certain countries – such as Canada and the UK – consistently achieved high self-assessment scores across the principles. Conversely, signatories in Brazil and Japan achieved lower self-assessment scores across the different areas of PRI implementation. (Appendix 9 gives a more detailed breakdown of uptake by principle.)

The impact of PRI is thus measured by investors themselves in the form of self-assessment of the degree of their adherence to each principle, which are presented in the annual Progress Reports. While these do contain a wealth of information, they cannot be viewed as a reliable guide to impact.

For academic studies, there are as yet no empirical results, though Eccles (2010) attempts an interesting 'thought experiment', noting that PRI signatories are specifically not being asked to sacrifice returns. Quite the opposite: 'the appropriate consideration of these [ESG] issues is part of delivering superior, risk-adjusted returns' (UN PRI, 2009b in Eccles, 2010:416).

Although there has been very little research on the impact of investment principles (or SRI in general) on social or environmental outcomes, there is no shortage of research on the impact of these strategies on investment returns.[27] Much of this is inconclusive, with the consensus being that there is little difference in returns when considered on a risk-adjusted basis.

The PRI suggests that signing up to its Principles may bring commercial advantages. This is quite explicit, with the 'overall goal' of the PRI apparently being to: 'help investors integrate consideration of environmental, social and governance issues into investment decision-making and ownership practices, and thereby improve long-term returns to beneficiaries' (UN PRI, 2009).

Eccles describes this perception of responsible investment as financially beneficial as a 'paradigm shift' from older notions of ethical investment:

The appeal of the PRI to institutional investors and the resultant mass subscription described above can arguably be attributed to the combination of this paradigm shift, and the voluntary nature of the Principles. Together, these ensure that adopting 'responsible' investment is not a threat to investment as usual.

(Eccles, 2010: 416)

The question of 'impact' is therefore aligned with maximising returns. Given that investors are already seeking to maximise returns, it is difficult to see what the value-added of PRI would be within this framework, beyond the straight business case of course. To test this, Eccles considers how PRI signatories would have responded to the issues raised by the apartheid regime in South Africa. He concludes that:

Armed with near perfect (hindsight grade) enhanced analytics, it is clear that the signals that such … 'responsible' investors would have sent to company management in terms of the apartheid issue would have been highly muddled and therefore ineffective. The net conclusion is that there is nothing inherently or inevitably 'responsible' about egoist [responsible] investment and that the aversion to behaving ethically amongst institutional investors must be challenged and not swept under a carpet of rhetoric.

(Eccles, 2010: 415)

Eccles points out that 'responsible investors' adopt a range of strategies – negative and positive screening, engagement and integrated. Given this plurality, the net impact on companies themselves would be confusing, as some investors would have screened out investments in apartheid-era South Africa, while others would not.

While it is not possible to say whether the PRI initiative will lead to major improvements in social and environmental outcomes, it is highly likely that this will be the case only if these positive changes are compatible with the maximisation of investment returns. Given that this is what institutional investors are seeking in any event (and often have a fiduciary requirement to do so), it is not clear what the long-term value-added will be.

THE EQUATOR PRINCIPLES

The Equator Principles have also grown rapidly: 68 major banks are now signatories, representing around 80 per cent of large-scale project finance globally. Signatories are required to self-report on their progress on an annual basis, as with PRI. Given the relative newness of the Equator Principles, it is perhaps not surprising that there is a paucity of independent assessments of their impact. However, this may also be explained by the difficulty of ascertaining impact in the sense of behavioural change.

Given this, and the reliance on self-assessments, it is therefore difficult to assess the actual impact of the Equator Principles. This is the case where projects are not undertaken but would have been (or vice versa), and even where there have been significant changes to the social and environmental outcomes from a particular project resulting from the adoption of the Principles.

An added difficulty is that we are dealing with huge, universal banks, where project finance is just one activity. As noted in an article in July 2008 in the *Banker* Magazine (the most respected industry publication), this can lead to major contradictions in approach:

UK-listed Asia Energy was created to develop a large coal mine and power station in Phulbari, Bangladesh. Barclays Capital acted as financial and, although its role did not involve a project finance loan, the project was prepared to be compliant with the EP. A source close to the transaction says that former IFC environmental experts acted as advisors and voluminous environmental assessments were carried out, but the IFC discreetly turned down the project, which would displace about 50,000 people, in April 2006, and BarCap started looking for new project. In August last year, however, a 10,000-strong crowd protested at Asia Energy's local office and the police opened fire, killing six people; subsequently, the Bangladesh authorities decided not to grant final the project. The company's shares immediately nose-dived. This did nothing to dissuade Barclays plc (a signatory to the principles) from acquiring 4.32 per cent of Asia Energy's shares on December 1, 2006). If the shares were acquired by Barclays Global Investors, the rock-bottom share price may well have been the very incentive that made the investment appealing to a fund manager – little worried by their project finance principles – who believes that the company (which changed its name to Global Coal Management in January this year and says it remains committed to implementing the Phulbari coal mine) [sic] any short-term difficulties and the share price will rise.

(Banker, 2008)

These tensions are not particular to any one institution, but face all major banks operating across the range of financial activities. For example, while the project financing department of a bank may decide against a project because the reputational risks outweigh the potential returns, this does not mean that the asset management or investment banking division will take the same view. Being an 'arm's-length' investor in the sense of owning shares is unlikely to carry the same reputational risk as being directly engaged as a project financier. As a result, less pressure can be applied to these sorts of investment activities, in which a purer focus on potential commercial returns is likely to dominate.

Disclosure clearly remains a problem, with many issues of relevance being categorised as 'commercially sensitive', and so restricted. One of the few studies available concludes that:

banks are disclosing very little information to help users assess the impact the Equator Principles have had on these banks' practices. It is also suggested that banks are reframing their identity through these principles, but it is still difficult to assess whether this is also transforming practice.

(Andrew, 2008: 1)

While banks have been keen to sign up to the Equator Principles – and the more that do so, the greater the potential cost in remaining outside this loop becomes – we have very little impartial evidence of the impact of this on actual behaviour.

In an analysis of banks' social, ethical and environmental policies, as well as their balance-sheets and risk-return characteristics, Scholten and Dam (2007) found significant differences between Equator Principle 'adopters' and 'non-adopters'. This was particularly marked for social and environmental policies, and adopters were far more likely to be very large. In contrast, other 'financial and firm characteristics' did not show significant differences, and the decision to adopt or not does not appear to have affected share valuations of banks. The authors concluded that:

We do not find support for the view that adoption of the Equator Principles is merely window dressing, since there are at least some costs involved and there are many project finance banks that do not adopt the Principles. We conclude that it appears that banks adopt the Equator Principles to signal their responsible conduct.

Scholten and Dam (2007: 1308)

A consortium of NGOs that has followed the adoption of the Equator-Principle process (and the IFC Principles upon which they are based) expressed concerns about the Principles themselves in a submission to the UN Special Representative to the Secretary-General on Human Rights and Transnational Corporations and other Business Enterprises (BankTrack, 2008). Three areas were identified, with a focus on human rights reflecting the nature of the submission:

- 'Substantive Standards: The PS/EPs do not address many critical human rights issues, and address others only partially or in ways that do not meet international norms and standards.
- Due Diligence Procedures: The PS/EPs do not provide an adequate procedural framework for conducting human rights due diligence. Although the PS/EPs require a comprehensive environmental and social assessment for high-impact projects, they do not require explicit assessment of potential impacts on human rights.

- Grievance Mechanisms: While the PS/EPs require project sponsors to implement project-level grievance mechanisms, these mechanisms are not required to meet any minimum due process standards' (BankTrack, 2008: 1).

Therefore, two main questions remain outstanding about the impact of the Equator Principles. First, what is the 'value-added'? There is no firm evidence that adopting the Equator Principles has changed behaviour, but rather that banks which saw the value of adopting this approach anyway, merely formalised this by signing up. Second, as suggested by some NGOs, do the Principles cover the areas that need to be covered?

EIB PRINCIPLES AND OECD GUIDELINES

Although the European Investment Bank (EIB) conducts its own internal impact assessment, there is no rigorous evidence of the impact of its approach on outcomes. The only comments available are from NGOs. The following comments are made by WWF:

- The EIB should avoid the use of vague language when presenting the environmental and social principles and standards. The statement should contain specific links to EU law and practices implementing the EU environment and social principles. Principles in the Treaty such as the precautionary principle, prevention of pollution at source and the polluters pay principle should be emphasized.
- The EIB statement should aim for equal environmental and social standards for operations both outside and inside the EU countries. The EIB should promote EU policies and standards when operating outside the EU.
- The absence of national Environmental Impact Assessment (EIA) laws is not a justification for financing a project without an EIA. The EIA standards and procedures should not be subject to discussion with project's promoters.
- Requiring a sound EIA process in countries without relevant legislation is a standard procedure for other Multilateral Development Banks like the World Bank and European Bank for Reconstruction and Development (EBRD). WWF agrees with Bankwatch that it would be unacceptable for an EU institution to require lower standards than these other institutions.
- The Bank should establish minimum criteria for its participation. This should be in line with the fundamental EU environmental and social standard and practices and International Conventions adopted by EU and country of operation.
- The EIB refers to the Equator Principles as an accepted approach when dealing with countries outside the EU. The EIB is not listed as an institution on the Equator Principles website as a supporting institution. This leaves in doubt the commitment the Bank has towards the principles inside and outside Europe.
- The EIB statement is missing important social elements including policies in development aid, conflict resolution, human rights, poverty alleviation, and good governance standards.
- The EIB must establish clear criteria for renewable energy and energy efficient lending.
- The EIB should be more specific about how it intends to implement the recommendations of the Extractive Industries Review and the World Commission on Dams.

(WWF, 2008: 1-2)

The thrust of these points is that the EIB should be more specific and allow itself less 'room for manoeuvre'. Explicitly stating that it will uphold hard international guidelines, rather than 'take them into account', would be one way of addressing this. In addition there is clearly a lack of emphasis on certain important social issues that would require change in order for the principles to better address the three pillars of sustainable development.

Yet these issues may be precisely those in which the trade-off with returns is highest. For many environmentally focused investments it is either possible to make a positive business case, or the reputational risk (of being associated with negative impacts) is strong enough to have a commercial impact. It is generally much more difficult to make a positive business case with respect to social issues, and reputational risks may also be lower. As a result, the negative commercial effects of taking social factors into account (such as higher costs and lower competitiveness) are likely to remain dominant.

One of the comments on the OECD Declaration makes precisely the same point. While praising the OECD for the breadth of issues covered, OECD-Watch (2011) is critical that:

Weak wording such as 'where practicable', 'when appropriate' water down the meaning of many paragraphs. The renewed implementation procedure still relies largely on the will of governments … Finally, the fact that the Guidelines do not refer to specific paragraphs of other international instruments like ILO and environmental instruments diminishes their value.

(OECD Watch, 2011)

PRIVATE PENSION AND INSURANCE PRINCIPLES

As noted above, there is little evidence that SRI investors do better or worse than other forms of investor, and it is clear that the bulk of the sector does not expect to sacrifice returns for principles. When the strategy is one of 'engagement', this is inherent, as the investment portfolio would be identical to that of a non-SRI investor. Negatively or positively screened portfolios would affect the investable universe, but the evidence is that negative approaches still dominate. Rather than making a positive contribution to social and environmental outcomes, these approaches will preclude certain sectors, and even countries, in some instances.[28]

Negative approaches of this form could only influence the behaviour of firms unable to access competitively priced capital from other sources. There is no evidence that this is the case. From the other perspective, positive screening approaches would need to provide capital to firms on better terms and at lower costs. Again, there is no evidence that this has occurred. While such forms of investment could have a significant impact, they would need to represent a far larger proportion of the total market than is currently the case. Until that is so, their impact is likely to remain marginal.

The same holds for institutional investors such as pension and insurance funds. As noted above, such funds have a fiduciary responsibility to their members to maximise returns.[29] Consequently, while they are able to take social and environmental factors into account, this is only where this would not reduce financial returns. Thus the 'value-added' question is similar to that for PRI investors. If pension and insurance funds are able to invest only in areas that maximise their returns, and this is their mandate anyway, it is hard to see how significant behaviour change, and so additional impact, can occur.

NATIONAL REGULATORY/ACCOUNTING/STOCK-EXCHANGE PRINCIPLES

National principles of this form are often relatively stringent, but tend to focus on issues of (social and environmental) reporting and corporate governance. There is little evidence that firms (and so those that invest in them) benefit from higher share valuations because of better social and environmental performance.

More fundamentally, these principles apply to companies and investors operating within developed-country jurisdictions, not their activities in developing countries. For this, we need to look to guidelines such as the OECD Declaration described above. However, as we have seen, it is far from clear that this is delivering real social or environmental improvements, beyond those that would have occurred in any event.

DEDICATED NATIONAL SRI INDICES

Indices of this form – most notably the Dow Jones Sustainability Index and the FTSE4Good – have grown enormously in recent years. While their development impact is inherently limited, for the same reasons as discussed above, the more stringent requirements do hold out the prospect of a more significant general effect.

One of the few studies to have examined the impact of membership of such indices on behaviour is Collinson *et al*., (2009). The authors interviewed and surveyed members of the FTSE4Good Index and concluded that:

Respondents indicated that inclusion in the indices had a significant effect on their firms' reputation, and on relationships with specific stakeholder groups. All interviewees emphasised that peer group pressure encouraged top management to maintain their membership of the indices. Questionnaire respondents indicated an even balance of views regarding tightening the admission criteria for the indices. The influence of FTSE4Good on corporate conduct was found to be limited and mainly confined to reporting activity, though policy and management systems were amongst other areas where some impacts were noted.

(Collinson *et al*., 2009: 1)

The study suggests that the main reason to list on the Index is reputational, and that membership did not really have much impact on behaviour. There is an important trade-off here in terms of the stringency of admission criteria. The looser these are, the more firms will wish to join, which is important as it is only once membership of indices of this form reaches a critical mass, and so starts to influence the terms on which finance is made available, that real impact is likely to be seen. But it is only with more-stringent criteria that this impact would be likely to lead to significant and *additional* social or environmental benefits.

SECTORAL PRINCIPLES, SUCH AS EITI

Clearly, bringing transparency to the process of financial transfers between private companies and governments is essential and a valuable task in its own right. A danger, however, lies in assuming that this will be some form of panacea, or in expecting too much of what is, in fact, a very restricted mechanism:

The forces behind the EITI contest that impoverished institutions, the embezzlement of petroleum and/or mineral revenues, and a lack of transparency are the chief reasons why resource-rich sub-Saharan Africa is underperforming economically, and that implementation of the EITI, with its foundation of 'good governance,' will help address these problems. The position here, however, is that the task is by no means straightforward: that the EITI is not necessarily a blueprint for facilitating good governance in the region's resource-rich countries. It is concluded that the EITI is a policy mechanism that could prove to be effective with significant institutional change in host African countries but, on its own, it is incapable of reducing corruption and mobilizing citizens to hold government officials accountable for hoarding profits from extractive industry operations.

(Hilson and Maconachie, 2009: 52)

As we have seen, there are numerous sets of principles and standards promulgated by industry bodies. It is not possible to examine the impact that these have had within the scope of this review – they do not directly relate to investment and there have been no relevant evaluations of which we are aware. However, industry best practice will – by definition – not be designed to negatively affect the bottom-line, so there is no possibility that social and environmentally positive impact will be achieved at the expense of returns.

A common theme has emerged in this review of impact: the trade-off between (some) social and environmental outcomes and (some) economic and financial imperatives. Where this is not the case, and these two sets of outcomes are well aligned, there should be no conflict, as investors and private companies do not need to be coerced into behaving in their own commercial interests.

Yet too often those promulgating and promoting sets of investment principles suggest that this alignment is always the case, and that responsible investment is also profitable. Clearly, this is not so: there are many examples where these two sets of goals will be in conflict with each other. Where there is vagueness in how principles are drawn up, where they are voluntary, and where monitoring and evaluation of adherence and impact is limited or non-existent, the economic/financial will take precedence over social or environmental considerations. In a commercially competitive environment, it could not be otherwise.

CONCLUSIONS AND RECOMMENDATIONS

Financial criteria still dominate investment decisions. This review demonstrates that investment decisions are still governed primarily by financial criteria – even where investment principles are employed that emphasise other criteria such as social and environmental. Often such principles are implemented 'where feasible' or 'where possible', which tends to mean where ESG criteria do not compromise financial returns and the ability of investors to meet their fiduciary responsibilities. The vague nature of some of the principles, such as the UN PRI's 'incorporate ESG issues into investment analysis and decision-making processes' also gives little clarity on how signatories should act: in this case, should investors screen out investment opportunities (either positively or negatively) or engage with those who are underperforming on ESG issues to help them improve? In many cases, the details are just not offered.

Investment principles tend to have a stronger focus on social issues than environmental issues – although this is not always the case. The OECD guidelines are very 'light' on environmental considerations, for example, but the PRI offers a more comprehensive approach, with a recommendation to integrate metrics of environmental impact into decision-making. The Equator Principles take this a step further, requiring detailed environmental impact assessments and mitigation plans before a project proceeds.

Some investment principles are better suited to certain types of investments. For example the Equator Principles focus on project finance and emphasise local community consultation and participation, whereas the PRI involve 'arm's-length' portfolio investors and place far less emphasis on local community consultation and participation. For some fund types, it is nearly impossible to apply any existing investment principles at all – such as pooled and passive funds.

There is no clear connection between commercial returns and the implementation of investment principles. For example, there is no connection between high labour standards and good rates of pay and profitability – and in some cases there may be an inverse relationship. Often, therefore, investment principles are perceived as being designed to restrain investors (whether institutional, banks or MNCs) from acting in ways that may be in their commercial interest, at least in the near term. If the longer-term benefits of accounting for non-commercial considerations in investment decisions remain unproven, the use of investment principles may remain fairly limited.

Some investors take decisions that have positive sustainable development implications, but it is not clear that they do so because of adherence to sets of investment principles. Rather, investors of this type are likely to see a business case for investing in this way (e.g. the long-term growth of the green-technology sector) and are therefore able to subscribe to principles: the principles do not alter the way they invest, but may provide some reputational benefit. Others may have less interest in investments of this form, but still wish to obtain the reputational benefits. Here, there may be some willingness to refrain from overtly negative investments, but only to the extent that the impact on returns is minimal.

In essence, investment principles appear to make the best of things within commercial constraints rather than altering the underlying basis of decision-making. Profitable investments with a positive sustainable development component will continue to occur and even increase, but they may do so regardless of the existence of investment principles designed to encourage them. The appeal of investments with neutral positive sustainable development implications is likely to be unaffected, while those with negative impacts will be less appealing, depending on the level of potential return. Understanding how to alter the underlying basis of decision-making is beyond the scope of this paper, but requires attention.

It is clear that the investment principles themselves can be improved in the short term. The language employed by the standards could be tightened so that they are less vague. Greater internal incentives are needed to encourage implementation of the principles within organisations, and capacity building is required – such as adequate training of staff. Disclosure and transparency regarding the implementation of principles could in many cases be improved, which would allow for greater accountability and better feedback for design and implementation of the principles.

The ambitious Collevecchio Declaration offers an inspiring example of what a set of investment principles could look like. It is interesting to contrast the principles reviewed in this paper with those contained in the Collevecchio Declaration[30] on the behaviour of financial institutions, proposed by a consortium of NGOs and civil society groups:

Financial institutions (FIs) such as banks and asset managers can and must play a positive role in advancing environmental and social sustainability. This declaration calls on FIs to embrace six main principles which reflect civil society's expectations of the role and responsibilities of the financial services sector in fostering sustainability. The following civil society organizations call on FIs to embrace the following principles, and take immediate steps to implement them as a way for FIs to retain their social license to operate.

(BankTrack, 2003: 1)

Financial institutions can and must play a positive role in advancing sustainable development

The Collevecchio Declaration's six principles for financial institutions (FIs) are as follows:

1 **Commitment to Sustainability.** FIs must expand their missions from ones that prioritise profit maximisation to a vision of social and environmental sustainability. A commitment to sustainability would require FIs to fully integrate the consideration of ecological limits, social equity and economic justice into corporate strategies and core business areas (including credit, investing, underwriting, advising), to put sustainability objectives on an equal footing to shareholder maximisation and client satisfaction, and to actively strive to finance transactions that promote sustainability.

2 **Commitment to 'Do No Harm'.** FIs should commit to do no harm by preventing and minimising the environmentally and/or socially detrimental impacts of their portfolios and their operations. FIs should create policies, procedures and standards based on the Precautionary Principle to minimise environmental and social harm, improve social and environmental conditions where they and their clients operate, and avoid involvement in transactions that undermine sustainability.

3 **Commitment to Responsibility.** FIs should bear full responsibility for the environmental and social impacts of their transactions. FIs must also pay their full and fair share of the risks they accept and create. This includes financial risks, as well as social and environmental costs that are borne by communities.

4 **Commitment to Accountability.** FIs must be accountable to their stakeholders, particularly those that are affected by the activities and side effects of companies they finance. Accountability means that stakeholders must have an influential voice in financial decisions that affect the quality of their environments and their lives – both through ensuring that stakeholders' rights are protected by law, and through practices and procedures voluntarily adopted by the FI.

5 **Commitment to Transparency.** FIs must be transparent to stakeholders, not only through robust, regular and standardised disclosure, but also through being responsive to stakeholder needs for specialised information on FIs' policies, procedures and transactions. Commercial confidentiality should not be used as an excuse to deny stakeholders information.

6 **Commitment to Sustainable Markets and Governance.** FIs should ensure that markets are more capable of fostering sustainability by actively supporting public policy, regulatory and/or market mechanisms which facilitate sustainability and that foster the full cost accounting for social and environmental externalities.

The fundamental difference here is that social and environmental considerations are given equal weight with the commercial. This mirrors recent understanding of sustainable development as an intimate, indivisible interweaving of social, environmental and economic objectives, rather than a trading-off of three 'pillars' that represent separate silos. All business activity needs to offer social, environmental and economic outcomes. Clearly, there is no chance of commercial institutions voluntarily adopting such an approach in the near future, as it would adversely affect their commercial interests. If all institutions adhered to these principles, however, the playing field would be level, and relative commercial interests would no longer be an issue.

Finally, there is a need for better monitoring and measurement of the impact of investment principles. Until we have a far greater understanding of what does produce positive social and environmental impacts in practice, it is of limited utility to attempt to improve existing investment principles. The lack of impact data also contributes to the argument against taking a mandatory approach – it is only justifiable to insist on something if we are confident that it works better than the alternative. An approach such as that set out in the Collevecchio Declaration, where social and environmental goals are afforded equal weight with commercial considerations, seems an obvious step in the right direction – but creating the appropriate regulatory frameworks to incentivise this transition is likely to be difficult. But recent governmental and business moves to explore 'green economy' policies and incentives at micro and macro level may be promising in opening the space for improving such frameworks

An essential first step, therefore, is for the huge range of initiatives to start the monitoring process properly, using objective, rigorous methods that allow us to analyse impact. Crucially, these also need to be comparable, so that we can assess which principles have the largest positive impact. It may even be that none of them are having much of an impact at all, not least because of the dominance of commercial considerations described above – but improved understanding of this is undoubtedly required. The ISEAL Alliance's[31] impacts code (ISEAL Alliance, 2011) could provide a useful framework for assessing impact (Box C.1) – but the bodies responsible for creating and implementing the principles will need to commit to using the Code.

There is a need for better monitoring and measurement of the impact of investment principles

BOX C.1: THE ISEAL IMPACTS CODE

According to the ISEAL Alliance (the global association for social and environmental standards):

The ISEAL Impacts Code provides a framework for standards systems to better understand the social and environmental results of their work, as well as the effectiveness of their various activities and programs. It suggests an approach to monitoring and evaluation whereby you set targets and review those targets in the light of your experience. The Impacts Code will apply primarily to social and environmental standard-setting organisations, though many of the requirements are applicable to other organisations that support social and environmental change.

(ISEAL Alliance, 2011)

Under the Impacts Code, which informs rather than strictly determines activities, organisations should undertake the following activities to assess their impact:

- choose from among a core list the social and environmental issues where the standards systems intends to have an impact
- define the intended impact that the system is seeking to achieve for each issue
- for each issue, define the desired behaviour change that is most likely to get to the intended impact (these are outcomes or areas of influence)
- define the strategies (areas of direct control – activities and outputs) that are being implemented to get to the outcomes
- choose indicators to measure whether the changes in behaviour or practices come about and whether these practices lead to the desired impacts
- gather data about changes in behaviour and practice through the audit process, including data about other issues prioritised by stakeholders and on unintended results
- conduct or contract out evaluations of impact to draw causal links between outcomes and impacts
- analyse data to determine contribution to impact and to learn the extent to which strategies are leading to desired outcomes and impacts
- put in place feedback loops to refine the content of the standard, the strategies for supporting uptake of the standard, and the theory for how change comes about (ISEAL Alliance, 2010).

If all promulgating bodies implemented this common approach, we would begin to build a real evidence base on how investment principles influence sustainable development outcomes. This is a basic precondition for adapting these principles to increase the positive impact that investment can have on people's lives in developing countries, and on the environments in which they live.

Shaping Sustainable Markets aims to monitor the use, implementation and impact of investment principles. In particular, we will keep track of whether and how the monitoring and evaluation of impact of these principles improves. Understanding the key barriers to the use and implementation of investment principles will be an important next step. This may shed light on how to create the appropriate conditions to incentivise investment that supports, rather than undermines, sustainable development.

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NOTES

[1] A market governance mechanism is a set of formal or informal rules designed to change behaviour (of individuals, businesses, organisations or governments) in order to improve the sustainable development outcomes of markets (see SSM, 2011 http://shapingsustainablemarkets.iied.org/about).

[2] There are many definitions of sustainable development, but one commonly cited is that of the Brundtland Commission: 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs' (WCED, 1987).There is general agreement that sustainable development consists of three 'interdependent and mutually enforcing' pillars – the economy, the environment and society. IIED typically uses a 'strong' version of sustainable development (one that weights the pillars equally) to emphasise poverty reduction (both inter- and intra-generational) and the responsible stewardship of natural resources.

[3] See Booz and Company (2009), for example.

[4] The main strategies used for SRI are:

- negative screening, where certain sectors, such as arms or tobacco, are excluded
- positive screening, where certain sectors, such as clean technologies, are focused upon
- engagement, where the entire 'universe' of potential stocks is included, but asset managers 'engage' with the companies whose shares they hold to persuade them to improve their performance
- integration, where environmental, social and governance (ESG) factors are incorporated fully into investment decision-making.
- The three main regions (Europe, US and Asia) take quite different approaches to SRI: in Europe, 'engagement' dominates, with three-quarters of the market; in the US, negative screening is most popular, with 77 per cent of all US SRI funds; in Asia, however, positive screening is used in 90 per cent of cases.

[5] The specific Guidelines for Responsible Investment adopted by the US Private Equity Council are to:

- consider environmental, public health, safety, and social issues associated with target companies when evaluating whether to invest in a particular company or entity, as well as during the period of ownership
- seek to be accessible to, and engage with, relevant stakeholders either directly or through representatives of portfolio companies, as appropriate
- seek to grow and improve the companies in which they invest for long-term sustainability and to benefit multiple stakeholders, including on environmental, social and governance issues
- seek to use governance structures that provide appropriate levels of oversight in the areas of audit, risk management and potential conflicts of interest and to implement compensation and other policies that align the interests of owners and management
- remain committed to compliance with applicable national, state, and local labour laws in the countries in which they invest; support the payment of competitive wages and benefits to employees; provide a safe and healthy workplace in conformance with national and local law; and, consistent with applicable law, respect the rights of employees to decide whether or not to join a union and engage in collective bargaining
- maintain strict policies that prohibit bribery and other improper payments to public officials consistent with the US Foreign Corrupt Practices Act, similar laws in other countries, and the OECD Anti-Bribery Convention
- respect the human rights of those affected by their investment activities and seek to confirm that their investments do not flow to companies that utilise child or forced labour or maintain discriminatory policies
- provide timely information to their limited partners on the matters addressed herein, and work to foster transparency about their activities
- encourage their portfolio companies to advance these same principles in a way consistent with their fiduciary duties.

[6] This refers to funds other than those managed by hedge funds, private equity and sovereign wealth funds. It was estimated that assets worth around US$8 trillion were managed by these entities in 2008 (IFSL, 2009).

[7] IFC is a member of the World Bank Group. It finances and provides advice for private sector ventures and projects in developing countries.

[8] The original groups were Citigroup, ABN AMRO, Barclays and WestLB.

[9] Projects are categorised in accordance with the environmental and social screening criteria of the International Finance Corporation:

- Category A: projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented.

- Category B: projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.
- Category C: projects with minimal or no social or environmental impacts.

(Equator Principles, 2006)

[10] Consultation should be 'free' (free of external manipulation, interference or coercion, and intimidation), 'prior' (with timely disclosure of information) and 'informed' (with relevant, understandable and accessible information), and apply to the entire project process and not to the early stages of the project alone (Equator Principles, 2006: 3). Free Prior and Informed Consultation (FPIC) is arguably a weaker form of the original principle, 'Free Prior and Informed Consent' that forms part of the International Labour Organization's Convention on Indigenous and Tribal Peoples.

[11] Equator Principles borrowers commit (that is, make a 'covenant') to certain actions. If the borrower does not comply, it is in breach of this covenant, and the bank can take corrective action, up to and including the cancellation of the loan and demand for immediate repayment (Equator Principles, 2006).

[12] The 1976 Declaration is a policy commitment by the governments of OECD countries on International Investment and Multinational Enterprises. The Declaration has four elements (OECD, 2008):

1. *The Guidelines for Multinational Enterprises* are recommendations on responsible business conduct addressed by governments to multinational enterprises operating in or from adhering countries
2. *National treatment* – a voluntary undertaking by adhering countries to accord to foreign-controlled enterprises on their territories treatment no less favourable than that accorded in like situations to domestic enterprises
3. *Conflicting requirements* – adhering countries shall cooperate so as to avoid or minimise the imposition of conflicting requirements on multinational enterprises
4. *International investment incentives and disincentives* – adhering countries recognise the need to give due weight to the interest of adhering countries affected by laws and practices in this field; they will endeavour to make measures as transparent as possible.

[13] The adhering countries are the 31 OECD member countries plus 11 non-member countries: Argentina, Brazil, Chile, Egypt, Estonia, Israel, Latvia, Lithuania, Morocco, Peru, Romania and Slovenia.

[14] See Mercer (2010), for example.

[15] See Azemar and Delios (2007) for a study of the impact of tax competition on the FDI from Japan, for example.

[16] For example, there are numerous principles of best practice that have been promulgated by organisations of private companies (e.g. the Ten Principles of the International Council on Mining and Metals (ICMM), or GlobalGap in agriculture), or companies and NGOs (e.g. the Roundtable on Sustainable Palm Oil (RSPO)), or NGOs alone (e.g. the Forestry Stewardship Council or Marine Stewardship Council). While these obviously do relate to investment at one level, they are not covered here for reasons of brevity and focus.

[17] ILO Convention 87 on Freedom of Association and Protection of the Right to Organize; ILO Convention 98 on the Right to Organize and Collective Bargaining; ILO Convention 29 on Forced Labour; ILO Convention 105 on the Abolition of Forced Labour; ILO Convention 138 on Minimum Age (of Employment); ILO Convention 182 on the Worst Forms of Child Labour; ILO Convention 100 on Equal Remuneration; ILO Convention 111 on Discrimination (Employment and Occupation); United Nations Convention on the Rights of the Child, Article 32.1.

[18] '*Responsible Property Investment (RPI) is an approach to property investing that recognizes environmental and social considerations along with more conventional financial objectives. It goes beyond minimum legal requirements, to improving the environmental or social performance of property, through strategies such as urban revitalization, or the conservation of natural resources. The key to managing and monitoring progress on these issues is the implementation of systems for measuring and benchmarking building and portfolio performance. RPI should be implemented from the property planning, design, and development stages and continually practiced throughout the property lifecycle, through the following examples: Developing or acquiring properties designed with environmentally and socially positive attributes (e.g. low-income housing or green buildings); Refurbishing properties to*

improve their environmental and social performance (e.g., energy efficiency, on site power generation, disability upgrades, natural light exploitation or other environmentally and socially responsible improvements); Managing properties in environmentally and socially beneficial ways (e.g., Green Leases, resource use and waste & recycling Benchmarking Practices to improve performance, fair labour practices for service workers or simply using environmentally friendly cleaning methods and products); Demolishing properties in a conscientious manner (e.g., reusing recovered materials on-site for new development)' (UNEP Finance Initiative, 2011a).

[19] For example: *The Natural Value Initiative*: '*A toolkit enabling investors to evaluate biodiversity impacts and ecosystem services dependency within the food, beverage and tobacco (FBT) sectors. UNEP Finance Initiative, international environmental NGO Fauna & Flora International, and the Brazilian business school FGV collaborated on this initiative which aims to raise awareness of the links between biodiversity, investment value and the finance sector*' (UNEP Finance Initiative, 2011b: www.unepfi.org/publications/biodiversity/). Footprint Disclosure project: '*a UK government-supported initiative, created to help investors identify how an organisation's activities and supply chains contribute to tropical deforestation, and link this "forest footprint" to their value*' (FDP, 2010: http://www.unepfi.org/work_streams/biodiversity/projects/index.html#ffd)

[20]

1. Regular publication of all material oil, gas and mining payments by companies to governments ('payments') and all material revenues received by governments from oil, gas and mining companies ('revenues') to a wide audience in a publicly accessible, comprehensive and comprehensible manner.
2. Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.
3. Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified.
4. This approach is extended to all companies including state-owned enterprises.
5. Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.
6. A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints (EITI, 2011b).

[21] Azerbaijan, Mongolia, Ghana, Timor-Leste and Liberia.

[22] Afghanistan, Madagascar, Albania, Mali, Burkina Faso, Mauritania, Cameroon, Mozambique, Central African Republic, Niger, Chad, Nigeria, Côte d'Ivoire, Norway, Democratic Republic of Congo, Peru, Gabon, Republic of the Congo, Guinea (suspended), Sierra Leone, Indonesia, Tanzania, Iraq, Togo, Kazakhstan, Yemen, Kyrgyz Republic and Zambia.

[23] Standard Chartered Bank is a good example of this. See: http://www.standardchartered.com/_documents/sustainable-lending-and-the-equator-principles/sc_sustainableLending.pdf.

[24] For more information, see: http://www.bicusa.org/en/Article.11915.aspx.

[25] '*Each year all asset owner and investment manager signatories receive an emailed invitation to participate in an annual online survey that asks for details on how they are putting the six Principles into practice. The responses to this survey are brought together to produce this "Report on Progress". The survey is self-reported and no independent third party has provided an assurance or audit of the responses. The PRI Secretariat however does perform an annual verification across one-third of participants. This involves a one-hour call that, among other objectives, has the purpose of identifying inconsistencies'* (UN PRI, 2009: Appendix 1).

[26] '*The Reporting and Assessment process was designed to recognise the diversity of PRI signatories in terms of asset allocation, the mix between internal and external investment management, and passive and active management approaches. Where signatories were asked to choose from possible answers (large extent, medium extent, small extent), guidance was provided regarding the interpretation of those responses. Nevertheless,*

with such diversity of practice and experience, it is inevitable that differences in interpretation of questions and answers remain in the data' (UN PRI, 2009: Appendix 1).

[27] See Lee *et al.*, (2010) or Kempf and Osthoff (2007), for example.

[28] See Soederberg (2007) for an analysis of CALPERS investment policies in this area.

[29] See the UNEP Finance Initiative (2009) for a recent review of the issue of fiduciary responsibility.

[30] The Declaration was released in 2003, and was endorsed by more than 100 NGOs and civil society groups.

[31] '*The ISEAL Alliance is the global association for social and environmental standards. Working with established and emerging voluntary standard systems ISEAL develops guidance and helps strengthen the effectiveness and impact of these standards*' http://www.isealalliance.org/.

APPENDIX 1: THE UN PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

1 We will incorporate ESG issues into investment analysis and decision-making processes.

Possible actions:

- Address ESG issues in investment policy statements.
- Support development of ESG-related tools, metrics and analyses.
- Assess the capabilities of internal investment managers to incorporate ESG issues.
- Assess the capabilities of external investment managers to incorporate ESG issues.
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms or rating companies) to integrate ESG factors into evolving research and analysis.
- Encourage academic and other research on this theme.
- Advocate ESG training for investment professionals.

2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles.
- Exercise voting rights or monitor compliance with voting policy (if outsourced).
- Develop an engagement capability (either directly or through outsourcing).
- Participate in the development of policy, regulation and standard setting (such as promoting and protecting shareholder rights).
- File shareholder resolutions consistent with long-term ESG considerations.
- Engage with companies on ESG issues.
- Participate in collaborative engagement initiatives.
- Ask investment managers to undertake and report on ESG-related engagement.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative).
- Ask for ESG issues to be integrated within annual financial reports.
- Ask for information from companies regarding adoption of/ adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact).
- Support shareholder initiatives and resolutions promoting ESG disclosure.

4 We will promote acceptance and implementation of the Principles within the investment industry.

Possible actions:

- Include Principles-related requirements in requests for proposals (RFPs).
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate).
- Communicate ESG expectations to investment service providers.
- Revisit relationships with service providers that fail to meet ESG expectations.
- Support the development of tools for benchmarking ESG integration.
- Support regulatory or policy developments that enable implementation of the Principles.

5 We will work together to enhance our effectiveness in implementing the Principles.

Possible actions:

- Support/ participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning.
- Collectively address relevant emerging issues.
- Develop or support appropriate collaborative initiatives.

6 We will each report on our activities and progress towards implementing the Principles.

Possible actions:

- Disclose how ESG issues are integrated within investment practices.
- Disclose active ownership activities (voting, engagement and/or policy dialogue).
- Disclose what is required from service providers in relation to the Principles.
- Communicate with beneficiaries about ESG issues and the Principles.
- Report on progress and/or achievements relating to the Principles using a 'Comply or Explain' approach.
- Seek to determine the impact of the Principles.
- Make use of reporting to raise awareness among a broader group of stakeholders.

APPENDIX 2: INTERNATIONAL AND NATIONAL REGULATORY AND ACCOUNTING AGENCIES PROMOTING ESG

International

International Accounting Standards Board's Work Plan (e.g. emissions trading)
www.iasb.org

16 global accounting organizations sign sustainability principles of the Prince's Accounting for Sustainability Project (July 2009)
www.accountingforsustainability.org

National

US SEC releases ESG review of Fortune 500 corporate reporting (undated – circa 2003)
www.sec.gov/divisions/corpfin/fortune500rep.htm

US SEC adopts rule requiring all US exchanges to revise their listing standards – to comply with auditing standards in Sarbanes-Oxley Act of 2002 (April 2003)
www.sec.gov/rules/final/33-8220.htm

US GAO report Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information (July 2004)
www.gao.gov/docdblite/summary.php?rptno=GAO-04-808&accno=A10929

Institute of Chartered Accountants in England and Wales, with financial support from the UK Environment Agency, releases guide Environmental Issues and Annual Financial Reporting (September 2009)
www.icaew.com/index.cfm/route/168043/icaew_ga/Technical_and_Business_Topics/Topics/Corporate_responsibility

UK Companies Act expands directors' duties and environmental reporting (2006)
www.opsi.gov.uk/acts/acts2006/20060046.htm
www.trucost.com/pressreleases/CompaniesAct.html

UK Accounts Modernisation Directive requires environmental reporting (2006)
www.defra.gov.uk/ENVIRONMENT/business/envrp/index.htm
www.frc.org.uk

UK Financial Services Authority's international activities
www.fsa.gov.uk/Pages/About/What/International/index.shtml

Chartered Accountants of Canada supports ESG corporate reporting (February 2007)
www.cica.ca/index.cfm/ci_id/36164/la_id/1

Japanese Institute of Certified Public Accountants report Disclosure in Japan of Investor-Oriented Information Concerning Climate-Change Risk: Current Circumstances and Issues (16 May 2007)
www.hp.jicpa.or.jp/english/images/0-3-33-2-20070516.pdf

China Securities Regulatory Commission releases Administrative Measures for the Disclosure of Information of Listed Companies (January 2007)
http://policy.mofcom.gov.cn/section/news!fetch.html?id=CXW0002316
www.lawinfochina.com/Law/display.asp?id=5926&keyword

China's Assets Supervision and Administration Commission releases CSR guidelines for state-owned enterprises (Spring 2008)
www.csr-asia.com/index.php?p=11096

Philippines Board of Investment requires CSR corporate reporting under 2007 Investment Priorities Plan (August 2007)
www.boi.gov.ph

Indonesia adopts Article 74 to require social and environmental responsibility programmes for companies related to natural resources (July 2007)
www.ibl.or.id/en/ibl/html/gateway.php?sid=news&mode=read&id=77

US SEC approves rule to accept International Financial Reporting Standards without reconciliation with GAAP (15 November 2007)
www.sec.gov/spotlight/ifrsroadmap.htm
www.sec.gov/about/offices/oia/oia_multilateral.htm

US SEC allows shareholders to file petition with Fidelity Mutual Fund regarding human rights and genocide (January 2008)
http://investorsagainstgenocide.googlepages.com/sec
www.sec.gov/divisions/investment/noaction/2008/fidelityfunds012208-14a.htm

China Securities Regulatory Commission releases document requiring environmental assessment with new public securities listings (February 2008)
www.csrc.gov.cn

US SEC announces roadmap toward adoption of International Financial Reporting Standards (27 August 2008)
www.sec.gov/news/press/2008/2008-184.htm

Taiwan Financial Supervisory Commission announces plans to require disclosure of CSR/ESG information for listed companies (December 2008)
www.fscey.gov.tw

US SEC releases report Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System (January 2009)
www.sec.gov/spotlight/disclosureinitiative.shtml

Qatar Financial Markets Authority releases Corporate Governance Guide for Listed Companies on the Doha Securities Markets (February 2009)
www.qfma.org.qa/en/index.html

US SEC creates Investor Advisory Committee to look at disclosure, related matters (June 2009)
www.sec.gov/spotlight/investoradvisorycommittee.shtml
www.sec.gov/news/press/2009/2009-197.htm

Bursa Malaysia, Securities Commission Malaysia and the Minority Shareholder Watchdog Group launch the Corporate Governance Index (June 2009)
www.mswg.org.my

UK Financial Services Authority explains its policy for investor advocacy networks (August 2009)
www.fsa.gov.uk/pages/Library/Communication/PR/2009/110.shtml

US SEC establishes new Division of Risk, Strategy and Financial Innovation (September 2009)
www.sec.gov/news/press/2009/2009-199.htm

US EPA provides website for the EPA Financial Markets Workgroup (October 2009)
www.epa.gov/opei/ocmp/financial/workgroup.html

US SEC provides for shareholder resolutions on social and environmental matters (October 2009)
www.sec.gov/interps/legal/cfslb14e.htm

APPENDIX 3: NATIONAL STOCK EXCHANGES PROMOTING ESG STANDARDS

Brazil's Bovespa
www.bovespa.com.br/indexi.asp

NYSE Corporate Accountability and Listing Standards (June 2002)
www.iasplus.com/resource/nysegovf.pdf

NASDAQ OMX Wholeheartedly Proud Policy (first approved by OMX Board in 2002)
http://ir.nasdaqomx.com/documentdisplay.cfm?DocumentID=3898

London Stock Exchange, UK Corporate Governance Code – the 'Combined Code' (2010)
www.frc.org.uk/documents/pagemanager/Corporate_Governance/UK%20Corp%20Gov%20Code%20June%202010.pdf

South Africa's Johannesburg Exchange (since 2004)
www.jse.co.za/sri

Tokyo Stock Exchange releases Charter of Corporate Behaviour (2004)
www.tse.or.jp/english/about/charter/index.html

Malaysia's Bursa Malaysia: CSR Framework for Malaysian PLCs (since 2006)
www.klse.com.my

Israel's Tel Aviv Stock Exchange with the Maala SRI Index (since 2006)
www.tase.co.il/tase

Shenzhen Stock Exchange releases Social Responsibility Instructions for Listed Companies (September 2006)
www.szse.cn/main/en/rulseandregulations/sserules

Shanghai Stock Exchange releases Report on Corporate Governance (November 2007)
www.sse.com.cn/sseportal/en_us/ps/home.shtml

Australian Securities Exchange Corporate Governance Council Guidelines (August 2007)
www.asx.com.au/about/corporate_governance/index.htm

Shanghai Stock Exchange releases Guidelines on Environmental Information Disclosure by Listed Companies (May 2008)
http://static.sse.com.cn/en_us/cs/about/news/en_news_20080514a.html

Hong Kong Exchange signs Corporate Responsibility Charter and Carbon Reduction Charter (December 2008)
www.hkex.com.hk/news/hkexnews/0812193news.htm

Stock Exchange of Thailand establishes Corporate Social Responsibility Fund to encourage listed companies to promote CSR activities (December 2008)
www.set.or.th/en/index.html

Australian Securities Exchange monitors corporate compliance with mining code (May 2009)
www.mondovisione.com/pdf/mr_140509_jorc_code_review.pdf

APPENDIX 4: DEDICATED ESG-FOCUSED INDICES

New York Mercantile Exchange (for commodities) launches Green Exchange in Spring 2008
www.greenfutures.com

China launches the Taida Environmental Index of 40 listed companies (January 2008)
www.csr-asia.com/index.php?p=11106

Dow Jones Sustainability Index
www.sustainability-index.com

FTSE4Good Index
www.ftse.com/Indices/FTSE4Good_Index_Series/index.jsp

National Stock Exchange of India collaboration with S&P, CRISIL on S&P ESG Index (2007)
www.nseindia.com

Hanover Stock Exchange (Borse Hannover) launches Global Challenges Index with oekom research ratings firm (September 2007)
www.gcindex.com/en

Vienna Stock Exchange launches Responsible Investment Universe Index (January 2009)
http://en.indices.cc/indices/themestyle/profiles/ceerius.html

Tokyo Stock Exchange to launch Environmental Stock Index in 2009 (announced mid-2008)
www.meti.go.jp/english/index.html

Korea Exchange launches Socially Responsible Investment Index (announced March 2009)
http://eng.krx.co.kr

Indonesia Stock Exchange launches the SRI-KEHATI Index (June 2009)
www.idx.co.id/NewsAnnouncements/EventsPressRelease/tabid/124/articleType/ArticleView/articleId/481/The-Launching-of-SRIKEHATI-Index.aspx

NASDAQ OMX and CRD Analytics launch Global Sustainability 50 Index (June 2009)
https://indexes.nasdaqomx.com

Warsaw Stock Exchange launches Respect Index (June 2009)
www.respectindex.pl

Shanghai Stock Exchange launches Social Responsibility Index (5 August 2009)
www.sse.com.cn/sseportal/en_us/ps/home.shtml#

Environmental Sustainability Index (not for investment in itself, but scores and ranks countries in terms of environmental sustainability)
www.yale.edu/esi

APPENDIX 5: INVESTMENT MANAGEMENT GROUPS PROMOTING ESG

Ceres, the Environmental Defense Fund, States and investors file petition with the US SEC to require corporate reporting on climate risk (September 2007)
www.ceres.org/Page.aspx?pid=445

The Society of Investment Professionals in Germany releases KPIs for ESG: Key Performance Indicators for Environmental, Social and Governance Issues (March 2008)
www.dvfa.de/die_dvfa/kommissionen/non_financials/dok/35683.php

CFA Institute (Institute of Chartered Financial Analysts) releases Environmental, Social and Governance Factors at Listed Companies: A Manual for Investors (May 2008)
www.cfapubs.org/toc/ccb/2008/2008/2

Aspen Principles report Long-Term Value Creation: Guiding Principles for Corporations and Investors chaired by the Aspen Institute (June 2007)
www.aspenbsp.org

Goldman Sachs adopts policies promoting ESG performance
www2.goldmansachs.com/our_firm/our_culture/corporate_citizenship/index.html

Trucost releases report on UK corporate reporting (November 2007)
www.trucost.com/pressreleases/EA-disclosures.html

Innovest annual ranking of corporate performance (since 2005)
www.global100.org

SAM Group and Pricewaterhouse Coopers launch The Sustainability Yearbook 2008 (January 2008)
www.sam-group.com/yearbook

Leading banks Citi, JP Morgan Chase and Morgan Stanley adopt The Carbon Principles (February 2008)
www.citigroup.com/citigroup/press/2008/080204a.htm

Network for Sustainable Financial Markets provides comments and recommendations on OECD Guidelines for Pension Fund Governance, including fiduciary duty (October 2008)
www.sustainablefinancialmarkets.net/wp-content/uploads/2008/10/oecd-guidelines.pdf

Ceres and 14 institutional investors ask the US SEC to require improved corporate climate risk disclosure and address a broader range of environmental, social and governance risks in disclosure requirements (October 2008)
www.csrwire.com/News/13537.html

Aviva Investors CEO Alain Dromer calls for all stock market listing authorities to require ESG disclosure (November 2008)
www.responsible-investor.com/home/article/aviva
www.aviva.com/index.asp?PageID=44&category=csr&year=Latest&newsid=4556

Norwegian institutional investors create Sustainable Value Creation collaboration and release report on ESG performance of companies on Oslo Stock Exchange (November 2008)
www.baerekraftigverdiskaping.no/english

International Corporate Governance Network releases ICGN Statement and Guidance on Non-financial Business Reporting (December 2008)
www.icgn.org

Three Nordic pension funds from Sweden, Finland and Norway create Nordic Engagement Cooperation Initiative to promote ESG policies with 4500 companies (December 2008)
www.ges-invest.com/pages/?ID=117

Domini Social Investments releases report on stock exchanges and regulatory bodies: Innovations in Social and Environmental Disclosure Outside the United States (December 2008)
www.domini.com/about-domini/News/index.htm

Interfaith Center on Corporate Responsibility and Trucost launch website with online database on 150 companies to receive shareholder resolutions on climate and other matters (February 2009)
www.iccr.org/shareholder/trucost/index.php

Association for Sustainable and Responsible Investment in Asia has published several reports on corporate disclosure in China:

- ESG – Reality Sets In: Trends in ESG Disclosure of Supply Chain Listings in Hong Kong (January 2008)
- The Devil is in the Detail: Natural Resources Disclosure in China (March 2007)
- A Cat and Mouse Game for Investors: Assessing ESG Disclosure of Supply Chain Listings in Hong Kong (August 2006)

www.asria.org/publications

F&C Management Ltd releases Responsible Investment Report 2008 and explains its initiative with the London Stock Exchange and the FSA to distinguish between UK domiciled companies (meeting LSE listing standards) and foreign companies (March 2009)
www.fandc.com//new/aboutus/?id=82810&PageId=&source=fnetsearch&locale=UK

Pax World Funds and KLD Analytics release first gender index (March 2009)
http://paxworld.com/newsmedia/2009/03/08/pax-world-kld-construct-first-gender-index-seriesfor-international-finance-corporation

Vanguard Group (mutual fund with $1 trillion under management) adopts new social investing policy, including human rights policy, in papers filed with US SEC (March 2009)
http://investorsagainstgenocide.net/vanguard

Eurosif calls for mandatory corporate ESG disclosure, other initiatives by European Union Directorates (press release, 16 April 2009)
www.eurosif.org/press_events/eurosif_press_releases

Global Alliance for Banking on Values is launched by 11 banks (March 2009)
www.triodos.com/com/whats_new/latest_news/press_releases/global_alliance_launched

South African PRI Network is launched by UN PRI signatories in South Africa (May 2009)
www.unpri.org/files/SA_network_final.pdf

Institutional Shareholders' Committee (UK) releases report Improving Institutional Investors' Role in Governance (June 2009)
http://institutionalshareholderscommittee.org.uk/sitebuildercontent/sitebuilderfiles/iscpressrelease050609.pdf

Investor Network on Climate Risk and other investors send letter to US SEC requesting corporate disclosure of climate risk and ESG matters (June 2009)
www.ceres.org//Page.aspx?pid=1106&srctid=1&erid=157014

ShareOwners.org is launched (June 2009)
www.shareowners.org

Social Investment Forum (US) sends letter to US SEC calling for greater ESG disclosure and participation in Global Reporting Initiative (July 2009)
www.socialinvest.org/news/releases/pressrelease.cfm?id=143

Australian Council of Super Investors releases A Guide for Superannuation Trustees on the Consideration of Environmental, Social & Corporate Governance Risks in Listed Companies (October 2009)
www.acsi.org.au/environmental-social-governance-guidelines.html

International Corporate Governance Network releases ICGN Corporate Governance Principles: 2009 (November 2009)
www.icgn.org

Ceres, the Environmental Defence Fund, and investors file supplemental petition with the US SEC to require corporate reporting on climate risk (November 2009)
www.ceres.org/Page.aspx?pid=1151

Network for Sustainable Financial Markets releases first annual report (December 2009)
www.sustainablefinancialmarkets.net/wpcontent/uploads/2009/12/nsfm2009report.pdf

Network for Sustainable Financial Markets launches the Climate Bonds Initiative with the Carbon Disclosure Project (December 2009)
http://climatebonds.net/wpcontent/uploads/2009/12/CBI_media_release_14Dec09.pdf

APPENDIX 6: NATIONAL PENSION FUNDS PROMOTING ESG

Norway's Ethical Guidelines for the Government Pension Fund
www.regjeringen.no/en/dep/fin.html?id=216

UK's Environment Agency Pension Fund
www.environment-agency.gov.uk/pensions

China's National Pension Fund includes responsible investment as a core principle
www.ssf.gov.cn

France's Article 19 of the Autorité des Marchés Financiers requires disclosure of social, environmental and ethical matters, and whether a rating agency is used (2005)
www.novethic.com/novethic/english/upload/SRI_Employee_Study.pdf

Canada's CPP Investment Board Responsible Investing Policies and Initiatives
www.cppib.ca/Responsible_Investing

CalPERS Investment Policies
www.calpers.ca.gov/index.jsp?bc=/investments/policies/home.xml

Australia's Regnan Ltd represents governmental and institutional funds totalling more than $50 billion
www.regnan.com.au

The Pension Benefit Guaranty Corporation (US) establishes new policy for $55 billion investment (18 February 2008)
www.pbgc.gov/media/news-archive/news-releases/2008/pr08-19.html

Florida State Board of Administration Corporate Governance Principles (pp. 48–61, March 2009)
www.sbafla.com/fsb/CorporateGovernance/tabid/378/Default.aspx

Australian Minister for Superannuation & Corporate Law, Senator The Hon. Nick Sherry, describes current efforts to promote ESG matters (29 May 2009)
http://ministers.treasury.gov.au

Association for Sustainable & Responsible Investment in Asia (ASrIA) releases report The Time to Lead is Now: The Adoption of ESG Analysis by Asian Government Pension Funds (July 2009)
www.asria.org/events/hongkong/09july22

Australia's Local Government Superannuation Scheme promotes ESG factors with analysis by Mercer investment consulting firm (August 2009)
www.lgsuper.com.au/news/2009/MEDIA%20RELEASE%20LGS%20appoints%20Mercer.pdf

Canadian MP John Oliphant introduces private bill to amend Pension Benefits Standards Act to require public and private pension funds to disclose ESG information (September 2009)
www2.parl.gc.ca/HousePublications/Publication.aspx?Docid=4104755&file=4

Germany's Environment Ministry and Fortis Investments release report Occupational pensions and sustainable investments in Germany (December 2009)
www.sd-m.de/files/Hesse_Occupational_pensions_and_SRI_in_Germany.pdf

APPENDIX 7: NATIONAL, REGIONAL AND GLOBAL INSURANCE AGENCIES PROMOTING ESG

Munich Climate Insurance Initiative (April 2005)
www.climate-insurance.org

China's Ministry of Environmental Protection explains progress using insurance for environmental protection (January 2009)
http://english.mep.gov.cn/News_service/news_release/200902/t20090211_134114.htm

The National Association of Insurance Commissioners (USA) adopts policy to require insurance companies to disclose financial risks from climate change (March 2009)
www.naic.org/Releases/2009_docs/climate_change_risk_disclosure_adopted.htm
www.ceres.org/Page.aspx?pid=1062

Arab Forum of Insurance Regulatory Commissions and Hawkamah release Policy Brief on corporate governance (March 2009)
www.hawkamah.org/news_and_publications/news/2009/51.html

The Multilateral Investment Guarantee Agency of the World Bank Group and the Dubai International Financial Centre sign agreement to promote investment in the Middle East and Northern Africa (October 2009)
www.miga.org/documents/DIFC_MIGA_MoU_PR.pdf

Insurance Working Group of the UNEP Finance Initiative releases The Global State of Sustainable Insurance (October 2009)
www.unepfi.org/fileadmin/documents/global-state-of-sustainableinsurance.pdf

APPENDIX 8: NATIONAL ECONOMIES, FOREIGN MINISTRIES AND TRADE AGENCIES PROMOTING ESG

UK Foreign & Commonwealth Office updates its CSR programme (since 1995)
www.fco.gov.uk/resources/en/pdf/pdf16/fco_csr_strategy_papers

Japan's Ministry of the Environment provides laws and guidance on environmental reporting, environmental management systems, and environmental accounting (since 2000)
www.env.go.jp/en/policy/economy/pecba.html

Japan adopts Law No. 77 on business information and responsibilities (2004)
www.env.go.jp/en/laws/policy/business.pdf

Japan's Ministry of the Environment begins programme to develop principles on environmental finance (2009)
www.csr-asia.com/weekly_detail.php?id=11793

Germany's Commission of the German Corporate Governance Code (since 2001)
www.corporate-governance-code.de/index-e.html

Dutch Corporate Governance Code Monitoring Committee, established in 2004, revises code to expand CSR/ESG factors (December 2008)
www.commissiecorporategovernance.nl

US Secretary of State's Annual Award for Corporate Excellence (since 1999)
www.state.gov/e/eeb/ace

US Department of State establishes Office of International Labor and Corporate Social Responsibility, convenes first Intergovernmental Forum at BSR Conference (2007)
www.state.gov/g/drl/lbr

www.state.gov/r/pa/prs/ps/2007/oct/94123.htm

Norway's Ministry of Foreign Affairs releases its Oslo Agenda for Change (2007)
www.csr-oslo.org

Korea's Labour Ministry implements Act on Social Enterprise Promotion with certificates for social enterprises (January 2007)
http://english.molab.go.kr/english/main.jsp

Spain's Council of Ministers creates the State Council for Corporate Social Responsibility (February 2008)
www.ipyme.org/IPYME/enUS/EmprendedoresCreacionEmpresas/Responsabilidad/rse.htm

Austria's Federal Ministry of Economics and Labour releases Trade Policy Doctrine with sustainable development and CSR discussions (April 2008)
www.bmwa.gv.at/BMWA/Schwerpunkte/Aussenwirtschaft/IntOffensivInvestition/oesterreichisches_aussenwirtschaftsleitbild.htm

Denmark's Ministry of Economics and Business Affairs releases Action Plan for Corporate Social Responsibility (May 2008)
www.samfundsansvar.dk/sw42800.asp

Saudi Arabia's General Investment Authority and Harvard's CSR Initiative establish dialogue and release report Corporate Social Responsibility in Saudi Arabia and Globally: Key Challenges, Opportunities and Best Practices (November 2008)
www.hks.harvard.edu/m-rcbg/CSRI/pub_reports.html

UK Government's support for fiduciary responsibility that includes ESG matters (2008)
www.responsible-investor.com/home/article/fiduciary

Norway's Ministry of Trade and Industry announces proposal to amend Accounting Act to promote corporate disclosure of ethical guidelines (January 2009)
www.globalreporting.org/NewsEventsPress/PressResources/Pressrelease_27_jan_09.htm

Norway's Ministry of Foreign Affairs releases report Corporate Social Responsibility in a Global Economy (January 2009)
www.regjeringen.no/en/dep/ud/press/News/2009/social_responsibility_abroad.html?id=543620

Egypt's Institute of Directors (of the Egyptian Ministry of Investment) launches Egyptian ESG Index (January 2010)
www.eiodqa.eiod.org/NewsDetails.aspx?ID=20&Lang=1

APPENDIX 9: UPTAKE OF EACH PRINCIPLE OF RESPONSIBLE INVESTMENT

According to the PRI *Report on Progress 2009* (UN PRI, 2009), signatories scored highest on principles 1 (integration), 2 (active ownership) and 5 (working together). Appendix 1 above lists all six principles in full.

Principle 1 (Incorporating ESG issues into investment analysis and decision-making)

- Non-corporate pension funds achieved higher scores than corporate funds on Principle 1.
- Screening is carried out by 53 per cent of asset owners and 77 per cent of investment managers. While ethical considerations are at the forefront in determining screens, so are the other issues more directly related to risk and return. Of those using screening, 58 per cent of investment managers and 52 per cent of asset owners cited controlling risk and/or elimination of long-term underperformers among their rationales.
- Although the proportion of signatories undertaking integration in asset classes such as fixed income, hedge funds and private equity remains relatively low, some of those that are attempting integration report good progress.
- Among investment managers, those with relatively simple organisational structures achieved higher Principle 1 scores than moderately or highly complex organisations. And SRI managers achieved substantially higher scores than mainstream managers.
- Signatories with internally managed assets report greater progress in integration in respect to the research and portfolio construction stages of the investment process, compared to ongoing process review and training.

Principle 2 (Active ownership of ESG in investment policy and practice)

- Of signatories, 64 per cent report that they vote on all resolutions where possible in domestic markets, and the corresponding figure for foreign markets is 47 per cent.
- Engagement is most often undertaken by internal staff, although the use of an external engagement service provider is common among asset owners in the Netherlands and Australia.
- While 68 per cent of investment managers and 51 per cent of asset owners have documented their approach to engagement, their documentation frequently does not cover the approach to selecting companies for engagement or measurement of engagement success.
- Only 5 per cent of signatories are not involved in any engagement.
- The median success rate for asset-owner engagements that ended in 2007 was 40 per cent, while for investment managers the median success rate was 50 per cent.
- The number of extensive engagements undertaken by internal staff of signatories in different countries varied greatly. The UK reported the highest national figure (with 445 engagements by asset owners and 2,468 by investment managers). Most countries reported numbers of extensive engagements ranging from the twenties to low hundreds.

Principle 3 (Disclosure on ESG issues by entities invested in)

- A number of signatories cited lack of information from underlying companies as a key barrier in their implementation of the Principles.
- About 90 per cent of signatories had a dialogue with listed equity issuers in developed markets regarding the production of standardised ESG reporting.
- Both stand-alone sustainability reporting and reporting on ESG issues included in the reports a company already produces are commonly requested, as is information within the Carbon Disclosure Project and the Global Reporting Initiative.
- A reasonable percentage of signatories are asking for ESG reporting in asset classes other than listed equities, including approximately 50 per cent of signatories in both corporate fixed income and private equity groups.

Principle 4 (Promoting acceptance and implementation of PRI in the investment industry)

- Around half (46 per cent) of investment managers incorporate RI/ESG elements into incentive arrangements for internally managed assets to some extent, or intended to do so in 2009.
- Over 62 per cent of asset owners said they now include RI/ESG elements in contractual relationships with external managers, a significant increase on last year when less than 38 per cent of asset-owner respondents did this.
- Incentive arrangements are much less commonly addressed by asset owners with respect to internally managed assets, and by both investment managers and asset owners with respect to externally managed assets.
- Two-thirds (65 per cent) of signatories encouraged their service providers to become PRI signatories and consider RI/ESG factors in 2008.

Principle 5 (Working together to enhance effectiveness in implementing PRI)

- Approximately 85 per cent of signatories indicated that they collaborate with other investors to at least some extent.
- Nearly two-thirds of PRI signatories logged into and viewed postings on the PRI Engagement Clearinghouse.
- The most widely supported collaborative initiatives were once again the United Nations Environment Programme Finance Initiative, Carbon Disclosure Project, regional social investment organisations and International Corporate Governance Network.

Principle 6 (Reporting on activities and progress in implementing PRI)

- Approximately one-quarter of both investment managers and asset owners have asked that responses to their assessment questionnaire are published in full on the PRI website, while a further 20 per cent are supplying a link to their own website where some of their responses to the assessment questionnaire will be provided.
- A very high proportion of signatories stated that voting records are reported in some form – 80 per cent of asset owners, and 94 per cent of investment managers.
- Reporting of RI/ESG-related engagement is strong, with 83 per cent of asset owners and 78 per cent of investment managers disclosing such activities to at last some extent.

INVESTING FOR SUSTAINABLE DEVELOPMENT?

A REVIEW OF INVESTMENT PRINCIPLES – TRENDS AND IMPACTS

How can investors be encouraged to consider more than purely commercial and short-term gains?

Various sets of investment principles have emerged in recent years. These principles aim to incorporate social, environmental and governance criteria into investment decisions in order to enhance the benefits and reduce the damaging effects of investment for development. Increasing numbers of organisations are signing up to these principles for reasons that range from improving their reputation to minimising risks and improving long-term investment prospects. Yet their impact on sustainable development remains unproven.

Focusing on four major sets of investment principles – the UN Principles for Responsible Investment (PRI), the Equator Principles, the Environmental and Social Principles of the European Investment Bank (EIB), and the OECD Declaration on International Investment and Multinational Enterprises – *Investing for sustainable development?* takes a first step in assessing the content, take-up, implementation and impact of investment principles.

The study finds that the main impact of investment principles on sustainable development so far is mitigation of the worst effects of investments rather than a shift in the underlying basis of decision-making. Investors are generally unwilling to compromise high returns for improved sustainable development outcomes.

The authors call for better monitoring and measurement of the impact of investment principles, as well as a better understanding of the broader institutional changes required to support them so the next generation of investment principles can be more ambitious and bring about investment that supports, rather than undermines, sustainable development.

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