



Report from Finance Watch's Expert Symposium: "From ESG corporate communication to non-financial performance indicators: boosting the impact, legitimacy and market share of responsible investment"

21 May 2014, Cavendish Hotel, London



Finance Watch

Making finance serve society



Twenty five European experts in responsible investing from the financial industry, academia and civil society met for a half-day discussion about how to push for responsible investment to become a mainstream activity. Their discussion and recommendations are summarised in this note.

The event was hosted by Finance Watch with technical support from 2° Investing and Novethic, facilitated by Chris Hewitt from the Finance Innovation Lab, and financial support from Caisse des Dépôts.

OVERVIEW

Various forms of responsible investing (RI) have seen a significant increase in popularity and volumes over the past few years, and associated policy initiatives.¹ The challenges now are to convince an even larger pool of investors and asset managers to adopt RI, and to answer recurrent criticisms of RI from different stakeholders.

These goals require better ways to measure the non-financial impacts of RI strategies, typically their impacts on the environment and on social and governance outcomes (ESG). How can ESG impacts be defined and measured? What are the main incentives and hurdles for asset managers to build and disclose these indicators? How can they be made comparable across funds?

These and other questions find additional momentum in the increasing demand from stakeholders for more accountability from the financial sector about its impact on society and the environment. Regulation plays a key role in this regard: the latest [EUROSIF SRI study](#) shows that between 2010 and 2012, 'legislative drivers' have moved from 5th to 2nd within the top five 'drivers of SRI demand' (after 'demand from institutional investors').

Up to now, RI has tended to focus only on the financial materiality of ESG factors – how they affect investment returns. A move to focus also on the externalities - the actual ESG impacts - could involve assessing the ESG performance of a portfolio, e.g. CO2 per euro invested, or its impact on companies' behaviour. Delegates at the event said that institutional investors want common indicators but typically find that corporate data disclosures are either incompatible, incomplete or irrelevant. Retail investors, on the other hand, want more transparency about where their money is going.

Adopt
common ESG
indicators

Delegates proposed a number of policy measures for different stages in the SRI reporting and investing chains. These include mandating more corporate ESG disclosures and supporting this with the creation of common ESG indicators to make such disclosures compatible, complete and relevant for retail investors. Asset managers and asset owners could be subject to a broader definition of fiduciary duty and required to know their retail customers' preferences on ESG matters, as well as having to disclose how their own practises and incentives reflect these preferences. Civil society and NGOs have a role to play educating the public and putting pressure on the financial industry and policymakers. Further research into the financial returns of sustainable investing and the costs of labelling would support this. Policymakers should also look at tax incentives to promote sustainable investments based on a legally defined label for 'sustainable' investing and at ways to help SRI funds become the default option for retail investors, among other things.

¹ Including the Global Reporting Initiative (GRI), the UN Global Compact, OECD Guidelines for Multinational Enterprises, ISO 26000 guidance standard on social responsibility, the International Integrated Reporting Committee (IIRC) framework, and the EU Directive on disclosure of non-financial and diversity information by large companies and groups.



“ The EU is beginning to focus on ESG disclosure, for example in the texts on PRIIPs and IORPs. ”

François Passant (EUROSIF)

DELEGATES

Subgroup 1

- Camilla de Ste Croix, ShareAction
- Stanislaw Dupré, 2° Investing
- François Passant, EUROSIF
- Mark Campanale, Carbon Tracker
- Jean-Philippe Desmartin, Oddo Securities
- Nathalie Cerutti, Pictet Asset Management
- Greg Ford, Finance Watch



Subgroup 2

- Dominique Blanc, Novethic
- Mike Everett, Standard Life
- Joost Mulder, Finance Watch
- Annika Cayrol, Réseau Financité
- Stefano Battiston, University Of Zurich
- Myriam Vander Stichele, SOMO



Subgroup 3

- Diane Strauss, 2° Investing
- Catalina Secreteanu, Sustainalytics
- Cédric Lombard, Impact Finance Management
- Marie Luchet, ECOFI, the asset management arm of Crédit Coopératif
- Hélène Charrier, Caisse des Dépôts
- Emanuele Fanelli, Carbon Disclosure Project
- Nicole Alix, Secretary of the Board of the Mont Blanc Meetings, Crédit Coopératif
- Caroline Metz, Finance Watch



Subgroup 4

- Benoît Lallemand, Finance Watch
- Stéphane Voisin, Kepler Chevreux
- David Korslund, GABV
- Katherine Teague, Christian Aid
- Martin Hassel, Nordic Financial Unions
- Helene Winch, UN PRI
- Victoria Land, Fidelity
- Manuel Coeslier, MINES ParisTech



Chris Hewitt, Finance Innovation Lab (moderator)

LIST OF RECOMMENDATIONS

Recommendations from the event to build on existing policy initiative are listed below, grouped into actions that concern corporates, asset managers and owners, civil society, researchers and database providers, sales networks, and policymakers.

Corporates

- Mandate ESG disclosure for company reporting to build retail investor demand
- Require integrated annual reports also to include the financial materiality of ESG factors, the company's strategy on sustainability and their KPIs on ESG (the International Integrated Reporting Council, IIRC)
- Harmonise a small number (5-10) of core and robust KPIs with guidance for all companies and create a larger number of sector-specific KPIs
- Include missing indicators such as supply chain effects, tax avoidance issues, lobbying positions taken by corporations.
- Include qualitative metrics as well as quantitative metrics
- Encourage the use of ESG ratings agencies to screen corporates for ESG factors
- Look at the purpose of corporations and ensure they reflect long-term outcomes
- Require companies to disclose their capital expenditure and check compliance with ESG objectives
- Identify who is accountable for the accuracy of any indicators
- Ensure that disclosure rules do not hurt small and medium sized firms
- Make sure indicators are designed for the targeted population (eg retail v ESG analysts) and avoid data overload

Asset managers and asset owners

- Require asset owners to survey their retail customers' behaviour and opinions on ESG and ensure that SRI key performance indicators (KPIs) reflect what retail investors are interested in, such as executive pay, whether a company pays a living wage, its use of tax havens etc. (e.g. pension funds could have members on the board, or legal requirement to survey members regularly)
- Require more traceability on the use of savers' and investors' money
- More cooperation between asset managers' ESG teams and their marketing teams
- Apply minimum legal requirements for a fund to label itself sustainable (such as a common standard of negative criteria, and a further set of validated positive criteria to differentiate between funds).
- Oblige asset owners and asset managers to report their ESG objectives and how these are integrated into their incentives according to the proposal of the European Commission for a Shareholder Rights Directive
- Set the time horizons of investment managers to fit better with the timeframe of ESG improvements
- Clarify fiduciary duty so it is clear about long term benefits to stockholders vs short term benefits for shareholders

- Clarify disclosure requirements for asset owners as set out in the proposal of the European Commission of the Shareholder Rights Directive
- Encourage big investors to request better non-financial data from companies
- Encourage voluntary ESG / SRI initiatives that can become standard or mandatory in future
- Ensure that performance indicators do not risk creating distortions and encouraging 'gaming' of the system by corporates or fund managers
- Create incentives at asset management level (eg Shareholder Rights Directive) alongside stewardship/ESG at asset owner level

Civil society and NGOs

- Educate the public with campaigns, help them put pressure on asset managers
- Put pressure on policymakers and the financial sector
- Encourage people to ask what their money is being used for
- Raise the social status of investments that create social value
- Educate in-house ESG people, as well as state and public authorities
- Endorse EUROSIF'S European SRI Transparency Code for fund labelling purposes

Academic researchers and/or ESG database providers

- Increase the research comparing long-term returns of sustainable versus less sustainable investments, to let the market do its work
- More research on labels, such as the labelling of financial products in France, including their cost
- Merge some of the different ESG methodologies in the market to improve comparability

Sales and distribution networks

- Regulate financial advisors so their assessment of what is an appropriate product for their client includes the client's ESG sensitivities, not only their capacity for financial risk
- Ensure analyst recommendations (buy /sell notes) include ESG factors
- Make SRI funds the default option for company pension funds

Regulators and policymakers

- Create fiscal incentives for sustainable funds
- Make SRI funds the default option for pension funds, following the experience of one of the Swedish national pension funds. This could apply to all companies with money purchase schemes
- Harmonise the terminology: 'responsible' and 'sustainable' are not the same.
- Increase competition from new types of ESG funds by relaxing MiFID rules on selling higher risk alternative funds, so the regulatory requirements are neutral as between higher and lower risk products
- Improve labelling for end users and retail investors, as with PRIIPs labels
- Consider the role of listing authorities and alternative SRI stock exchanges

SUMMARY OF DISCUSSION

Opening remarks



Benoît Lallemand (Finance Watch)

Benoît Lallemand (Finance Watch) welcomed the delegates to Finance Watch's first ever expert symposium and thanked Caisse des Dépôts, 2 Degree Investing and Novethic for their financial and intellectual contributions towards preparing the event.

He said that up to now, financial regulatory reform (and Finance Watch) has been focussed on ensuring that the financial system does not hurt society. It is only now starting to look at how it can help society. Today's event heads in that direction and will focus on the impact and measurement of socially responsible investing.

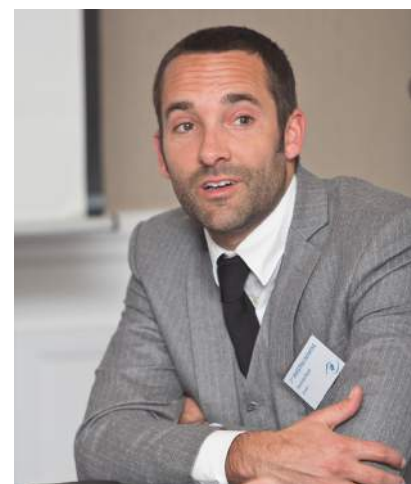
Chris Hewitt (moderator, Finance Innovation Lab) explained the structure of the day, and that to cut through the "chicken and egg" logic of supply of SRI and demand for SRI, the delegates should assume in Workshop 1 that demand

for SRI exists, and then in Workshop 2 focus on how to boost SRI demand. The delegates presented themselves around the table.

Dominique Blanc (Novethic) then presented the findings of Novethic's January 2013 report "Choosing indicators to measure the ESG performance of investments", on which the background paper for the current event was based. He commented that while portfolios can be judged against an SRI benchmark, they cannot be compared with each other because each uses different SRI metrics. There is a lot of focus on the financial output of ESG funds but not much focus on the ESG output, in other words the impact. Many funds apply to Novethic for their label and they do respond to incentives to increase their chances of being allowed to use it. Many fund managers said that their retail clients were interested in data on greenhouse gases (GHG) but the raw data at company level was very diverse. Aggregation at portfolio level is also difficult as the parameters for aggregation differ.

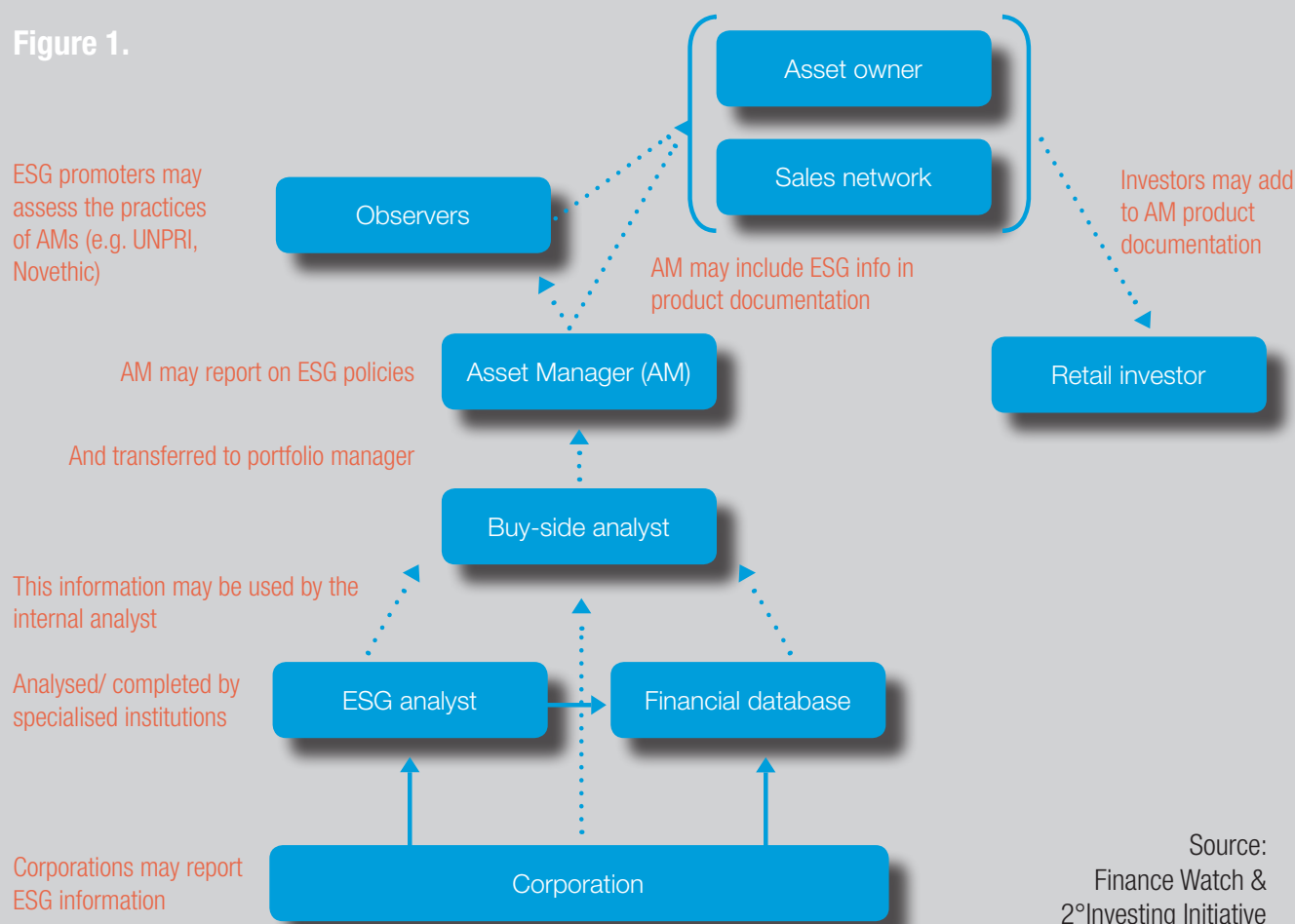
DB said there was political momentum from the focus on energy transition to find common aggregators. Institutional investors want common indicators so they can communicate to their beneficiaries. Retail investors are interested. The French fund management association is working on consensus indicators. The fossil fuel divestment campaign (which follows work done by Carbon Tracker and others) is having some success.

BL closed the introductory speeches by presenting a graphic of the SRI reporting chain (Figure 1) and invited delegates to comment critically on it during the break-out sessions. He said the discussion should include whether to view ESG indicators as distinct from the financial indicators or as an integral part of the financial narrative.



Stanislaw Dupré (2° Investing)

Figure 1.



Opening plenary

A short plenary discussion followed.

Delegates felt that several actors were missing from the SRI reporting map in Figure 1 including: auditors (although no legislative basis exists for their work in this area); people, citizens or society at large should be distinguished from retail investors; corporate stakeholders aside from their investors, such as their suppliers and employees; policymakers should be included as they set the norms; civil society should be included, perhaps as observers.

Emanuele Fanelli (Carbon Disclosure Project) said retail investors, institutional investors and asset owners should all be in the same 'end-user' category.

Several delegates said that data disclosures were incompatible, incomplete or irrelevant and there was a need for greater compatibility. Also, ESG disclosure requirements could create a disproportionate burden on smaller companies, and an unlevel playing field between listed and unlisted companies with different reporting obligations.

Stanislaw Dupré (2° Investing) said that disclosure was meaningless unless corporate managers also had incentives to improve their outputs.

Marie Luchet (ECOFI) said data and metrics should be made understandable for retail investors. Data also needs to be reliable and available from corporations.

Catalina Secreanu (Sustainalytics) said asset managers request data from corporations, so the arrows on the chart should flow in both directions.

Stephane Voisin (Kepler Chevreux) said there two kinds of metrics: some that affect finance and others that affect society. He said it may be useful to distinguish between materialities (financial) and externalities (social).

Workshop 1

Delegates were asked to divide into four groups, each containing a mix of financial industry, civil society and other delegates. Each group was asked to critique the SRI reporting flowchart (Figure 1) and to identify examples of who or what could be improved along the chain, and report its findings at the end.

Subgroup 1 discussed the purpose of SRI reporting and whether the goal should be to find alternative markets and reporting channels (“revolution”) as an expanding niche, or to improve existing channels (“adaptation”) in mainstream investing. The sub-group’s recommendations included:

- Ensure that buy /sell notes include recommendations based on ESG factors
- Lengthen the time horizons of investment managers to fit better with the timeframe of ESG improvements
- Create tax breaks for SRI funds sold to retail (and other) investors
- Require the financial materiality of ESG factors to be disclosed along with financial reporting

Subgroup 2 discussed the differences between having an influence on an asset manager or on a corporate, and a difference between the performance of a portfolio and the impact of the portfolio manager on companies’ behaviour.

Subgroup 3 reported a discussion focussed on the goal of corporate reporting; the question of who should be accountable for what along the reporting chain as two people could interpret the same data differently depending on their roles and incentives; who would use the data: a larger definition of public than just retail investors, policymakers and citizens; how to include missing indicators such as taxation or supply chain issues; how to ensure that SRI key performance indicators (KPIs) include positive as well as negative factors.

Retail investors are often interested only in headline factors (eg executive pay, whether a company pays a living wage, its use of tax havens) which may not be among the ESG criterion supplied by agencies.

In a discussion on terminology and performance vs impact, **Marie Luchet (ECOFI)** and **Hélène Charrier (Caisse des Dépôts)** said they understood ‘impact’ to mean the effect that the asset manager or investor could have on the corporation, e.g. by sitting on the corporation’s board or engaging with it, while ‘performance’ referred to the fund’s ESG performance.

There was a question whether investors would prefer companies with the best ESG indicators in order to have a clean portfolio or the worst in order to benefit as corporates improve their ESG performance. Some investors may be more interested in the change element, others in having a clean footprint.

There was also a discussion of whether indicators are aimed at analysts or retail investors, in which case the format would be different.

Subgroup 4 reported that Figure 1 was both too complex and not universal enough: for example employees are also citizens. There is a problem of what data is made available, as corporates tend to publish what they like, not what people want to know. Auditors can help but investors should not rely on them too much. As demand evolves, it is hard to get a standard set of indicators.



“ To us, ‘impact’ means the effect that the asset manager or investor can have on the corporation by engaging with it, while ‘performance’ refers to the fund’s ESG performances. ”

Hélène Charrier (Caisse des Dépôts)

Workshop 2

Plenary

The session began with opening remarks from **Cédric Lombard (Impact Finance Measurement)** and **François Passant (EUROSIF)** followed by a plenary discussion.

CL said investors' experience with micro-finance shows the great importance of considering externalities of investment. A feature of reporting on those externalities is that asset managers and their clients demand different things but both types of demand can be supplied from the same data.

FP said EUROSIF focusses on ESG disclosure and on the active ownership (shareholder right) agenda. Governments are looking to SRI to help them meet social goals. The EU is beginning to focus on ESG disclosure: for example the Packaged Retail Investment and Insurance Products (PRIIPs) regulation requires product providers to substantiate claims on ESG; the Institutions for Occupational Retirement Provision (IORPs) directive mentions climate risk.

Joost Mulder (Finance Watch) said the EU introduced a country-by-country reporting obligation for banks as part of the Capital Requirements Directive IV package and that this will be extended to all companies with the full disclosure of five or six tax and subsidy-related criteria.

Stanislaw Dupré (2° Investing) said the Commission felt with PRIIPs that it was too soon to introduce mandatory ESG reporting.

Benoît Lallemand (Finance Watch) said asset managers are not interested in disclosing ESG data but a requirement to disclose it would drive retail investor demand for the data.

Myriam Vander Stichele (SOMO) said regulators had a role to play here.

Katherine Teague (Christian Aid) said there is a lesson from tax justice campaigning: that civil society organisations can change public perceptions, as Christian Aid, ShareAction, WWF and others have done in recent years over corporate taxes. There is a responsibility to educate the public in a responsible way about these, for example, if I support these ESG changes will I still get a pension at the end?

Nicole Alix (Crédit Coopératif) said it was not just about letting people compare funds but about letting them know where their money is going. There should be full transparency about where people's money is going.

*Mandate
ESG
disclosure*



“ There is a lesson from the recent campaigns on tax justice: civil society organisations can change public perceptions. We must educate the public in a responsible way. ”

Katherine Teague (Christian Aid)

Camilla de Ste Croix (ShareAction) said it is possible to increase the demand from institutional investors when a vocal minority of end customers speaks up. For example, after an online campaign for retail investors to email their pension funds and ask about their policy on the carbon bubble, it only needed 140 emails for one pension fund to review their policy. She added that getting the teams responsible for ESG and marketing inside pension funds to work together would help. So would a broader interpretation of fiduciary duty, as this would prevent managers from using fiduciary duty as an excuse not to include ESG factors.



“ Getting the teams responsible for ESG and marketing inside pension funds to work together would help. ”

Camilla de Ste Croix (ShareAction)

David Korslund (GABV) said demand from institutional investors for sustainable banks is growing as data show that returns from banks that meet sustainability criteria are better than returns from (big) banks that do not. Bank investors are starting to care more about the financial materiality of ESG factors and have concluded that there is something fundamentally wrong with the business models of big banks. He added that there is a club of institutional investors and analysts who find it convenient to avoid change and use fiduciary duty [to maximise short-term returns] as a “cheap excuse” to ignore ESG factors.

Legal definition for funds that want to label themselves "sustainable"

Annika Cayrol (Réseau Financité) said retail investors are wary of greenwashing so there should be a legal definition of “sustainability” using a small number of well-defined criteria. Her organisation carried out a study of the minimum legal requirements for a fund to label itself sustainable and recommended that there should be a common standard comprising negative criteria, and a further set of positive criteria, checked by third parties, that can be used to differentiate between funds.



“ How can we raise the social status for investments that create social value? ”

Stefano Battiston (University Of Zurich)

Stefano Battiston (University Of Zurich) said there is a latent demand for ESG – people want to know how their money is used but only if asked. Regulators have stepped away from ESG to worry only about financial stability, buoyed by market theory that the market knows best. The question is how to reward investments that create social value, e.g. through financial returns, an improved risk profile or by raising social status for investments that create social value.

Stephane Voisin (Kepler Chevreux) said there are standards with which companies must comply but there is no obligation to tell the public if they comply with those standards or not. He said this applies, for example, in the chemicals industry.

Stanislaw Dupré (2° Investing) said analysts do not look at the longer term risks to future cashflows beyond five years or so. There should be disclosure of a company's capital expenditure to see if it is in compliance with its ESG objectives.

Benoît Lallemand (Finance Watch) said civil society can push for regulators to set standards that will create mass demand for SRI, it is not needed in advance.

Jean-Philippe Desmartin (Oddo) said companies should include ESG factors in their annual report.

Sub-groups' recommendations

Delegates were asked to return to the same sub-groups as before and generate ideas to increase the demand for, and improve the measurement of, ESG impact indicators.

Sub-group 1:

- Improve communication between fund managers and their retail customers: require pension funds to have pension scheme members on their board, to carry out surveys of members about how seriously they view ESG matters (there was some discussion whether this was suitable for only final salary schemes of all pension schemes).
 - Regulate financial advisors so their assessment of what is an appropriate product for their client includes the client's ESG sensitivities, not only their capacity for financial risk.
 - Make SRI funds the default option for pension funds, following the experience of one of the Swedish national pension funds. This could apply to all companies with money purchase schemes
- Harmonise the terminology: 'responsible' and 'sustainable' are not the same.
- Agree policy goals behind mandatory ESG disclosure requirements
- More competition from new types of ESG funds, relax MiFID rules on selling higher risk alternative funds so the regulatory requirements are neutral as between higher and lower risk products
- Better guidance for companies about ESG disclosure
- Promote the use of standards from the International Integrated Reporting Council (IIRC), so that company annual reports include the company's strategy on sustainability and their KPIs on ESG.
- Harmonise a small number (5-10) of core common KPIs for all companies and create a larger number of sector-specific KPIs
- Civil society to give more endorsement to EUROSIF'S European SRI Transparency Code for fund labelling purposes
- Fiduciary duties and disclosure requirements for asset owners

Require fund managers to act on their clients' ESG preferences



“ Make SRI funds the default option for company pension funds. ”

Mark Campanale (Carbon Tracker)

Subgroup 2 reported these ideas:

- Fiscal incentives for sustainable funds
- Education of in-house ESG people and the public (as with ShareAction), as well as state and public authorities
- Oblige ratings agencies to screen for ESG factors
- Transparency for all financial institutions on how money is used



Subgroup 3 reported these ideas:

- Need for tax incentives (as with 'solidarity based funds')
- Need for educational incentives for clients. UK campaigns such as 360, Good Money Week, National ethical investment week, and the ShareAction campaign can be drivers of demand for ESG criteria. This will increase demand: asset owners, if better educated, will ask for ESG criteria, which will influence corporations
- Oblige asset owners and asset managers to report their ESG objectives and how these are integrated into their incentives
- Improve labelling for end users and retail investors, as with PRIIPs labels
- The group noted a number of existing regulatory initiatives: the French 'Grenelle laws' introduced in 2009 and 2010 make ESG reporting and independent verification mandatory for all large corporations with activities in France. The UK from 2013 has required LSE-quoted companies to report their annual greenhouse gas (GHG) emissions in their directors' report, and the UK government the recommendations of the 2012 'Kay review of equity markets and long-term decision making', designed to improve the performance of UK companies and returns to savers.
- The Asset Owners Disclosure Project is an independent global not-for-profit organisation whose objective is to protect members' retirement savings from the risks posed by climate change. Aim is to help funds to redress the imbalance in their investments between high-carbon assets (50-60% of a portfolio) and low-carbon assets (typically less than 2%) and realign the investment chain to adopt long-term investment practices (see [here](#)).
- Most of these initiatives are voluntary but often what is first voluntary become 'best-practice' and then standard, paving the way for later regulation.
- Research on labels, such as the labelling of financial products in France, would be helpful especially on whether integrating ESG data increases the cost of labelled products (compare with fair trade labelling).

Educate the investing public, help them to put pressure on their fund managers



“ Retail investors want to know where their money is going. ”

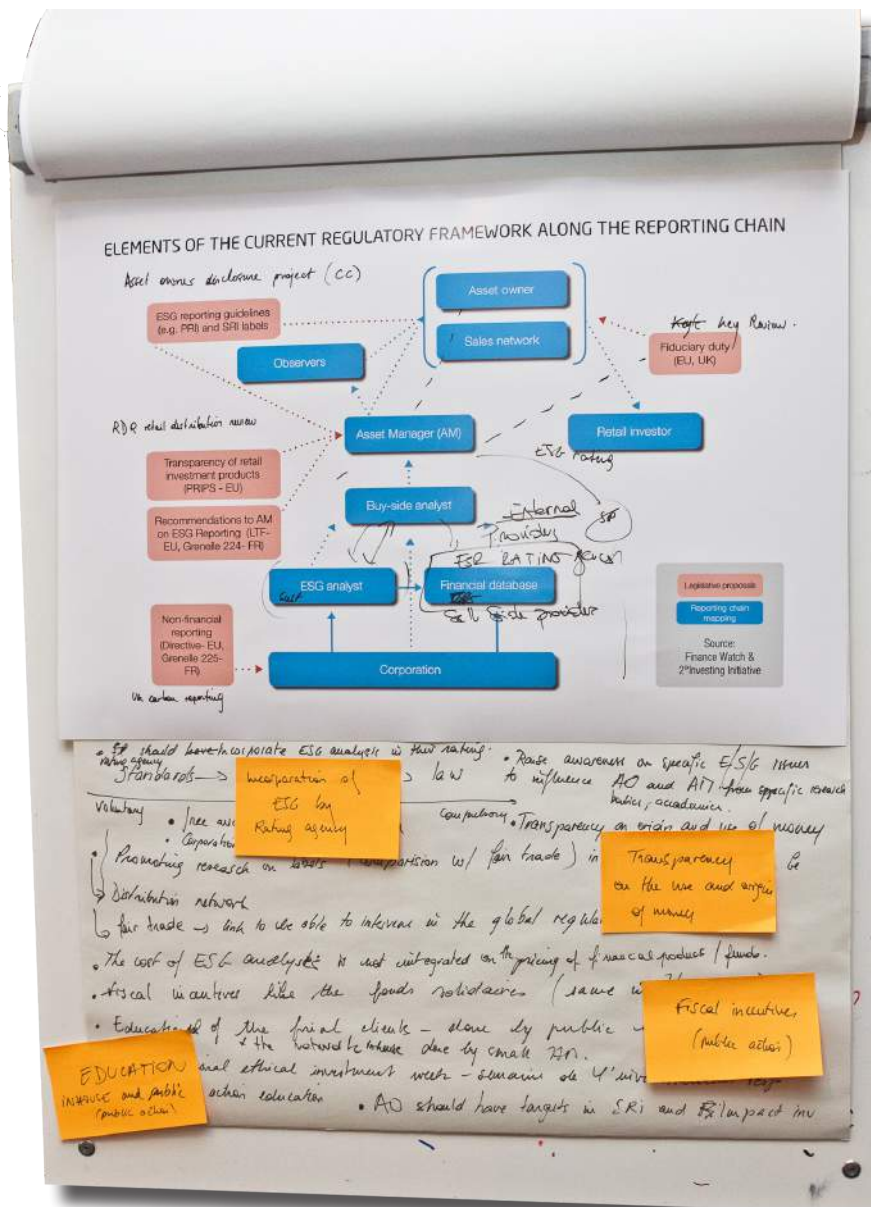
Nicole Alix (Crédit Coopératif)

Subgroup 4 reported these ideas:

- Look at the purpose of corporations and ensure that long-term outcomes are included
- Increase the research comparing long-term returns of sustainable versus less sustainable investments, to let the market do its work
- Avoid overloading people with data by studying the impact of non-financial disclosures
- Encourage big investors to request more non-financial data from companies
- Pay attention to the size of firms, to avoid hurting small and medium sized enterprises



Helene Winch (UN PRI), David Korslund (GABV)



Comments on good practice on indicators and data

- Are E, S & G equal in weight in terms of impact?

Environment indicators

- CO2 – yes, although how far is the scope, use of products, impact of supply chain etc.
- Number of environmental laws breached

Social indicators

- Job creation – but what about the quality of the jobs?
- Employment satisfaction surveys

Governance

- Taxation policies – avoidance behaviour etc (Fair Tax Mark)
- Corporate lobbying positions

About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society. Its mission is to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch's members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large number of European citizens. Finance Watch's founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, but that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society. For further information, see www.finance-watch.org



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