asfa
the voice of super

ASFA Policy and Industry Practice

Integration of Environmental, Social and Corporate Governance (ESG) Factors into Investment Processes for Trustees

Discussion Paper

April 2010

Association of Superannuation Funds of Australia

ASFA Secretariat
Level 6
66 Clarence Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 1005
Ph: +61 2 9264 9300
Fax: +61 2 9264 8824

Outside Sydney
1800 812 798

Website: www.superannuation.asn.au

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290

Acknowledgement

ASFA would like to recognise the contribution of the "ESG Working Group" which put the paper together in 2009/10. The ESG Working Group comprised:

- Phil Preston, Seacliff Consulting (Chairman)
- Geoff Ferguson, CBA Officers' Superannuation Fund
- Liza Rosser, HealthSuper
- Julie Taylor-Mills, Regnan
- Amanda McCluskey, Colonial First State Global Asset Management
- Danielle Welsh, VicSuper
- Kate Grant, Queensland Investment Corporation
- Joanna Davison, Colonial First State Global Asset Management
- John Pinkerton, ASFA

The **ASFA Investment Committee** members who reviewed this paper were:
Steven Carew (JANA Investment Advisers - Investment Committee Chair, 2009/2010); Lorraine Berends FASFA (Marvin & Palmer Associates); Mark Abramovich (Herbert Geer); Brett Elvish (Financial Viewpoint); Martin Goss (Towers Watson); John Hamer (Pengana Capital); Joanna Davison (Colonial First State Global Asset Management); Geoff Ferguson (CBA Officers' Superannuation Fund); Alex Harken-Yumru (AMP Services Ltd); David Hartley (Sunsuper);Brad Holzberger (QSuper); Anthony Serhan (Morningstar); Paul Kessell (Professional Associations Superannuation); Matthew Griffith (ES Super Board)

David Graus
General Manager, Policy and Industry Practice

Document History
Version 1 (April 2010)

Table of Contents

ASFA Discussion Paper: The Integration of Environmental, Social and Corporate Governance (ESG) Factors into Investment Processes for Trustees.

Executive summary

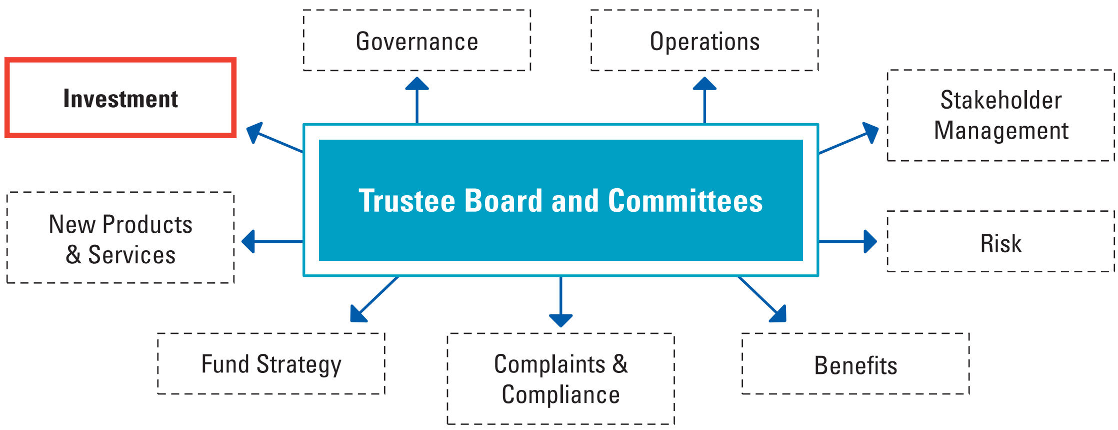
The purpose of this discussion paper is to provide trustees with information and practical guidance that will assist with the consideration of Environmental, Social and Corporate Governance (ESG) factors within the context of their funds' investment processes.

ASFA, recognising that many trustees have not made a decision to integrate ESG factors into their investment processes, has issued this paper as a discussion paper. ASFA will continue to monitor what constitutes best practice in this regard and this may lead to ASFA issuing an ESG "best practice" guide at some time in the future.

ASFA believes that ESG factors can influence investment performance and suggests that each trustee considers ESG factors within the context of their fund's investment processes. There are a number of approaches that can be taken to integrate ESG factors can be integrated into investment processes, which may allow a more comprehensive set of investment risks to be managed and investment opportunities identified to the benefit of fund members risk adjusted returns.

Note that, as per Diagram 1, this paper deals with investment issues only.

Diagram 1: Superannuation fund functionality



There is no standard, prescriptive way of implementing ESG practices. This is because an implementation strategy for a fund will be heavily influenced by the fund's own characteristics. This paper does, however, provide guidance and practical examples that will help trustees to form a view on the 'look and feel' of ESG integration.

The current level of interest suggests ESG policies and practices are likely to become components of broader investment policies and practices over time.

What is meant by "the integration of ESG factors"?

By integrating ESG factors into investment practices, a trustee is acknowledging that ESG factors can influence investment performance and it is responding by refining those practices. The primary objective of ESG integration is to improve the risk adjusted returns achieved from investment portfolios.

Many factors that fall under the ESG umbrella can influence investment performance over both short and long term timeframes. For investors - in particular superannuation funds with long term investment horizons - there is a strong incentive to ensure that underlying investment processes are aligned with their investment horizons. There are numerous factors that fall under the umbrella of 'ESG'. Some examples of prominent ESG factors are given in Table 1.

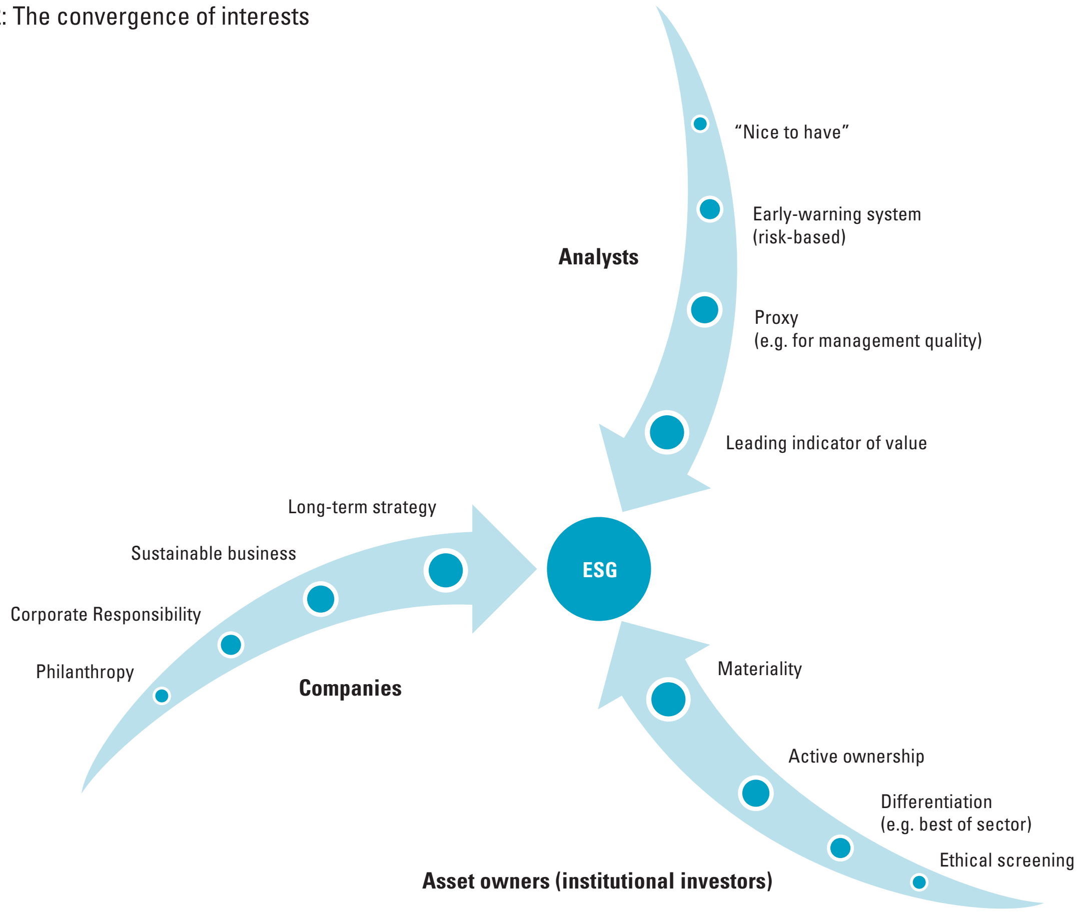
Table 1 – Some examples of prominent ESG factors at the company level

Environmental	Social	Corporate governance
Pollution / emissions	Workplace health & safety	Board structure
Energy use	Human capital	Executive remuneration
Water use	Intellectual capital	Dealings with associates
Waste management	Demographic trends	Disclosure

The essential element for an ESG inclusive investment process is that the question, “If, when and how much could ESG factors affect company performance and investment returns?” is both asked and evaluated. A systematic process for identifying ESG factors provides investment analysts and portfolio managers with an information set that can then be used to address the question of investment materiality.

Integrating ESG factors can be thought of as the convergence of company and shareholder interests. Diagram 2 shows how the interests of three key stakeholder groups, namely analysts, investors and companies, have converged over time towards a common interest, centred on ESG factors. The activities of companies have evolved from more specialised ones, such as those centred on philanthropy or basic sustainability, towards a point where ESG factors are seen as important influences on long term financial performance. Likewise, the views and approaches by analysts and investors have evolved from simpler interests to more complex ones.

Diagram 2: The convergence of interests



Source: Regnan

ESG factors are relevant to all classes of investments. The approach taken to manage these factors will be a function of the features of the asset class and the characteristics of the superannuation fund in question. Much of the ‘language’ used in the industry regarding ESG issues to date has been framed in the context of the listed equities asset class, however, trustees should be aware that ESG issues are just as important for all asset classes. Appendix A contains an overview of how ESG factors are relevant to the major asset classes.

Notwithstanding the fact that trustees should take into account other factors, such as the investment structure of their fund and their stated investment beliefs when making investments, the 'mainstreaming' of ESG may increasingly become recognised as best practice. The term 'mainstreaming' means that ESG factors are considered and integrated across the investment processes for all asset classes rather than a few selected ones.

ESG integration is different from screening techniques used in ethical investing and socially responsible investing (SRI)

Ethical investing and SRI are investment styles that often integrate personal or moral values into investment decisions. Such approaches may use 'negative screens' to avoid categories of investments or 'positive screens' to include only activities that affirm the values criteria. For example, an ethical investor may view activities such as gambling, weapons, alcohol, tobacco and forestry as being unacceptable and automatically screen them out of the investment universe. There is nothing inherently 'wrong' with a screening approach, especially if the beneficiaries are aligned in their personal beliefs, but the inherent difficulty of the process lies in forming a common set of values when the beneficiaries are broadly based.

The integration of ESG practices into traditional investment processes does not use values-based screening techniques. It is about the implementation of an investment process that includes thorough analysis and ongoing management of all relevant investment factors, including those of an ESG nature.

For example, if a company behaves in a way that is contrary to the desires of its customers and key stakeholders then, ideally, the investment manager would have an integrated ESG process which would include:

- sufficient rigour and research skill to identify the issue;
- the ability to translate these factors into decision-making, such as into financial metrics and / or stock valuation processes;
- a process for using this output in the portfolio construction process; and
- a policy and framework in place to specify how and under what circumstances the investment manager would seek to influence the company in improving its management of the identified ESG-related and other issues;

Conversely, a company may be exploiting opportunities that arise as a result of proactive ESG management, positioning or product innovation in order to gain competitive advantage over rival firms. The same points apply in this situation.

Performance factors

The case for good ESG management producing superior risk adjusted returns is an intuitive one, namely: a better understanding of, and framework for managing, ESG factors can only improve the depth and quality of information used in the investment process which, in turn, will improve risk adjusted portfolio returns. The proposition for trustees to consider is: "What risk is the fund being exposed to and what opportunities may be missed if ESG factors are not well managed?"

The break out boxes below give examples of the practical implications of ESG factors on company performance and analysts' interpretation.

Company X is a transport and logistics business currently embarking on major expansion. Applying an ESG filtering system, analysts recognise that the company offers little disclosure on its workplace health and safety (WHS) policy and implementation practices and it has incurred a high casualty rate in the last 18 months. Its 'lost time injury frequency rate' has gradually increased in the last 5 years with no public disclosure as to the reasons.

These issues are highly material for such a business and suggest a possible lack of board oversight of material ESG issues. An ESG framework applied by an analyst highlights these strategic risks for firms. Experienced analysts in this sector recognise that WHS is a key management indicator that may influence valuation estimates in a sector such as transport and logistics.

Company Y operates in the extractive industries. Its business model is based on coal and steel. Although there is acknowledgement that the company will be impacted under an emissions trading scheme or a carbon tax, it has not modelled the possible impacts and nor has it communicated to shareholders its strategy with respect to the risks faced by carbon intensive industries. **Company Z** operates in the same industry and its board has modelled the possible impacts extensively. As a result it has taken the decision to explore other business opportunities – in geothermal energy and gas.

The implications of an emissions trading scheme (ETS) for a company operating in the steel and/or coal sector are significant and may pose a significant risk for the sector. Experienced analysts regard the manner in which companies in these sectors address their carbon strategy as a key indicator of management quality which, in turn, feeds into valuation estimates.

A contrarian notion is that "market forces" will eventually punish or reward companies with respect to their ESG management. This may well turn out to be true over longer time periods. However, as will be discussed in the next section, trustees should contemplate whether the lack of an ESG management framework is exposing their fund to unnecessary risk.

A concept that is often mentioned in relation to ESG practices is that of the 'universal owner'. It is the notion that institutional investors, collectively, represent a large portion of the investment universe, and therefore their performance will be closely correlated with the performance of the economy as a whole. This, combined with their relatively longer term investment horizons, provides them with a rationale for working collaboratively to improve the performance of the companies and markets in which they invest.

In summary, ESG factors are relevant for superannuation trustees because they can be seen as an important influence on investment and fund performance. By systematically integrating ESG policies and practices into investment processes, the investment risks can be better managed and the investment opportunities that arise can be better identified and captured.

Legal considerations

Implementing robust management of ESG factors gives trustees a more comprehensive investment framework, rather than a set of constraints, through which to manage the investment process.

Trustees, when managing superannuation funds, are regulated by the Superannuation Industry (Supervision) Act ("SIS") and common law relating to trustees duties. Under SIS, a trustee must have regard to (amongst other things) the sole purpose test as well as the requirements of section 52 (2)(f) of formulating and implementing an investment strategy that has regard to the fund's circumstances, risk and return, diversification and liquidity. The implementation of ESG policies and practices that seek to improve risk adjusted returns is well aligned with this statutory requirement.

Therefore trustees who to take a strong approach to the integration of ESG factors into their investment process should have nothing to fear from doing so. A prominent report issued in 2005 by international law firm, Freshfields Bruckhaus Deringer, referred to in the industry as "Fiduciary I", examined all of the major jurisdictions and arrived at conclusions that were consistent with the above views. It concluded that the management of ESG factors is permitted and "arguably required" by law.

A follow up report, known as "Fiduciary II", was released in July 2009. It affirmed the original report's findings and provided a legal roadmap for trustees looking to 'operationalise' their commitment to ESG integration. It made two key statements:

1. Trustees should consider embedding ESG considerations into their legal contracts with investment managers; and
2. Asset consultants have a duty to proactively raise ESG issues within their advisory process.

These two landmark reports tend to dominate international views on trustees legal obligations with respect to ESG practices. They have been produced by credible practitioners and arrive at strong conclusions - but it is acknowledged that there is limited depth of this type of research in the industry.

The section of this report entitled "Transparency and Disclosure" provides discussion of disclosure requirements under Section 1013D(1)(l) of the Corporations Act.

Please refer to Appendix E for references to significant legal views on the significance of ESG factors.

United Nations Principles for Responsible Investment (PRI) as a framework

The PRI was developed in 2006 via a forum convened by the United Nations involving an influential group of institutional investors who saw ESG factors as being increasingly relevant in the investment process. The principles provide a framework that investors can use to integrate ESG factors into investment decision making and ownership practices in their efforts to improve risk adjusted returns for beneficiaries.

Note that the term 'responsible investment' is used within the industry to describe investment processes that contain ESG integration. As discussed previously, this term should not be confused with a particular investment style, such as ethical investing or SRI.

Funds and investment managers may elect to become signatories to the PRI for the purpose of publicly showing their support for the principles and signalling their own commitment to the integration of ESG factors into investment processes. In return, they get access to resources and collaborative networks. Apart from a commitment to the principles, there is no minimum entry requirement in terms of integration to be met in order to sign up to the PRI. A voluntary fee currently applies, with a mandatory fee scale to apply from 2011 (refer Appendix C).

In summary, signatories commit to adopt and implement the following six Principles:

Table 2 – United Nations Principles for Responsible Investment

#	Principle
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 report on our activities and progress towards implementing the Principles

Being a relatively new initiative, the nature of the PRI is constantly evolving. In Appendix B, there is a table that gives examples of the types of practical actions that could arise under each of the Principles. Appendix C lists some pros and cons of signing the PRI.

Signing the PRI or otherwise is an individual decision for each trustee. Membership of the PRI is voluntary and progress is self assessed, therefore signing the PRI is not a proxy for ESG-practice accreditation. Perhaps, for these reasons, the Phase One Preliminary Report from the "Cooper Review" (14 December 2009) stated: "The Panel does not believe that the PRI adoption should be prescribed and, accordingly, makes no recommendation in this regard".

Implementing ESG integration– First steps for trustees

How do trustees commence the implementation process? This section provides some practical steps that can be used to get the process moving. It is important to note that there is no easy "one size fits all" solution to integration – some elements may be standard across funds, but the precise strategy and implementation plan adopted will be determined by the fund's own characteristics, its broader investment objectives and strategy and its desired positioning in the market.

The very first step should be to ensure there is clarity about the meaning and intent of ESG integration. The trustee and executive management of a fund can use the discussion so far in this paper to form a common understanding of answers to the following questions:

- What is ESG integration?
- Why is it important?
- How is it different to ethical investing and SRI?
- How does it fit in with a trustee's fiduciary duty?

Provided that these issues are well understood and there is a common belief that ESG factors are material to investment processes and potentially improve risk adjusted returns, then the formation of high level policy is a reasonable starting point for an integration process. This policy can form an over-arching view of ESG factors and help to guide implementation at the operational level. It may be a stand-alone document or integrated into other high level, strategic documents.

Table 3 – Sample content for high-level ESG policy statements

Issue	Statement
Introduction	Define what is meant by 'ESG factors' and how these considerations fit in with other policy documents.
Beliefs	Broad beliefs about the impact of ESG factors on investment performance.
Goal	What the fund is seeking to achieve through the formation of ESG policies.
Context	High level statements about fund-specific factors that may drive the ESG integration process, such as: • Fund size or demographics • Complexity • Investment style • Investment management structure • Related entities / partnerships
Approach	Document the process being adopted by the fund to assess and implement ESG practices into investment processes. This may include statements about: • Accountability • Timeframe • The policy development process and ongoing review • Key investment issues • Expectations of service providers / suppliers • Transparency and reporting • Costs and benefits

When forming a specific implementation plan, there are a host of investment-related issues to consider, including those given in Table 4. A more detailed list of actions (corresponding to each of the PRI principles) can be found in Appendix B, and Appendix E contains the detailed reference to the ACSI guidelines.

The implementation plan should identify the benefits to the fund and the likely costs incurred in the process.

Table 4 – Implementation issues

Issue	Considerations
Implementation management	Identification of the internal structure to manage and monitor implementation
PRI	Are there net benefits to be gained by signing up? And if so, are there any specific work streams worth participating in?
Investment policy	Integrating ESG factors into existing policy or establishing a stand-alone policy
Investment management structure	Mapping out objectives and policies relative to the structure of investment management. Investments may be held and managed directly, by mandate or via pooled vehicles. Refer to Appendix D for ESG integration comments.
Corporate governance policy	How will implementation affect any existing policies?
Industry activity	There may be industry collaborations that provide a more effective way of promoting ESG integration across various parts of the investment chain.
Asset consultants	Review their ESG abilities and services offered
Investment managers	Formation of strategy to encourage ESG integration by underlying investment managers (internal or external): • Assess existing managers investment capability • Assess whether remuneration structures are aligned with the fund's aims • Develop minimum requirements for RFPs • Is ESG to be mandatory in contractual agreements? • For pooled funds, build ESG requirements into the assessment and review process

Issue	Considerations
Positioning statements	The fund may wish to develop high level statements about key ESG issues, such as climate change, forestry, human rights etc. These statements also help funds to provide considered and consistent responses if queried by fund members.
Macro investment issues	What impact, if any, will there be on considerations for: • Strategic asset allocation • Tactical asset allocation • Sector allocation • Thematic investments • Portfolio risk
Micro investment issues	Define the objective of 'active ownership', including: • Company engagement • Proxy voting
Stakeholder management	• Communication of ESG policy and implementation strategy to members and service providers • Educational needs • Transparency, disclosure and reporting strategy

Transparency and Disclosure

Section 1013D(1)(1) of the Corporations Act requires disclosure in a PDS of "the extent to which labour standards or environmental, social or ethical considerations are taken into account" (in the investment process). Regulation 7.9.14C requires actual disclosure on the issue of whether or not these matters are taken into account – and if they are stated to be taken into account, disclosure of which considerations are taken into account and the extent to which they are taken into account (refer ASIC Regulatory Guide 65).

In addition to disclosure requirements, industry best practice is for funds to provide transparency on their ESG integration strategy and progress. Many signatories to the PRI use the compulsory annual survey as the basis for their public reporting. To date, the survey responses have been private; however the PRI announced late in 2009 that it intends to publicly disclose certain segments of the survey responses from 2011. Another disclosure mechanism that can be used by funds is to do so via a sustainability report.

Conclusion

ASFA believes that ESG factors can influence investment performance and suggests that trustees consider ESG factors within the context of their funds' investment processes. There are a number of approaches that can be taken to integrate ESG factors into investment processes, which may allow a more comprehensive set of investment risks to be managed and investment opportunities identified to the benefit of fund members' risk adjusted returns.

ASFA welcomes feedback from trustees on this paper and is interested in maintaining an ongoing dialogue with trustees about their ESG integration experiences.

Appendix A – ESG across asset classes

Asset class	Why the potential risk?	Approach by investment managers	Possible first steps for super funds
Australian equities	Listed companies are often exposed to some level of ESG risk that may not be factored in by the market. Assuming there is stock liquidity, the risk can be actively traded, so it is important that managers are aware of the risks and opportunities. Australian superannuation funds are usually heavily exposed to this asset class and are therefore subject to market risk (beta) and stock or sector selection risk (alpha). ESG factors can be a significant driver of performance in these areas.	Generally, Australian equity managers have some form of implicit ESG considerations in their investment process, which would fall mainly under the category of "management quality" assessment. It is more challenging for quant and index managers to "integrate" ESG considerations into investment processes given the limited history of available ESG-related data; however all participants have the ability to engage companies and to exercise their voting rights.	• Ask managers to report on their ESG activities, including company engagement and proxy voting • Encourage investment managers to up skill on ESG issues • Appoint or join up with an engagement provider to lend weight to activities that encourage good governance across the whole market • Instil ESG capability as a requirement for all new manager appointments
Global equities	As per above, but noting that exposure and proportional holdings are typically smaller than for Australian equities. Investors may be exposed to different types of ESG factors than those most relevant to Australian companies. There may be wider opportunities for selecting managers with integrated ESG practices or for implementing thematic strategies.	There is a varied response to ESG integration globally and there is sometimes. misunderstanding of the differences between the mainstream ESG integration and ethical investing. A challenge for Australian funds - as they are often in pooled vehicles for global equities – is to exert significant influence over basic things such as the voting of shares.	• Request proxy voting reporting from all international managers. • Request consultants include ESG considerations in all international equity manager reviews. • Instil ESG capability as a requirement for all new manager appointments • Join international collaborative engagement initiatives such as CDP and IGCC.
Direct property	Given the low liquidity and immobility of investments in this asset class, there is incentive to 'future-proof' assets. Funds could become 'stuck' with poor performing assets in terms of operational efficiency and leasing ability (as the market trend is towards demand for more rated 'green properties'). In the long term, property managers who do not understand supply chain impacts (eg. energy intensity of building material) are likely to face cost pressures.	Australian property managers are recognised for their leadership in their approach to sustainability issues for the built environment. Only a few do not have in-house expertise and rigorous policies in place. Globally, responses are varied and often depend on the regulatory environment of the jurisdiction in which they operate.	• Use the governance process in place to ensure a systematic consideration of ESG issues • Request sustainability performance reporting at the 'whole of portfolio' level (eg. 'star ratings' for buildings and the plans the manager has in place to improve those ratings) • Request ongoing ESG reporting from investment managers on the environmental performance of assets

Asset class	Why the potential risk?	Approach by investment managers	Possible first steps for super funds
Australian and international fixed interest	Governance issues are often the most material ones for credit exposures due to their sometimes 'sudden' impact on credit quality. There are limited examples of companies that have failed directly as a result of mismanaging environmental and social issues. The issuer's performance in the management of environmental and social issues may give good insight into the quality of management and the effectiveness of governance.	Few managers to date have a clearly articulated a process for dealing with ESG risks for credit portfolios. This area is expected to develop rapidly in the near future. The PRI is keen to develop the integration of ESG factors in the fixed interest asset class, including a focus on sovereign debt.	• Engage managers in the annual review process and convey interest in explicit ESG management strategy. • Formulate and communicate a timeline for requiring ESG capability of investment managers
Cash	There is a generally low level of ESG risk in traditional instruments (bank bills, NCDs etc), although enhanced cash funds may venture into more elaborate instruments that are exposed to higher credit risk, causing ESG factors to become more important.	Similar to fixed interest fund manger response.	• Similar to fixed interest fund manger response.
Alternatives	The risk profile depends on the nature of the investment. For example, hedge funds often exhibit governance risk; 'clean tech' funds would be exposed to technological risk. Many alternatives exhibit relatively high liquidity risk, providing a rationale for greater due diligence at the front end of the process.	There is a low level of engagement from managers in the private equity and hedge fund sectors; funds that are built upon ESG integration or thematics are likely to be engaged.	• Benchmark all investments for ESG risk and opportunity • Engage with all managers • More intensive due diligence on hedge fund managers prior to investing to try to identify the conduits of ESG risks, including leverage • Monitor new developments (such as the private equity group in the PRI)
Direct infrastructure	Given the low liquidity and immobility of investments in this asset class there is incentive to 'future-proof' assets.	Investment managers who are longer-termed in their focus and diversified across infrastructure assets are often rigorous ESG managers. However, those with a much shorter-term focus tend to be more like private equity and less engaged on ESG.	Given the potential materiality of the risks to the assets (eg. electric utilities), funds may consider a focused engagement strategy with both the investment manager and asset consultants

Appendix B – Practical actions arising under each of the PRI initiatives

Some possible actions are listed next to each principle in order to illustrate practical measures for implementation. They reflect the guidance given by the PRI initiative:

Principle 1	We will incorporate ESG issues into investment analysis and decision-making processes
Possible actions	• Address ESG issues in investment policy statements • Support the development of ESG-related tools, metrics, and analyses at the stock, portfolio and fund level. • Provide rigour around policies with respect to investment managers and ESG integration, engage investment managers in formal dialogue, review investment management agreements (IMAs) • Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or ratings companies) to integrate ESG factors into evolving research and analysis • Encourage academic and other research on this theme • Advocate ESG awareness and training for investment professionals

Principle 2	We will be active owners and incorporate ESG issues into our ownership policies and practices
Possible actions	• Develop and disclose active ownership policies • Exercise voting rights (if internally managed) • Monitor compliance with voting policy (if externally managed) • Develop an engagement capability if appropriate • Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights) • Participate in collaborative engagement initiatives, for example: a) The Carbon Disclosure Project b) The Investor Group on Climate Change c) PRI-led initiatives • Require investment managers to undertake and report on ESG-related engagement activities

Principle 3	We will seek appropriate disclosure on ESG issues by the entities in which we invest
Possible actions	• Support collaborative efforts to push for standardise company reporting on ESG issues (using frameworks such as the Global Reporting Initiative) and the integration of such information into key financial reports • Support collaborative efforts that seek the adoption of and adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact) • Support shareholder initiatives and resolutions promoting higher standards of ESG disclosure by companies

Principle 4	We will promote acceptance and implementation of the Principles within the investment industry
Possible actions	• Include ESG-related requirements in requests for proposals (RFPs) • Align investment monitoring procedures, performance indicators and incentive structures accordingly to ESG integration • Communicate ESG expectations to investment service providers • Formulate policy with respect to dealing with service providers who fail to meet ESG expectations • Support regulatory or policy developments that support the implementation of the Principles

Principle 5	We will work together to enhance our effectiveness in implementing the Principles
Possible actions	• Support / participate in networks and information platforms where it is advantageous 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

Principle 6	We will report on our activities and progress towards implementing the Principles
Possible actions	• Use the PRI framework and annual survey as an internal and external reporting template • 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 ESG • Communicate with beneficiaries about ESG issues and the Principles • Make use of reporting to raise awareness among a broader group of stakeholders

Appendix C – Pros and cons of signing up to the PRI

The PRI is a voluntary initiative that superannuation funds and other asset owners (along with investment managers and professional service partners) may sign up to. It is a public, aspiration-based statement that the fund intends to implement ESG-practices.

The process for joining is relatively simple and listed on the PRI website (www.unpri.org/sign/). It requires superannuation fund signatories to read a brochure about the principles and email a letter from the fund's CEO to the PRI.

The following table lists some of the pros and cons of signing up:

Pros	Cons
• It is a major, high profile, global investor initiative that is increasingly recognised in the industry • It is a public statement about aspirations with respect to an emerging class of investment risk and opportunity • No ESG implementation is required prior to joining • It may assist internal awareness and impetus for ESG implementation • The reporting process is by way of annual self-assessment (new signatories are allowed a grace year) • Gaining access to information and resources that is restricted to signatories, such as practical case studies and asset class specific initiatives • Gaining access to company voting and other collaboration mechanisms • Gaining access to focused working groups, such as the 'Small Funds Initiative' • Eligibility to attend the annual PRI conference and other forums • Each signatory receives a benchmarking report after the reporting process is completed, showing where it sits relative to peers	• Annual reporting is compulsory and signatories commit to making certain parts of the response public, although this could also be viewed as a positive as the PRI process serves as a performance benchmarking and reporting tool • Given it is voluntary and self-assessed, it does not have the attributes of an accreditation system • A minimum fee will apply from 2011 that will be scaled according to fund size (a cap of US $10,000 will apply) • Some collaborative engagements can be time intensive • Signatories may be delisted if not fulfilling compulsory commitments • It is possible that compulsory obligations may change in the future • It is possible that future public reporting undertaken by UNPRI may change in the future

Appendix D – Investment Management Structures

Integrating ESG factors into investment decision-making requires consideration throughout all levels of the investment management process. Trustees should consider the impact on the following areas:

- Investment beliefs and philosophy;
- Investment policy statements and fund policies;
- Investment products, asset allocation, sector allocation and stock selection; and
- Investment management structure.

The development of ESG beliefs, policies, statements, and processes will be partly driven by the fund's investment management structure.

Management structure	ESG integration comments
Internal	• Trustees and management have direct control over ESG outcomes. • Investments are managed actively according to the abilities of the fund, such as voting proxies, company engagement, actively managing direct assets • Other activities may include purchasing specialist ESG research, signing the UNPRI, collaborating in forums such as ESG Research Australia (ESG RA). • The fund resources the key activities to ensure ESG opportunities and risks are appropriately managed in accordance with trustee policies.
External – via discrete mandates with investment managers	• Trustees and management have direct control over mandate structures and can influence ESG aspects of the investment management process through requirements specified in the RFP during mandate reviews • Trustees and management have indirect control over specific investment decisions • The resourcing of ESG management is shared between the fund and underlying investment managers, with the overall process complying with trustee policies.
External – via pooled vehicles	• Trustees and management have direct control over allocation to investment vehicles • Trustees and management, as a unit holder or co-investor, have indirect control over ESG outcomes • Trustees and management will be subject to the external manager's standards, although may be able to engage with and influence improvements in those standards.

Appendix E – Useful resources for Trustees

General ESG and Performance

Author / Issuer	Paper	Source
ACSI	A guide for superannuation trustees on the consideration of environmental, social & corporate governance risks in listed companies (2009)	http://www.acsi.org.au/images/stories/ACSIDocuments/es_guidelines_for_super_funds_final_pdf.pdf
CFA Institute	Environmental, Social, and Governance Factors at Listed Companies: A Manual for Investors	http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2008.n2.1
Finsia, Griffith Business School, PKF	In the long grass – leadership in adversity Climate change, ESG and the finance industry	http://www.finsia.com/AM/Template.cfm?Section=Current_campaigns&Template=/CM/ContentDisplay.cfm&ContentID=6731
Michael E Porter & Mark E Kramer	Strategy & society, the link between competitive advantage and corporate social responsibility	Preview(Harvard Business Review) http://hbr.org/2006/12/strategy-and-society/ar/1
The Carbon Trust	Climate change – a business revolution? How tackling climate change could create or destroy company value	http://www.carbontrust.com/publications/CTC740_business_rev%20v5.pdf

Legal and Fiduciary

Author	Paper	Source
ASIC	Regulatory Guide 65: Section 1013DA disclosure guidelines	Australian Securities & Investments Commission (2003)
(The) Cooper Review	Clearer Super Choices: Matching Governance Solutions	www.supersystemreview.gov.au
Jason Denisenko	Managing financial risk over the long-term – ESG factors and the evolution of trustee's fiduciary duties – a legal perspective	Contribution to the above Finsia forum: In the long grass – leadership in adversity, held in Sydney (2009)
Freshfields Bruckhaus Deringer	A legal framework for the integration of environmental, social and governance issues into institutional investment	A report sponsored by the UNEP Finance Initiative (2005) http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf
UNEP Finance Initiative	Fiduciary responsibility. Legal and practical aspects of integrating environmental, social and governance issues into institutional investment	The Asset Management Working Group of the UNEP Finance Initiative (2009) http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf