GET READY FOR MORE INVESTOR SCRUTINY ON ENVIRONMENT, SOCIAL AND GOVERNANCE ISSUES

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The UN Principles for Responsible Investment has taken an important step forward with the launch of a new framework, which will require its institutional investor signatories to report publicly in much greater detail how they integrate environmental, social and governance (ESG) issues into their investment policy.

Though the Principles are aimed at investors rather than companies, the new regime may have a significant impact on companies in the Gulf region. Those that are listed may find their investors becoming more interested in engagement on ESG issues. Those that are not listed may still note a growing interest in the financial community on how companies respond to these challenges, as well as greater pressure from stakeholders to increase their reporting on sustainability issues.

The Principles are the product of an initiative undertaken in 2005 by then UN Secretary General Kofi Annan who invited a group of the world’s largest institutional investors to develop a new approach to responsible investment. The resulting launch of the six principles at the NY Stock Exchange in 2006 marked an important milestone in responsible investment, not least because of its global significance. Responsible investment was no longer just an issue for individual national markets in the developed world. An important feature of the UN Principles is its worldwide reach.

Nonetheless the impact to date has been modest. In the US, for example, general counsels and other governance professionals have been slow to understand the relevance of the principles to capital markets. Few US-based asset owners—though some major asset managers—have signed on, and only a comparative handful of investors raise the principles when meeting with companies in which they hold stakes. The new framework means this could be about to change.

Until now, signatories had little obligation beyond payment of an annual fee and the publication of a bland statement of their adherence to the principles. Going forward, however, they will have to fill out a detailed 34-page online questionnaire, and their answers on portions of the document will subsequently be published. Both asset owners and asset managers will be required to do this and, though many are unhappy about the additional workload and exposure, they are under pressure to comply. Few are likely to want to suffer the embarrassment of being de-listed from the Principles or to be exposed as taking them lightly in comparison with rivals or peers. Asset managers, in particular, could face the
loss of clients, especially in Europe where asset owners are more dedicated to the integration of sustainability concerns into the asset management discipline.

By mid 2014, therefore the PRI expects 800 of its signatories to have used the reporting framework to disclose their policies, processes and performance in an objective and systematic way, using a common language to describe what they do. According to Wolfgang Enshuber, Chair of the PRI Advisory Council, “calls for the global investor community to be more transparent about how it is responding to the governance and sustainability challenges that define our era have grown louder since the financial crisis.” The new framework, he said, “will enable institutional investors to demonstrate how they are embedding material ESG factors into their processes and working to strengthen the governance of companies and the market as a whole.”

There are a total of six principles, but the first three are the ones that are most relevant to the new framework. The first commits funds to integrate environmental, social and governance risk factors into investment analysis so it is an important driver of their decisions whether to buy or sell securities and whether and how to engage with company managements. The second Principle requires signatories to be “active owners and incorporate ESG issues into ownership policies and practices.” This means going further than simple voting of shares at general meetings. Finally, the third Principle requires companies to integrate and report on ESG factors through channels such as the Global Reporting Initiative.

The new reporting framework will therefore compel both asset managers and owners to describe in detail just how they mesh responsible investment approaches into their trading and asset allocation decisions. This is likely to lead to a greater emphasis on ESG research, either conducted in-house or bought in from outside. It also means they will pay greater attention to company disclosures on governance, climate and workforce-related issues. Boards are likely to need to step up their reporting on these issues.

Asset managers will also have to disclose their approach to voting and engagement in greater detail, as well as what steps they have taken to push companies to undertake integrated reporting. Behind the scenes, therefore the pressure is growing. Companies everywhere are likely to feel the impact.