4. Integrating ESG factors in the investment decision-making process of institutional investors

This chapter reviews the different approaches institutional investors have taken towards environmental, social and governance (ESG) investments, and describes the main methods and tools institutional investors use when integrating ESG factors into their investment decisions. It focuses on the challenges and opportunities specific to pension funds and insurance companies, in light of their fiduciary duty and the long-term prospect of their investments. It also discusses the impact institutional investors' reliance on external ESG data and service providers has on how they approach their ESG investments, outlining issues pension funds and insurance companies need to address if this is the case. Finally, the chapter lists the main information and data points that institutional investors indicate as lacking or missing in order to conduct or rely on a robust ESG analysis. These insights can be of practical assistance to institutional investors looking to develop appropriate ESG governance structures and methods.

4.1. Introduction

Environmental, social and governance (ESG) investment, sustainable investment, socially responsible investment, impact investment, moral investment and other terms are being used more or less synonymously to define the practice of incorporating ESG factors in investment decisions. These factors are of increasing interest for many institutional investors and other market players. However, institutional investors vary in their approach to considering ESG factors for investment decisions, with different types of strategies, datasets and methods they use to integrate ESG factors in their decision-making.

This chapter describes the different approaches, practices and tools institutional investors use to integrate ESG factors into investment policies, and identifies possible trends. It also outlines the main challenges and opportunities they face when considering the integration of ESG factors in their investment decisions. These insights can be of practical assistance to institutional investors looking to develop appropriate ESG governance structures and methods. The COVID-19 crisis also points to the need to build more resilient portfolios that take varied factors into account.

Previous OECD work on the regulatory frameworks that apply to institutional investors in different jurisdictions concluded that integrating ESG factors in investment decisions is generally permitted if consistent with the financial obligations of insurance companies and pension funds towards their beneficiaries and members (OECD, 2017[1]).

The analysis in this chapter is based on several sources of data, including data from the United Nations Principles for Responsible Investment (UN PRI) and from an OECD survey on ESG integration circulated to insurance companies and pension funds in November 2019 (OECD ESG survey). The UN PRI data used includes information only from UN PRI signatories that are insurance companies and pension funds.[1] The OECD ESG survey collected information from institutional investors to better understand if and how ESG factors are considered and applied in their investment process.[2]

To understand these issues, section two examines whether and how insurance companies and pension funds consider ESG factors in their investment decision-making. Section three looks at the investment strategies used to integrate ESG considerations. Section four focuses on the different methods and tools used to analyse ESG criteria, either internally or by relying on external providers. Section five covers the main data points and practical tools that institutional investors report they are still missing to adequately integrate ESG factors in their decision-making processes. Section six concludes and highlights some of the main findings of this chapter.

4.2. Integrating ESG factors in the investment decision-making process

Institutional investors vary in their approaches to integrating ESG factors into their investment decisions. This section looks at whether or not ESG considerations are taken into account and, if so, which part of the organisation is responsible for setting and implementing their ESG strategy. It then describes some of the considerations institutional investors make for integrating ESG factors in their investment decision-making process.

4.2.1. Level of ESG integration

The integration of ESG considerations in investment decisions is becoming a more common practice among institutional investors. According to a survey conducted in 2018 by Natixis Investment Managers, nearly two-thirds of institutional investors believe that the integration of ESG factors will become standard in the industry within the next five years (Natixis Investment Managers, 2019[2]).[3]

However, not all institutional investors integrate ESG factors in their investment decision-making process at the moment. The OECD ESG survey results confirm that:

- Although many insurance companies and pension funds do make ESG considerations when selecting investment opportunities, a significant number do not.
- A majority of respondents declared that they integrate some ESG considerations into their investment decision process: 20 pension funds (out of 25 respondents) and 30 insurance companies (out of 51) considered at least some environmental, social or governance factors on new investments.
- Eighteen insurance companies and four pension funds responded that they do not take any ESG factors into account in their investment decision-making process.
- A small number of institutional investors – three insurance companies and one pension fund – which have not yet started integrating ESG factors -- responded that they were planning to do so in the future. These respondents indicated that the main reasons for not yet integrating ESG factors were a lack of resources, internal knowledge and guidance from policy makers on how to take ESG considerations into account.

According to both the OECD ESG survey and UN PRI data, most institutional investors that choose to integrate ESG factors in their investment decisions implement this through their general investment procedure. A small percentage of the insurance companies and pension funds that are UN PRI signatories offer sustainability themed funds focusing on one or more of the E, S and G pillars. Some themed funds are structured in a way that the investments would be (entirely or mostly) in firms whose products or services aim to meet an environmental or social needs, or firms that focus on long-term and strategic trends. Others may focus on efforts or targets that institutional investors set for themselves, for instance to invest only in firms that take significant steps to cut their carbon footprint.

Among institutional investors that integrate ESG factors, some may only consider one or two of the three dimensions, rather than all three of them. For example, an Asian insurance company responding to the OECD ESG survey stated that governance factors are integrated in all of its investment decisions, but not environmental or social factors. Regulation and the level of market development may be possible reasons for considering only some of the dimensions.

4.2.2. ESG considerations made by institutional investors

Institutional investors integrating ESG factors in their investment decisions face both challenges and potential opportunities and, in addition, estimating the potential risks and returns generated by E, S and G factors is complex. This complexity may be particularly relevant for insurance companies and pension funds that invest on behalf of their beneficiaries and policyholders, and have long-term investment objectives.[4]

ESG integration may be perceived as leading to a trade-off between promoting ESG objectives and risk-adjusted financial returns. As Chapter 1 also shows, empirical and academic studies find mixed evidence on the effect of ESG integration on financial returns:

- ESG integration may **reduce the diversification of portfolios and consequently increase risk**. ESG integration techniques such as exclusionary screening or divestment limit the range of available investments. According to modern portfolio theory, this could have a negative impact on returns over the long-term. Barnett and Salomon (2006[3]) find that applying a low number of ESG filters to build a stock portfolio may reduce the financial performance of the portfolio. However, they also conclude that financial returns can be augmented if a high number of ESG filters are used to select stocks.

- ESG factors in investment decisions may have a **non-negative or even a positive effect on financial returns and risk measures**. Studying equities over five regions between 2009 and 2018, Renshaw (2018[4]) concludes that integrating ESG factors in investment decisions may not always increase portfolio performance, but is also unlikely to be a significant drag on returns. Focusing on worldwide corporate bonds over a period of five years, Ferrarese and Hanmer (2018[5]) analyse that integrating ESG factors may lead to an increase in investment returns and a reduction in their variability.[5] Combining over 2 000 empirical studies since the 1970s, Friede, Busch and Bassen (2015[6]) find a correlation that is at least non negative between ESG investing and corporate financial performance in about 90% of cases, with a positive relation in the majority of cases, while Clark, Feiner and Viehs (2015[7]) show that 80% of 200 academic studies conclude that stock price performance is positively influenced by good sustainability practices.
- E, S and G factors may have **different impacts on financial performance, both in terms of scope and the relevant time horizon**. A correlation study of companies listed in the German Prime Standard between 2010 and 2014 shows that governance performance has the strongest impact on financial performance in comparison to environmental and social performance, where E, S and G performance are assessed through the change in Datastream scores for E, S and G (Velte, 2017[8]).[6] This could be due to the impact of changes to governance being visible more quickly than those from environmental and social changes.
- Any superior performance of portfolios integrating ESG factors may be due to the relatively recent integration of these factors by investors. If better risk-adjusted returns can be obtained by investors integrating ESG factors in their portfolios, then efficient markets should adjust to this reality and lead to a correction in the pricing of ESG factors. In this case, as ESG integration by investors becomes more widespread, **risk-adjusted performances should converge towards those of traditional portfolios**. E, S and G factors may already be reflected in asset prices, partially or fully. Core, Guay and Rusticus (2006[9]) show that firms with weak governance exhibit significant operational underperformance but that market prices already take this into account, which therefore does not translate into poor stock market returns.[7]
- It might take time for the effect of ESG integration to fully materialise. The implementation of E, S and G policies began only in the past decades, while these policies are long-term by nature. Companies that started considering these aspects recently might not immediately observe a positive impact on their share price or on the cost of their debt. E, S and G policies may also bear fruit over several years. Assessing the full impact of ESG integration on **investment returns may therefore only be possible over the long-term**, and it is still too early to know with certainty.

Due to the long-term nature of their investments, institutional investors may be better placed to shape and benefit from ESG policies. Insurance companies and pension funds are so called universal owners that invest long-term and have large and diversified portfolios. This gives them access to long-term opportunities, and the need to assess long-term risks when making their portfolio choices. Investors that do not require short-term liquidity may be in a better position to influence the management of companies they invest in or finance, so that corporate directors focus on long-term firm value (Busch, Bauer and Orlitzky, 2016[10]).

Institutional investors are expected to act according to transparency and financial consumer protection principles and other relevant regulations, and thus disclose whether ESG factors and risks are taken into account in their investment decision-making process. This is important because:

- Disclosure of ESG integration enables individuals to make informed choices concerning both a provider and an investment strategy, when that option is available. For life insurance and voluntary pension products, individuals should choose a provider and an investment strategy appropriate for them by understanding the potential risks and rewards of these investments,

including the criteria used to assess their performance. The investment strategy should be in line with their personal circumstances and preferences. Those willing to invest or save with companies that defend certain values may be willing to take E, S or G considerations into account, whereas other individuals might choose to focus on more conventional considerations. In New Zealand, for instance, individuals joining the KiwiSaver voluntary pension scheme who do not actively select an investment strategy are allocated to a default fund. From 2021, the default funds will be banned from investing in companies producing fossil fuel or illegal weapons, and will be required to disclose a responsible investment policy on their website.[8]

- Mandatory pension schemes or occupational pension plans, for which members may not have the option of choosing a provider or an investment strategy, should at least disclose whether ESG factors are taken into account as this may affect the performance of people's retirement savings. Norway's sovereign wealth pension fund, for instance, publishes a responsible investment annual report detailing the principles applied and expected of investee companies, how shareholder rights are used to encourage responsible business conduct, and how sustainability and ethical factors may affect its investment or divestment decisions.[9]

While some institutional investors view ESG as part of their fiduciary duty, others believe ESG integration may breach their fiduciary duty by taking into account interests other than those of the beneficiary (Schanzenbach et al., 2018[11]).[10] Institutional investors may argue that they are required to act according to the best interests of the people whose assets they manage and, given that E, S and G factors may be perceived as being outside of the financial spectrum, they should therefore not be included in their investment considerations. Most OECD countries do not have regulations that prevent institutional investors from investing in ESG opportunities, as long as they comply with their obligations towards their beneficiaries and notably with respect to fiduciary duty (OECD, 2017[1]). The United States requires fiduciaries to consider only the pecuniary benefits to beneficiaries when selecting investments, not collateral goals or other non-financial objectives.[11]

In most OECD countries, there is no obligation for institutional investors to consider ESG factors in the investment process. In the United Kingdom, however, pension funds have been required to integrate ESG issues into their investment approach since October 2019.[12] This includes issuing a statement of investment principles detailing how financially material considerations, including ESG, are taken into account in the investment-making process. The approach to shareholder engagement and stewardship must also be explained. In 2019, the International Organisation of Pension Supervisors (IOPS) published non-binding guidelines for supervisory authorities on the requirements needed for the integration of ESG considerations into investment and risk management processes.[13] In the European Union, the European Insurance and Occupational Pensions Authority (EIOPA) is currently working on an action plan to encourage insurance companies and pension funds to take sustainability considerations into account when making investment decisions.[14]

Differences in regulations related to disclosure requirements may partially explain some of the discrepancies in ESG integration between different jurisdictions. Several jurisdictions, including the European Union and Israel, require disclosure on whether and how any ESG considerations are taken into account by institutional investors.[15] Pension funds and insurance companies in countries with mandatory ESG disclosure requirements tend to exhibit improved ESG risk management practices. It is unclear whether this correlation is due to governments in these countries having a stronger regulatory approach in general, or to more comprehensive disclosure allowing investors to better analyse ESG-related risks and opportunities. It is also possible that regulation follows the market trends and adjusts to more advanced ESG practices that are already in place (UN PRI, 2016[12]).

Many institutional investors choose to comply with guidelines defined by international agreements and initiatives, such as the UN PRI or the Paris Agreement on Climate Action (Paris Agreement).[16] There may be several reasons for investors joining such initiatives:

- Regulations on ESG disclosure may be a catalyst for institutional investors to take part in ESG-related investor initiatives. Almost three quarters of European occupational pension providers surveyed by EIOPA as part of the 2019 stress test report declared subscribing to international principles for responsible investments such as the UN PRI.[17] Whilst regulations in the European Union do not require pension providers to subscribe to international principles for responsible investment, national competent authorities of the EU require institutional investors to report on ESG factors, which may indirectly influence providers to adhere to such principles.
- Institutional investors may do so in response to a demand from their clients, members or other stakeholders such as shareholders or employees. In 2018, 47% of the British pension provider NEST's members stated that it matters a lot to them to know that their pension provider considers how companies and markets they invest in are run, and how they treat people and the planet (NEST, 2018[13]).[18]
- Institutional investors may also wish to take part in the setting of guidelines and common rules applicable to investors.
- Membership of international initiatives such as the UN PRI allows institutional investors to access additional information and aggregated data on ESG factors, which enables them to make better informed investment decisions.
- Institutional investors that choose to join such initiatives publicly demonstrate their commitment to the principles set in the initiative's guidelines. This may have a positive influence on their image and reputation. A worldwide 2018 survey from State Street Global Advisors shows that 35% of pension funds declare adopting ESG principles primarily to avoid reputational risk (State Street Global Advisors, 2019[14]). Civil society input may also influence the behaviour of institutional investors.

4.2.3. Where ESG responsibilities lie

Whether institutional investors have an overall policy regarding ESG issues, or whether they manage ESG-related topics on a case-by-case basis, will affect how embedded ESG considerations will be. Most companies review their ESG policy objectives regularly. Out of the 255 institutional investors in the UN PRI sample reviewed, 147 have reported that they review their ESG policy objectives annually, 72 more frequently (quarterly or more often), and 23 less than once a year. Only 13 institutional investors reported that they review their ESG policy objectives on an ad hoc basis.

In different companies, ESG matters are examined at different levels of the organisational hierarchy. The implementation of ESG considerations in investment decisions does not necessarily mean that the company has a person or a unit in charge of oversight of responsible investments. Whether ESG or responsible investments are overseen and, if so, the seniority of the person or unit responsible – board, CEO, CIO, investment committee, or lower levels – will have an impact on the ultimate decision-making process.

When designing the governance structure for the setting, implementing and overseeing of ESG policy, it is important to consider the implications of the different approaches. On the one hand, involvement from senior management would demonstrate stronger commitment towards the issue. The distance between the person holding ultimate responsibility for ESG matters and the board may be one of the factors considered when estimating the ESG rating of a corporation.[19] On the other hand, ESG principles set at too high a level may be difficult to practically implement in actual investment decisions.

ESG matters are often dealt with at the board level, at least to some extent. Board involvement may demonstrate commitment and the relevance of ESG matters within the company. The board of directors may be involved in different stages of ESG implementation:

- ESG policy and principles: Company boards usually set out a policy that addresses the main ESG principles. The board may also set more concrete ESG targets and goals. Often, the investment committee is held responsible for implementing the set policy in the investment decisions.
- ESG governance structure: Some companies choose to establish a governing body that is designated for ESG topics and holds responsibility for all sustainability-related issues, such as an ESG board or a socially responsible investment (SRI) board committee. ESG governing bodies could consist of several board directors, to which all functional departments are required to report directly on any ESG-related issue.
- ESG oversight: Some boards are not actively engaged and ask to receive periodic reports and to be informed on ESG sustainability-related issues, on a regular basis.

The board of directors may also choose to delegate the responsibility for ESG investment decisions to different levels of management. Segregation of ESG responsibilities may occur, for example, when meeting the set ESG targets is the responsibility of the chief financial officer, while reporting ESG investment decisions to the board is the responsibility of the chief investment officer.

Some insurance companies and pension funds have a designated officer, committee or task force for ESG or responsible investment issues. This is more common in bigger companies or groups with necessary resources to allocate specific functions to ESG topics. In companies with smaller investment teams, ESG-related functions are more likely to be carried out jointly with other responsibilities.

Companies can choose to have a multilevel governance structure dedicated to ESG issues. For example, a large insurance group, which integrates ESG factors in its insurance and investment activities, has structured the governance accordingly. The highest governing body for sustainability-related issues is the group's ESG board, which includes some of the group's board members. The group's corporate responsibility management team acts as the executive office for the ESG board, and is responsible for managing the strategic framework for all group-wide sustainability activities and supporting the different operational functions in the integration of the strategic sustainability approach and policies into the business processes.[20]

4.2.4. The level of ESG integration varies among companies

Given that ESG integration is an ongoing process, investors may approach it in a phased manner. The first phase of integration would be to see ESG through the risk lens, and assess each ESG factor by their potential impact on financial returns. The second phase would be to consider the impact of different investments on ESG-related objectives when choosing between two comparable assets. The third phase for institutional investors more "advanced" in their ESG journey would be to set themselves goals or objectives in terms of ESG effects. These objectives are often linked to the UN Sustainable Development Goals (UN SDGs), the Paris Agreement or other initiatives.[21]

Institutional investors may view ESG factors, mostly, as an additional risk factor. Here, the aim would be to widen the scope of risk management to include ESG factors to complement traditional financial analysis and portfolio construction, and ultimately improve the risk-adjusted financial returns. Some institutional investors may include ESG factors in their overall risk assessment and management, while others will consider ESG factors as an integral part of the traditional analysis performed when examining the risks for specific investments. For example, when investing in real-estate assets, ESG risks would be considered in connection with the property location.

Investors often report that they perceive the incorporation of broader ESG criteria as the next phase in their development. Some insurance companies that have already integrated a number of ESG criteria in their general investment process reported that they plan to further expand their ESG investments into ESG-themed funds, bonds, and other impact investments.

Several institutional investors already approach ESG factors as part of their overall decision-making process and investment decisions not only as financial criteria but also as factors external to financial considerations. This policy usually follows a strategic decision made by the investor or the group. For example, one large insurer, which operates according to the policy of its group, has an ESG strategy and a climate strategy that is applied in the investment process. Here investments are perceived as an effective means to achieve change.[22]

ESG considerations may also play a role when asset management is delegated to an external manager. Some institutional investors require that all external asset managers they contract with must be UN PRI signatories. Others assess the ESG-related policies and practices of their selected asset manager, both during the initial selection process and on an ongoing basis.

Impact investments are often portrayed as a more "advanced" ESG strategy. Investors that focus on ESG objectives, such as climate change mitigation, may put more weight on the ESG factors that are relevant to these objectives, which they may apply either to specific funds they manage or to the whole of their managed assets. For instance, in 2020, a large Danish pension fund that has been integrating responsibility and sustainability principles in its investment decisions for several years introduced a pension product that focuses its investments in selected climate-focused assets. This product targets similar long-term returns as "traditional" pension products offered by the provider. However, since fewer potential investments are available due to the special focus and characteristics of the investment policy, the provider clarifies that it is plausible that the returns of this fund would be more prone to volatility and fluctuation in the shorter term.[23] This is an example of advanced ESG integration, where ESG-related objectives are the main focus of investments, and ESG criteria may overcome traditional ones such as the expected risk-return profile.

4.3. Strategies used for the integration of ESG criteria

Several types of strategies are being used to integrate ESG factors in investment portfolios. Chapter 1 lists the different types of ESG integration investment strategies used by investors. This section discusses the merits of some strategies depending on different objectives and asset classes.

4.3.1. Main strategies to integrate ESG criteria

Exclusion or avoidance is often the first step in ESG integration that nearly all OECD ESG survey respondents use. **Divestment** is also widely used among institutional investors. Controversial sectors such as weapons, coal and tobacco are most-frequently cited for exclusion and divestment. Investors also often exclude investment in fossil fuel exploration and production, alcohol, gambling, gender imbalanced boards and pornography.

Norms-based or inclusionary screening, including best-in-class investing, is frequently used after performing the initial step of exclusion. Among the assets suitable for the portfolio, the choice of the specific assets to invest in may be made according to various E, S and G factors. Investors therefore use a rating system or scale, which has been developed internally or externally, to assess the relative performance and ESG rating of the different assets. The final selection of assets may be done by selecting all companies that are higher than the average, or those that achieve a score higher than a set threshold or achieve the top ratings in each one of the asset classes.

The best-in-class approach may also apply to different sectors and specific ESG objectives. For carbon-intensive sectors, for instance, some investors mention that the best-in-class choice would be based on the carbon footprint and that they invest only in companies with a low carbon footprint or those taking serious steps to improve their current carbon footprint.

Active ownership and engagement are also widely used ESG-integration strategies, although not all institutional investors apply this strategy. The G20/OECD Principles of Corporate Governance (G20/OECD Principles) emphasise the importance of active engagement for fiduciaries but also recognise that not all institutional investors may be willing to engage as active shareholders and that making engagement mandatory may be ineffective. For investors that choose to engage as active shareholders, via voting at shareholder meetings as well as via other channels, the G20/OECD Principles set forth guidelines regarding the disclosure of voting policy and decision-making processes, and the proper management of potential conflicts of interest, (OECD, 2011[15]) (OECD, 2015[16]). It should be noted that regulations may prevent institutional investors from carrying out certain practices related to active ownership. For example, in Colombia and Costa Rica, pension funds are prohibited from voting at shareholder meetings.

When applying an active ownership and engagement strategy, institutional investors may choose to vote in person. However, the most common practice is to use proxy voting, due to the scope of manpower and resources needed for the operation of such a strategy. Some institutional investors as well as some external service providers establish collaboration and joint mechanisms for voting and engagement.

Sometimes, in cases when engagement efforts are not successful and a company is irresponsive to such measures, divestment may be the next step taken by institutional investors. Divestment may also be applied as a response to an ESG-related event that is expected to have an effect on the performance of the company. For example, after pursuing multiple attempts to communicate and engage with a Mexican mining firm concerning the risks posed by the firm's new tailings dam, a large Danish pension fund announced in 2020 that, in the absence of a response to their efforts, the mining firm is now blacklisted and their investments sold off.[24]

Thematic ESG focus is another commonly-used strategy by institutional investors. Some investors direct their thematic investments towards assets that promise secure investment returns as well as positive sustainability impact, such as green, sustainable and social bonds and microfinance funds.

4.3.2. Relevance of different strategies

Responses to the OECD ESG survey show that different strategies may be used to achieve similar goals, or act as a substitution for one another:

- Companies not using exclusion or divestment still declared using active ownership for equity investments and ESG risk management across all asset classes, possibly through external managers that may apply exclusionary screening or divestment.
- The only two insurance companies that declared that they were not using any exclusionary screening process for their investments reported using thematic investment for at least some of their asset classes. This may imply that thematic investment may be used as a substitution to exclusionary screening. Thematic investment could also be seen as a means to apply positive - rather than negative – screening to an investment portfolio.

Not all strategies are relevant to all portfolios, and some of the strategies commonly used for the integration of ESG factors may not be suitable for certain institutional investors. For instance, engagement is sometimes perceived as irrelevant by certain investors. According to UN PRI 2019 data, institutional investors mention two prominent reasons for not engaging: when managing a passive investment portfolio and when amounts invested in companies are small. For investments with such characteristics, the ability of the institutional investor to make an impact by engaging may be limited.[25] Some investors also mention the labour intensive nature of engagement and active ownership as reasons for choosing not to engage.

Strategies may vary according to the relevant asset class:

- In general, the incorporation of ESG factors in the investment decision is more common for some asset classes than others. According to UN PRI 2019 data, most institutional investors

incorporate ESG factors when investing in listed equities, fixed income investment instruments, private equity and infrastructure. For other asset classes, especially complex ones such as hedge funds, ESG incorporation is still relevant but less common.

- Some of the ESG integration strategies are relevant only to certain asset classes, while others apply to a broader set of assets. For example, active ownership applies only to holdings where the investors are directly involved in management or have voting rights, such as real-estate or equities. In infrastructure, private equity or hedge funds, the limited partnership format of investments may restrict the ability of institutional investors to apply active ownership strategies. As for engagement, this is applicable to many asset classes, and institutional investors can use it to influence corporate decisions through their equity holdings, as well as investments in debt instruments such as bonds and loans.
- ESG impact investments may be difficult to apply to passive investments, as these investments are based on the tracking of an external index and leave less room for the discretion of the asset manager. Therefore, it is more likely that investors will apply this strategy to active asset classes.
- Thematic investment is frequently applied via investing in designated funds. Many institutional investors mention applying the strategy of thematic investment by investing in funds that invest in companies that are involved in specific activities linked to an environmental or social theme.

Some ESG strategies may be more common for certain asset classes than for others. For example, currently, for impact investments, investors often choose green bonds and ESG-themed funds that focus on targets that relate to E, S or G.

4.3.3. Investment characteristics considered when evaluating ESG criteria

Institutional investors integrate ESG considerations in the investment decision-making process to generate investment ideas and themes, to select individual assets for their portfolio, but also to decide on the weights of different assets in the investment portfolio. This would involve examining ESG factors at the country level, company level and asset level.

Insurance companies and pension funds use various methods to examine the country of an issuer in their ESG assessment. Institutional investors may exclude investment in countries based on their own criteria relative to E, S and G, such as countries subject to international sanctions for instance, or those with an oppressive regime or limited civil rights, based on an internal assessment. Insurance companies and pension funds may also rely on external country ESG ratings to authorise investment in foreign countries. For instance, institutional investors may apply sovereign exclusions based on thresholds for the E, S or G criteria, or the overall ESG rating of a country provided by an ESG rating company. Institutional investors may also use ESG strategies such as active ownership to improve the awareness to ESG criteria in foreign companies, rather than using sovereign exclusions.

When looking at the country level, the ability of the institutional investor to identify and assess any material sustainability risk may be more important than the regulatory approach of the country. Most institutional investors responding to the OECD ESG survey reported that they were mainly concerned with understanding the potential long-term risks threatening a company, rather than the rules and regulations in its country of establishment. As long as institutional investors can access the data required for their ESG assessment, insufficient or lacking local regulatory standards on ESG matters and disclosure will not be obstacles to investing in most cases. Investors may even expect certain ESG standards to be met by potential investee companies, regardless of the local applicable regulation.

By applying a financial approach to ESG, institutional investors may examine the impact of the regulatory framework on future returns as one of the aspects that could affect the value of companies or assets, rather than examining the regulatory framework itself. However, some institutional investors also rely on a country's regulatory approach to ESG to influence their investment decisions. Several pension funds

answering the OECD ESG survey indicate that ESG regulations and disclosure of ESG standards in foreign countries are part of the drivers of investment decisions.

The company or issuer level is the main level of assessment of ESG factors when contemplating an investment. Table 4.1 details some of the categories analysed by institutional investors when evaluating the ESG classification of an issuer, together with concrete examples of the criteria examined.

Table 4.1. ESG criteria assessed by institutional investors at the issuer level

Type	Category	Example
E	Climate change	Carbon emissions, climate change mitigation, climate change adaptation, environmental strategy
E	Pollution	Air polluting emissions, spills, waste prevention and management
E	Water	Use of water resources, water management and conservation
E	Energy	Energy consumption
E	Biodiversity	Land, flora and fauna diversity
E	Animal welfare	Animal testing
S	Privacy	Data security
S	Community involvement	Social impact of business operation, products and services
S	Human capital	Diversity and inclusion, training and development
G	Corporate governance	Board skills, balance of power and authority within the board, quality of accounting and audit, management turnover, shareholders' rights, disclosure of remuneration
G	Market behaviour and business ethics	Blocking competition, short-selling, transparency for investors
S and G	Involvement in controversial situations	Corruption, violation of human rights
S and G	Human rights in the workplace	Work conditions, health and safety, non-discrimination

Source: OECD 2019 ESG survey.

Finally, institutional investors may also look at the asset type itself to integrate ESG factors in their investment decision. Some asset types may be directly designed according to ESG criteria, such as green bonds. Other assets may be earmarked for specific projects, purposes or activities in connection with ESG opportunities, such as renewable infrastructure financing for instance.

4.3.4. Are specific ESG strategies more suitable when targeting specific goals?

Some strategies are more common, and perhaps better suited, for specific ESG considerations. Institutional investors may choose to opt out of certain common market practices if they feel that these practices may contradict their general principles or philosophy of investing. For example, a large pension fund recently decided to suspend stock lending on its portfolio, due to the short-term nature of this practice, the potential effect of short selling on capital markets, and the lack of transparency stock lending entails. Such institutional investors promoting a long-term perspective of investments may find that practices such as stock lending are inconsistent with their investment policy.[26]

Environmental factor integration is widely done via impact and thematic investing. Insurers and pension funds may, for instance, have a specific team managing investment in renewables and greenfield within their infrastructure investment allocation, define targets for investments in green bonds, social infrastructure or renewable energy projects, or have specific investment options that invest in green bonds and companies addressing environmental issues.[27]

Engagement is another strategy used for the promotion of environmental objectives. Institutional investors may, for instance, develop engagement activities in countries where the economy highly depends on the

coal sector by implementing a dialogue with stakeholders such as companies and customers with the aim of lowering carbon emissions in these countries.[28]

Exclusionary screening may be used to integrate all three aspects of E, S and G factors in investments. A large Australian pension fund offers its members a "socially aware" investment option, which applies exclusions based on E, S and G factors.[29] This investment strategy does not invest in fossil fuels or uranium reserves, companies flagged as having human rights, labour, environmental or governance controversies, companies that produce tobacco, cluster munitions or landmines, and large Australian companies with exclusive male or female boards. Similarly, a large international insurance group excludes sectors and companies that are problematic in terms of social, human rights, ethical or environmental aspects, such as controversial weapons, coal mining and coal-based power generation, palm oil, food commodity derivatives and tobacco.[30]

The integration of social factors in investment decisions can also be achieved through engagement. Institutional investors, for instance, promote social responsibility and sustainable business practices by implementing ESG integration in their investment policy. Criteria such as gender equality, freedom of union and exclusion of child labour can be targeted, and engagement through dialogue with companies and issuers used to promote these objectives.[31] Another example for engagement strategy can be found in the increasing pressure that comes from institutional investors to improve gender diversity in corporate boards and senior levels of management. Some institutional investors set thresholds regarding the share of women on company boards, and engage with the management of companies that fail to meet such thresholds (Goodman and O'Kelley, 2017[17]).

4.4. Methods and tools to evaluate ESG criteria

Institutional investors that integrate ESG in their investments use different methods for the evaluation of ESG factors, whether they conduct the analysis in-house or outsource it.[32] Even investors that perform their ESG analysis internally often rely on external data and other service providers for the evaluation of ESG factors. This section describes the methodologies and tools being used by investors for ESG analysis, and reviews the reasons for using external providers and some of the implications of the broad use and reliance on such providers.

4.4.1. Methodology for in-house ESG analysis

Exclusionary screening is usually the initial step of ESG analysis. The exclusion can apply to specific sectors, or be based on a minimal threshold score for different issues deemed controversial. The minimum ESG rating consists of metrics that are in connection with the different pillars of ESG. For insurance companies and pension funds that are part of a financial group, exclusion policies may apply across the group, or be company specific.

Different factors that are taken into account when evaluating the ESG performance of the company under consideration may then be included in the analysis.

a) ESG issues can be part of the financial analysis performed by investors when analysing the fair value of a company and its micro-economic attributes, rather than a market as a whole. It requires examining the specific ESG factors that can influence a company's valuation or cost of debt.

b) Other investors develop specific methodologies for ESG analysis, which are added as an extra ESG layer to the general investment analysis. Some institutional investors have set up a complete ESG methodology, which is used to assess environmental risks and opportunities based on detailed analysis and indicators.[33]

A best-in-class approach may be applied after analysing and classifying different assets. It is usually applied separately for each asset class and for each sector. The weight of the different criteria may vary according to the sector. For instance, the energy consumption of an issuer from the financial sector is not the same as the consumption of an issuer from the transportation sector, and therefore will be evaluated differently for each of these sectors.

4.4.2. ESG data and analysis tools

Institutional investors use a variety of tools to make ESG-related investment decisions, whether they conduct their ESG analysis in-house or externally.

Insurance companies and pension funds using their in-house model to analyse ESG factors often rely on global frameworks and initiatives as inputs. Several respondents to the OECD ESG survey use a variety of international norms and standards as tools for their proprietary ESG model, including the following:

- **OECD Guidelines for Multinational Enterprises**: these government-backed recommendations set standards for responsible business conduct across a range of issues such as human rights, labour rights, and the environment.[34] Compliance of potential investee companies with these guidelines is a requirement for several pension funds and insurance companies surveyed by the OECD. In 2017, the OECD articulated key considerations for institutional investors in carrying out due diligence to identify and respond to environmental and social risks, within their portfolios (OECD, 2017[18]).
- **International Labour Organization** (ILO) conventions and recommendations: the legal instruments developed by ILO constituents (governments, employers and workers) set out basic principles and rights for workers. ILO conventions are binding, whereas ILO recommendations serve as non-binding guidelines. Including criteria on the application of ILO conventions in their checklist is a common approach for institutional investors.
- **United Nations Global Compact**: this voluntary initiative is based on a commitment by the management of companies to implement strategies and operations according to principles related to human rights, labour, environment and anti-corruption.[35] The ten principles of the Global Compact are derived from the Universal Declaration of Human Rights, the ILO's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and the UN Convention Against Corruption.
- **International Organisation for Standardisation** (ISO) standards: these standards apply to products and processes and represent best practices as defined and agreed by experts in different fields of work.[36] ISO standards which institutional investors may require investee companies to fulfil range from health and safety standards, quality standards, to information technology security standards and food safety standards, and environmental management and energy management standards.
- **United Nations Principles for Responsible Investment** (UN PRI): Insurance companies and pension funds may be signatories of the UN PRI. They may also require that any investment-related firm they invest in, or with, also sign the principles and commit to the reporting and accountability framework established by the UN PRI.
- **Sustainability Accounting Standard Board** (SASB): SASB develops standards on the reporting of financially material sustainability information for investors. The 77 standards set out by SASB are industry-specific and come with metrics to assess and compare the materiality of E, S and G factors across companies in a sector. Pension funds and insurance companies use the SASB standards and agreed metrics as inputs to their ESG internal models.

Insurance companies and pension funds may also rely on external data providers for ESG-related data to make related investment decisions: private providers of ESG data through ratings, rankings or indices; and providers of engagement and stewardship advice.

ESG rating and index providers are a common source of data on ESG risks and opportunities. Some providers offer ESG data as a subset of their traditional financial data analysis, while others specialise in ESG data only. ESG data providers may cover all asset classes or focus on an area or category only. Table 4.2 illustrates some of the providers used by pension funds and insurance companies that responded to the OECD ESG survey.

Table 4.2. ESG index and rating providers

	Global data provider	ESG data only	Asset classes covered	ESG ratings/rankings	ESG indices
Bloomberg	X		All	X	X
CDP		X	All	X	
Factset	X		All	X	
GRESB		X	Infrastructure and real estate	X	
ISS Financial		X	All	X	
Morningstar	X		All	X	
MSCI	X		All	X	X
Refinitiv / Thomson Reuters	X		All	X	X
S&P's Trucost		X	All	X	
Sustainalytics		X	All	X	X
TruValueLabs		X	All	X	X

Note: The providers listed were cited by respondents to the OECD ESG survey.
Sources: https://www.bloomberg.com/professional/solution/esg/; https://www.cdp.net/en/data; https://www.factset.com/products-data/esg-solutions ; https://gresb.com/; https://www.issgovernance.com/ ; https://www.morningstar.com/company/esg-investing ; https://www.msci.com/ ;https://www.refinitiv.com/en; https://www.trucost.com/; https://www.sustainalytics.com/esg-data/; https://www.truvaluelabs.com/.

Private data providers may publish rankings of companies according to ESG criteria, or may design indices according to ESG investment strategies. They may also provide ESG-related data based on some internal calculations for institutional investors to use as inputs in their own models. For instance, TruValueLabs provides ESG scores based on the processing of data through artificial intelligence, using custom and standardised criteria such as the SASB standards.

Proxy voting and stewardship advice is also often outsourced by insurers and pension funds to external advisors and pooled among institutional investors. The joint action allows investors to increase their relative share and influence on companies. Two main types of engagement and stewardship advice providers exist:

- Private specialised engagement consultants such as Hermes EOS or CGI Glass Lewis specialise in dialogues with company directors on behalf of shareholders and bondholders to influence management decisions on E, S and G issues. Engagement and voting policies offered by such consultants are based on research and analysis of the underlying companies, and can be accompanied by technical support solutions to manage proxy voting and class action claims.
- Associations or public groups of interest work collectively with other long-term investors to influence corporate behaviour through voting. For instance, the Australia Council of SuperAnnuation Investors (ACSI) provides recommendations to pension funds and other institutional investors holding direct shares of equity on how to vote at annual general meetings

of Australian listed companies.[37] ACSI focuses mainly on board diversity, corporate governance, climate change, workforce issues and corporate culture. Another example is the Red Line Voting campaign developed by the Association of Member Nominated Trustees in the United Kingdom, which defines several key ESG areas on which fund managers in charge of managing the assets of UK pension funds should actively vote against management decisions in annual general meetings.[38] Key areas include topics related to climate change and environmental damage, corporate social responsibility, equal opportunities and labour ethics, and board election and remuneration.

The use of external providers for stewardship advice may facilitate transparency and disclosure requirements for institutional investors. Several OECD jurisdictions have imposed obligations to disclose voting and engagement policies when representing individuals. For example, institutional investors based in the European Union must apply the Shareholder Rights Directives (I and II) which require them to publish (free of charge) online information regarding the development and implementation of their shareholder engagement policy. In the United Kingdom, the statement of investment policy published by pension funds must also include a stewardship policy. External providers may facilitate this process for insurers and pension funds, which may not have the internal skills and manpower to justify the voting and engagement policies, as well as ensuring their consistency and application.

4.4.3. Reasons for the use of external ESG data and service providers

The data necessary for evaluating ESG criteria are not always available publicly as private companies are not always required to disclose information related to ESG issues, such as carbon emissions (E), diversity and inclusion (S), and board decisions (G). Even for publicly listed companies, information that may be required to assess how they function with respect to some E, S or G factors may not be available to the public.

Institutional investors often rely on public sources to obtain relevant ESG data for their internal models. Sources such as government publications, reports from international organisations (including Eurostat, International Energy Agency, OECD, United Nations, World Bank), and non-governmental organisations are commonly used by insurance companies and pension funds when they are analysing ESG risks and opportunities. However, investors are not always able to aggregate and analyse the available data by themselves. This is particularly the case for smaller organisations, which tend to work with external asset managers.

Models and metrics are not yet broadly accepted or agreed upon, and developing models based on existing data requires both funding and manpower, which institutional investors may not have or be willing to use.

In addition to the need for data and metrics in order to assess and evaluate ESG criteria, the ongoing operation of some of the ESG strategies themselves may also require vast manpower and funds that investors may be reluctant to spend. It is common for institutional investors to outsource activities related to strategies such as active ownership and engagement. It is however worth mentioning that using external ESG data providers also has a cost, which not all institutional investors may be willing or able to pay.

4.4.4. Implications of using external providers for ESG analysis services

The models and metrics used by external providers are not transparent and not always robust across different providers. ESG ratings and indices may lack consistency and investments made according to the criteria set by one provider may not fare well according to the E, S or G criteria selected by another provider (Chapter 1).

Many investors rely on the same data for ESG integration, which may have implications on financial markets. Whether relying on indices, on the recommendations of a data provider, or using their own internal models to decide on investment and allocation, institutional investors often rely on similar data providers

or sources for their analysis of ESG investments. Using the same data may lead to some form of standardisation of ESG data, thereby improving comparability between sources. However, financial markets may also be relying heavily on data that is not adequate or fit for purpose.

The use of external providers for stewardship advice, especially when pooled and joint with other investors, may increase the effectiveness of voting and engagement policies through the coordination of decisions among shareholders. Yet, using pooled service providers for stewardship advice may also lead to herding behaviour and paradoxically favour disengagement if many institutional investors apply the same rules with little internal analysis of E, S and G factors and impacts.

Outsourcing the analysis of ESG considerations to external service providers may paradoxically result in a decrease in the involvement by institutional investors. Insurance companies and pension funds may rely too heavily on external consultants, and engagement, voting policies and ESG integration in general may become a box ticking exercise rather than rise higher up in the management agenda of asset owners.

The cost of using external providers for ESG analysis and data provision may prevent some institutional investors from integrating ESG factors and risks in their investment decision-making. Many providers of ESG data and indices are private companies and charge for their services, which not all pension funds and insurance companies may be able or willing to purchase.

4.5. Additional data and information that is currently missing

Even institutional investors that rely on several sources of data and modelling to assess ESG criteria may find that there are some gaps in the data and missing information for them to perform their analysis robustly. This section reviews the main data points and analytical tools that institutional investors responding to the OECD ESG survey mention as lacking, and some suggestions brought up by institutional investors as possible solutions.

In general, investors express concerns regarding the lack of transparency and global standards for data disclosure and analysis. Currently, the datasets are inconsistent and incomplete (OECD, 2017[1]). Not all companies disclose information on their ESG polices and performance, and when information is disclosed, companies often tend to give a qualitative and verbal disclosure. The need for a reliable, coherent and comparable information is particularly important for institutional investors, due to their fiduciary duty when managing other people's money.

Thus, many institutional investors voice the need for universal standards for the disclosure of ESG-related data. This will require standardised datasets to ensure their coherence and comparability. Reliable and comparable data is critical in order to improve the quality of ESG analysis. Shifting to a standardised and quantitative disclosure would allow better measurements and evaluation of companies' efforts, leading to a better understanding of the risks and opportunities of investments and compare different companies and assets. It is worth mentioning that several initiatives to establish consistent and comparable disclosure frameworks are currently underway.[39]

There is also a demand for alternative data that does not depend on companies' disclosure. Independent data is considered important in order to increase the ability of investors to understand companies' exposure to ESG-related risks and to have a more comprehensive view of companies' performance.

Specific points of data and information that institutional investors consider important to perform a thorough ESG analysis, and which is missing or inaccessible, include the following items:

- Investee companies' environmental policies:
    - Companies' climate targets.
    - Improved data quality on companies' carbon emissions.

- Social policies:
  - Inequality indicators.
  - Community impact.
  - Evaluation and measurement of impact investment.
- Investee companies' governance:
  - Companies' corporate governance and tax issues.
  - Additional granularity on revenues to better identify positive and negative business units.
  - Companies' ESG policies and strategies.
  - Companies' future capital expenditures and strategic plans.
- Fund portfolio:
  - Breakdown of fund portfolios to the level of individual companies or assets.
  - Analysis of ESG factors for investments in private equity.
  - Climate change scenario analysis at the portfolio level.

As most institutional investors base their investment decisions on different models, rating scales and indices, there is a high demand for transparency of the structure, metrics and relative weights of the models, and for a more detailed explanation of the different ESG rating construction methodologies. Access to granular data upon which analysis is based would enable institutional investors to evaluate external ratings.

In addition to the standardisation of datasets, developing standardised processes and globally accepted indicators that are comparable and financially valid is very important for institutional investors that need to rely on these indicators when making investment decisions.

Establishing publicly available datasets for companies and countries could allow comparing different ESG rating agencies' scores. Some institutional investors call for solutions guaranteeing that the analysis performed by ESG rating agencies and external service providers is done according to set quality measures, which would increase institutional investors' trust when incorporating ESG criteria in their investments. Such datasets could also alleviate the reporting burden on corporates, by reducing the number of different measures and indicators they are required to provide to be assessed by ESG rating agencies. In March 2020, the European Commission published the EU Taxonomy which sets performance thresholds on several E, S and G factors to assist investors and companies that choose to consider such factors.[40]

4.6. Conclusion

Pension funds and insurance companies are increasingly choosing to integrate ESG factors in their investment decisions. Some examine ESG factors mainly via the risk management lens as an opportunity for higher financial returns, while other institutional investors perceive ESG as non-financial objectives such as carbon emissions or other sustainability-performance targets that they aim to promote.

Despite the growing interest in ESG factors, ESG integration is still challenging for many investors. The effect of ESG factors on the financial performance of investments is unclear, and the resources necessary to make informed decisions remain high. Reliable ESG data is not yet widely accessible, which may prevent institutional investors from being able to assess and analyse ESG factors and opportunities.

There are different strategies to integrate ESG factors into investments, and institutional investors select those which are best suited to their portfolio and approach to ESG integration. Insurance companies and

pension funds may combine several ESG strategies to achieve objectives, which can be set in their ESG policy or in their general investment policy.

Active ownership and engagement, when available, are ESG incorporation strategies which could be particularly relevant for pension funds and insurance companies due to their portfolio size and long-term focus, with the potential to influence corporate and market behaviours. However, engagement may also be costly and thus less relevant for some institutional investors, in particular those with smaller volumes of assets under management.

External data providers are a significant element in the ESG integration process for institutional investors. There are a broad range of ESG considerations which require specialised data analysis, and may lead institutional investors to rely, at least to some extent, on external data providers and ESG rating indices and agencies. The use of external ESG service providers may contribute to reducing the cost of ESG analysis and to strengthening the influence of institutional investors on corporate and market behaviours. However, using external private providers may also lead to ESG becoming a box-ticking exercise for institutional investors or to them relying heavily on data and models that are not transparent.

Cost implications of integrating ESG factors should also be considered. Whether outsourced or implemented in-house, ESG integration entails some costs for institutional investors, which are likely to be ultimately borne by members, beneficiaries and customers.

Improving the availability, consistency and quality of ESG information could help institutional investors better understand how they might approach the integration of ESG factors and risks, and would allow pension funds and insurance companies to further integrate ESG in their investment decisions, if they choose to do so.

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Notes

[1] The UN PRI has an international network of over 3 000 investor signatories which are required to report annually on their responsible investment activities according to a set framework. https://www.unpri.org/about-the-pri. As of 2019, 255 of the UN PRI signatories provide services in connection with pension or insurance: 69 are corporate pension, superannuation, retirement or provident funds or plans; 132 are non-corporate pension, superannuation, retirement or provident funds or plans; and 54 are insurance companies. The geographical split of the UN PRI signatories under consideration demonstrates that a majority (150 out of 255) of pension funds and insurance companies that are UN PRI signatories are based in Europe, whereas 37 are based in North America, 32 in Australia and New Zealand, 16 in Asia, 11 in Central and Latin America and 9 in Africa.

[2] The OECD ESG survey received responses from 51 insurance companies that run life, non-life and reinsurance business lines, with total assets of over USD 2,445 trillion at the end of 2018, and 25 pension funds managing over USD 2.4 trillion in assets at the end of 2018, across 21 countries overall. Insurance companies from 11 countries (Canada, Finland, France, Italy, Japan, Korea, the Netherlands, Portugal, Slovenia, Sweden and Switzerland), and pension funds from 14 countries (Australia, Austria, Brazil, Canada, Croatia, Denmark, Finland, Iceland, the Netherlands, New Zealand, Norway, Russia, Spain and Sweden) responded to the survey. Assets managed were provided by companies responding to the OECD ESG survey and converted to US Dollars using the International Monetary Fund published exchange rate for 31/12/2018.

Given the ESG focus of the survey, it should be noted that the institutional investors who responded may not constitute a representative sample as it is possible that they already have an interest in ESG considerations. This potential self-selection bias does not preclude conclusions being drawn on some of the needs and processes used to integrate ESG factors in investment decision-making processes.

[3] Institutional investors covered by this survey include asset managers, as well as insurance companies and pension funds.

[4] It is worth noting that insurance companies and pension funds might delegate part of the management of their assets to external asset managers, and request them to use similar ESG integration strategies.

[5] The study breaks down the corporate bond universe of the ICE BofAML indices into quintiles, based on ESG scores from Sustainalytics. Over 12 months, the credit spread of portfolio with the best ESG-rated companies tightened by about 20%, compared to a tightening of around 12% for the portfolio with the worst ESG ratings.

[6] The German Prime Standard is a market segment of the Frankfurt Stock Exchange that includes companies which comply with transparency standards higher than those of the General Standard, which is regulated by law. The German Prime Standard is made of the DAX30, TecDAX and MDAX. The DAX30 is a blue chip stock market index consisting of the 30 major German companies (by market capitalisation) trading on the Frankfurt Stock Exchange. The TecDAX stock index tracks the performance of the 30 largest German companies from the technology sector. The MDAX includes the 60 Prime Standard shares from

sectors excluding technology that rank immediately below (by market capitalisation) the 30 companies included in the DAX index.

[7] Shareholder rights are used to represent governance through data from the Investor Responsibility Research Center surveys of investor rights and takeover protection on a sample of American companies between 1990 and 1999.

[8] https://www.beehive.govt.nz/release/default-kiwisaver-changes-support-more-responsible-investment.

[9] https://www.nbim.no/contentassets/aaa1c4c4557e4619bd8345db022e981e/spu_responsible-investments-2019_web.pdf.

[10] The results of a survey by State Street Global Advisors show that 41% of pension funds declared that viewing ESG as a fiduciary duty was the main reason for adopting ESG principles in investments (State Street Global Advisors, 2019[14]).

[11] https://www.federalregister.gov/documents/2015/10/26/2015-27146/interpretive-bulletin-relating-to-the-fiduciary-standard-under-erisa-in-considering-economically.

[12] The 201888 amendment and modification of UK pension fund regulations can be found at http://www.legislation.gov.uk/uksi/2018/988/made/data.pdf.

[13] http://www.iopsweb.org/iops-supervisory-guidelines-esg-factors.htm.

[14] https://www.eiopa.europa.eu/browse/sustainable-finance_en?source=search#EIOPA%E2%80%99sprojectsinsustainablefinance.

[15] The EU regulation on disclosure for financial market participants can be found at https://eur-lex.europa.eu/eli/reg/2019/2088/oj ; the Israeli regulation can be found at Section 9(a)12 of https://www.mof.gov.il/hon/Documents/%D7%94%D7%A1%D7%93%D7%A8%D7%94-%D7%95%D7%97%D7%A7%D7%99%D7%A7%D7%94/Codex/Gate5_Part2_Chapter4.pdf.

[16] UN PRI signatories, both in responses to the OECD ESG survey and in the UN PRI data, have reported to be fully aligned with its guidelines and to already integrate ESG criteria in their investment decisions, apart from those that only recently joined the UN PRI and are still implementing the integration of these criteria in their decision-making process.

[17] EIOPA plans to launch a similar stress test to assess ESG risks in the insurance sector, starting 2020.

[18] NEST is the national employment savings trust, i.e. the occupational pension provider set up by the United Kingdom government to ensure all employers are able to offer their employees an occupational pension in line with regulatory requirements. NEST covers over 880 000 employers, over 8.6 million members, and GBP 10 billion of retirement assets https://www.nestpensions.org.uk/.

[19] Detailed ESG rating methodologies are generally not publicly available. The FTSE4Good Index inclusion criteria of 2016 included a parameter linked to the distance between the highest responsibility for ESG and sustainability topics and the board, https://blog.metu.edu.tr/sascigil/files/2016/02/FTSE4Good_Inclusion_Criteria.pdf.

[20] https://www.allianz.com/en/sustainability/strategy-governance/governance.html.

[21] The UN SDGs address global challenges, including poverty, inequality, climate change, environmental degradation, peace and justice. The Paris Agreement includes the target of reducing global warming to well below 2 degrees Celsius. Other initiatives include the UN Asset Owner Alliance, which is formed of investors who aim net zero emissions in their portfolios by 2050.

[22] https://www.bnpparibas-am.com/en/sustainability/.

[23] https://english.pfa.dk/news-archive/2020/02/02/19/54/introduces-climate-focused-pension-solution/.

[24] https://www.ipe.com/news/atp-resorts-to-dkk13m-divestment-after-mexican-mining-giant-fails-to-engage/10043476.article.

[25] However, it should also be noted that other passive investors see engagement as an important tool for promoting ESG as they cannot easily divest from certain companies. https://www.blackrock.com/uk/individual/blackrock-client-letter.

[26] https://www.ft.com/content/9b228d14-1c34-11ea-97df-cc63de1d73f4.

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[28] https://www.generali.com/our-responsibilities/our-commitment-to-the-environment-and-climate.

[29] https://www.australiansuper.com/campaigns/socially-aware.

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[31] https://www.asrnl.com/-/media/files/asrnederland-nl/investor-relations/jaarverslagen/2019/2019-annual-report-asr-nederland.pdf?la=en.

[32] Some of the larger institutional investors have in-house investment teams that perform ESG analysis internally (e.g. CPPIB, GPIF).

[33] https://www-axa-com.cdn.axa-contento-118412.eu/www-axa-com%2Fcf61ff6c-ee1d-4dcb-92ba-ed243ae7f2fb_2018+tcfd+full+report+-+final+-+b.pdf.

[34] The OECD Guidelines for Multinational Enterprises are adhered to by 49 countries. National Contact Points for responsible business conduct are established by adhering countries to promote the Guidelines and handle cases of alleged non-observance of the Guidelines by companies. The list of countries can be found at http://mneguidelines.oecd.org/ncps/.

[35] The UN Global Compact involves 12 840 active signatories in over 160 countries. https://www.unglobalcompact.org/participation on 20 May 2020.

[36] https://www.iso.org/standards.html.

[37] ACSI's members include 41 Australian and international asset owners and institutional investors, collectively managing over AUD 2.2 trillion in assets, and owning on average 10 per cent of each of the 200 largest Australian listed equities by market capitalisation (S&P ASX200 index). https://acsi.org.au/.

[38] The Red Line Voting campaign is based on the ten principles of the United Nations Global Compact, and on the UK Corporate Governance Code. http://redlinevoting.org/what-is-red-line-voting/.

[39] Examples of such initiatives include the Global Reporting Initiative, the Carbon Disclosure Project, the GreenHouse Gas Protocol, the Climate Disclosure Standard Board, and the International Integrated Reporting Council. https://www.globalreporting.org/Pages/default.aspx, https://www.cdp.net/en, https://ghgprotocol.org/, https://www.cdsb.net/, https://integratedreporting.org/.

[40] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf.

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