



More news, views, research and events from The London Accord and other organisations looking at issues where finance and investment interact with ESG policies. The London Accord created the first 'open source' resource enabling investors to manage risk and evaluate opportunities in these areas and facilitating those in the wider society seeking to produce market-based solutions.

## News .....

### *On The London Accord front:* **Index-linked bonds the saviour of the carbon market?**

**Potential climate change investors have "one big doubt" whether governments are committed to de-carbonising the economy. Uncertainties surrounding government commitments create risks that developers of low carbon projects and their investors are not willing to bear.**

Such uncertainties have three specific risks: government carbon emission targets missed, fossil fuel prices remain low and carbon emission prices also remain low. All these risks reduce the profitability of clean energy or cause losses, so how can such risks be hedged?

Two founding members of The London Accord Professor Michael Mainelli and Jan-Peter Onstwedder have proposed a hedging instrument, index-linked bonds. The authors consider that an attractive option would be for project developers to issue bonds indexed to the three key risks – government performance against targets, fossil fuel prices against a break-even level, and carbon prices against a break-even level. "Such an index-linked bond would reduce the cost of capital for a developer exactly in those situations where the profitability of clean energy is threatened by government action or inaction."

Bonds indexed to emissions, fossil fuel prices or carbon prices would transfer the risk from the developer to the investor. Investors however are not keen to bear those risks, noticeable

### **Promoting good practice**

**The City of London Corporation (the local authority for the Square Mile) makes many claims to be unique or first but its work to anticipate and lead in those areas that enhance energy efficiency and carbon reduction are second to none in the public sphere.**

In 1975 the City was the first local authority to set up a (small) department and appoint a committee that addressed solely the issues of energy usage and efficiency. Straight from the doldrums of the mid-1970s oil crisis this seemed to be an important issue to a major conurbation that relied upon and needed a secure and relatively cheap energy supply. We then anticipated that the price of oil would rise and thereby heighten the need for energy saving - in fact in relative terms it did not and so energy efficiency did not then become the major issue for businesses that perhaps it should have done. We have been playing catch up ever since.

The City worked steadily on ways to improve. It set up its own combined heat and power scheme that has been operating since 1993 located in the heart of Smithfield Market. This helps to save carbon for 10 City sites. The City strives hard and continued improvement in this area has meant that over the last three years the City Corporation has made a 4% reduction in energy use and saved hundreds of thousands of pounds.

This area has an even more urgent appeal today as now not only are energy prices rising frighteningly but the need for Energy Performance Certificates and compliance with the Carbon

from their reluctance to fund many clean energy projects. Investors cannot easily hedge those risks, but that is where government can help – by issuing debt with the opposite risk profile. "Index-linked government carbon bonds would provide greater returns if government falls short of achieving its targets, if fossil fuel prices remain low, or if carbon prices remain low." This kind of index-linked gilt could easily be issued, consider the authors and it would provide a natural hedge against a project developers' government risk. An investor would invest in a low-carbon project (either equity or debt), and simultaneously buy a proportion of index-linked government carbon bonds.

Other structures are also possible, linking the principal repayment to fossil fuel prices, or either interest rate or principal to actual emissions in, say, 2020.

*For the full article: Can Index-Linked Bonds Save the Carbon Market, Professor Michael Mainelli (Z/Yen Group) and Jan-Peter Onstwedder (The London Accord) visit: <http://ecosystemmarketplace.com>*

Reduction Commitment Scheme mean that its work is at the centre of the budgetary process and statutory compliance. The City is busy working out strategic practical detailed and costed plans for carbon reduction for the next 25 years.

As Chairman of the Energy Working Party (as we are now called) I have been promoting the good practice of the City of London Corporation and ensuring support to the City businesses that want to participate. The City has recently been awarded the Carbon Trust Standard, which shows that we measure, manage and genuinely reduce the carbon footprint of the City. This is in addition to being awarded Beacon Council status in 2008 for our work in tackling the issues of climate change. Awards do not make us good but do recognise the excellent work that the City does to promote good practice and prepare for the challenging times ahead.

*Alderman Alison Gowman is Alderman for the Ward of Dowgate, Chairman of the City of London Corporation Energy Working Party and Partner at DLA Piper UK LLP [www.alisongowman.org.uk](http://www.alisongowman.org.uk)*

## Hermes supports London Accord aims

In a letter of support to The London Accord, Hermes Equity Ownership Services (EOS) said they had a shared view that climate change and its related issues are “of primary importance to long-term investors.” EOS works with a wide range of research providers to encourage them to take full account of climate change and would be happy to encourage these firms to make research reports available to The London Accord website after a suitable time period. “By so doing, research providers can make an important contribution to enhancing the understanding of those charged with policy making about the impact of climate change in investment decisions,” said Jennifer Walmsley, associate director at Hermes.

### News from other organisations:

## Companies not managing ESG risks effectively

**Only a quarter of companies are adequately managing their environmental, social and governance (ESG) risks, according to new research from global responsible investment specialist EIRIS.**

*At risk? – How companies manage ESG issues at board level* focuses on 2,200 companies listed on the FTSE All-World Developed Index, tracking progress on the management of non-financial ESG risk issues over the three years from 2005 to 2008.

At the London Summit in April this year, the G20 leaders released a statement that included pledges ‘to build an inclusive, green, and sustainable economic recovery’. By incorporating ESG criteria into their investment decision-making and ownership practices investors can directly influence companies to improve performance in the areas of board responsibility, risk management systems and the identification of ESG risks, plus potential ESG liabilities and opportunities.

EIRIS’ research reveals that many companies are not managing their ESG risks effectively presenting “a wake-up call to investors.”

The research found that:

- The financial sector was the worst performer: in 2008 nearly 25% of financial institutions failed to disclose any evidence of ESG risk management, at least twice that of any other sector.
- Companies demonstrated limited progress in ESG risk management – only 7.4% over the three years.

## Investor responsibility – a gap in performance

**Major UK pension funds are acknowledging the potential of ‘non-financial’ issues to affect investment values, but many still lack key strategies to manage these risks, according to a new research report from FairPensions. The report also raised questions about the fund management industry’s ability to meet clients’ changing requirements.**

The research by FairPensions, which campaigns for UK pension funds and fund managers to adopt responsible investment practices, includes a ‘league table’ of the UK’s 30 biggest pension funds, which have 4.86 million members in total, are worth an estimated £351 billion (US\$514 billion), and are viewed as industry trendsetters. Similar research in November 2008 assessed fund managers (see *SRIB19*).

All funds surveyed now have statements recognising the potential impact of ESG issues on financial performance, although one-third failed to apply these when instructing, selecting or receiving reports from their fund managers. Almost 50% employ no internal or external personnel to be responsible for ESG issues either.

Almost half of the funds surveyed showed a lack of transparency by not disclosing their biggest investments and two-thirds did not disclose voting records, according to FairPensions, despite government powers to force voting disclosure if there is no voluntary disclosure.

On the upside however a growing minority of funds now require fund managers to have stronger ESG risk-management capabilities: 35% of those surveyed use UN PRI signatory status as a standard in fund management selection with 25% using

• Japanese companies showed the biggest improvement in their risk management systems (19%), in contrast to Australian and New Zealand companies, which showed very little (0.4%).

• The resources sector was the best performer, partly a reflection of the very public ESG issues that these companies have had to deal with.

Initiatives such as the UN Principles for Responsible Investment (PRI) and the UN Global Compact plus increasing scrutiny by regulators have pushed ESG issues up the investment agenda. In the light of this EIRIS considers there is likely to be increased pressure on companies to provide evidence that they are managing their ESG risks, while those companies that are not may incur significant costs to their business.

“There is a growing view among investment professionals that ESG issues can affect the performance of investment portfolios ... Our new global ESG risk management criteria will enable investors to build a comprehensive picture of how well a company is managing the issues and opportunities presented by ESG risk,” said Stephanie Maier, head of research at EIRIS.

*For further information visit: [www.eiris.org](http://www.eiris.org)*

climate change competence as a standard. There also appeared to be correlation between schemes that are UN PRI signatories and those showing good practice.

Bank pension schemes (collectively worth around £60 billion) were all in the lower half of the table; in contrast the greater transparency requirements for local authority funds appeared to produce better all-round responsible investment performance, considered FairPensions. “This raises questions about the transparency responsibility of funds sponsored by banks which are now in the ‘public sector’.”

“Pension funds are now recognising that ‘non-financial’ issues can become financial issues, but many still need to match words with deeds if they are to be ready for major challenges associated with issues like climate change. Fund managers and advisors also need to anticipate changing client needs if they are to rebuild trust and retain the business of clients who becoming more aware and assertive of their long-term needs,” said Catherine Howarth, chief executive of FairPensions.

*For the full report: [Investor Responsibility? Performance and Accountability on ‘Extra-financial’ Risks by UK Pension Funds](http://www.fairpensions.org) email: [ben.watson@fairpensions.org](mailto:ben.watson@fairpensions.org)*

## Setting the standard

**Leading European corporate sustainability research organisations have recently launched a new international Voluntary Quality Standard (VQS) for corporate sustainability and responsible investment research.**

Launched by the Association of Independent Corporate & Responsibility Research (AI CSRR) the VQS has been developed to drive high quality research and analysis for organisations in the field.

The standard is a direct response to growing investor and company demand for research organisations to incorporate the key principles of integrity, transparency and accountability into their research on the ESG and ethical performance of companies. The VQS is designed to enhance quality within the research process of each provider without redetermining and dictating the precise output.

A number of research organisations in Belgium, France, Germany, Italy, Spain, Sweden and the UK have met the standard criteria with others in the pipeline. These include Ecodes, EIRIS, Ethifinance, GES, Imug, Oekom and Viego.

The VQS assessment and auditing process requires research organisations to:

- Focus on continuous quality improvements and develop an action plan to drive quality across all research areas.
- Develop and implement best practice and codes of conduct

to ensure independence, integrity, probity, transparency and accountability within each research organisation as well as in the research process.

- Ensure the robustness of each organisation's research processes and embed continuous monitoring of quality in the work process.
- Reassure clients and other stakeholders that research organisations 'do what they say they do.'
- Publish an externally verified Transparency Matrix that reveals the data necessary to reinforce trust and confidence in each research organisation's methodology.

The launch of the new VQS follows a European Commission funded development process and consultation with key stakeholders led by AI CSRR.

"The principles of integrity, probity, transparency and accountability have never been so important. The development of quality standards should help further increase confidence in ESG research providers at a time when openness and accountability are valued by an ever increasing number of responsible investors," said James Gifford, executive director of the UN PRI, commenting on the launch.

*For further information visit: [www.csrr-qs.org](http://www.csrr-qs.org)*

## Global trends and winners in CR reporting

**Following the recent CR Reporting Awards '08 (CRR '08), CorporateRegister.com has now published a report summarising and analysing global CR (corporate responsibility) reporting statistics producing some interesting conclusions.**

CorporateRegister.com's statistics show that the world's largest companies are disclosing more - the quantity and quality of CR reporting continues to develop. Two-thirds of Global FT 500 companies are producing CR reports. CR reporting has become an important element of business communication by the world's leading companies, with over 3,200 reports published during 2008.

However, in the midst of a global recession it is impossible to

predict if and how this trend will continue. With corporate budgets under increasing pressure, it is likely that many stand-alone CR reports will become integrated with Annual Reports & Accounts – a cost-saving trend that may actually lead to better reports, more on-line reporting and fewer printed reports.

*The report: Global Winners & Reporting Trends also provides details about the winners of the CRR '08. Visit: <http://www.corporateregister.com>*

## Research .....

**Investment research reports have a short shelf life and a small audience within the financial services community yet there is added value in sharing this research appropriately with a wider community as the research produced covers a variety of topics of interest to industry, NGOs, policy makers and politicians alike.**

The London Accord increases the social value of the existing investment research process, adding value for the authors and their firms by enhancing policy recommendations. The City of London Corporation, in cooperation with London Accord participants leads this 'open source' research project and shares this resource with society.

**It would be of major assistance to The London Accord for more core participants to share new environmental, social or governance (ESG) investment research reports that are now not commercially sensitive. If firms have any ESG reports they would like to donate, please contact Professor Michael Mainelli, Z/Yen Group at: [michael\\_mainelli@zyen.com](mailto:michael_mainelli@zyen.com)**

*For the full reports visit The London Accord website: [www.london-accord.co.uk](http://www.london-accord.co.uk) This issue highlights:*

## Testing for a safer world

**The growing political will to measure and control the impact of industrial activities on the environment and public health & safety strengthens the role of verification, testing and certification players. This is due to three factors: the impetus for stricter global regulation in the areas of security, health and the environment; globalisation which makes the links between producer and consumer more complex and increases company risk; and the growing trend towards outsourcing these activities to private-sector players.**

In spite of the economic slowdown, these structural drivers underpin the market's organic growth of between 5%-6% per annum. This is in addition to players' gains in market share and macroeconomic factors such as increased trade and higher raw material prices.

*A safer world. Corinne Gagne and others (CA Cheuvreux)*

## Political impact of climate change policies

The current economic crisis is likely to affect political momentum on climate change, but energy security concerns are boosting support for many climate change-related investment themes. Cheuvreux provides a prospective analysis of the political forces driving the ongoing review of the climate and energy package that will enact the CO<sub>2</sub> constraint in the EU by 2020. At stake is a wealth transfer estimated at ~€440 billion (US\$574 billion) between 2013 and 2030 from EU industries to governments, taking the form of CO<sub>2</sub> rights auctions.

The economic slowdown has increased fears of job losses induced by the potential relocation of EU heavy industries due to CO<sub>2</sub> constraints, although many sectors are likely to be exempt. Being low-carbon remains key in sectors where a gradual phase-in of auctioning is still possible.

*Climate change policies impact. Erwan Créhalet (CA Cheuvreux)*

## Carbon ETS forecasts ...

Over the medium-term, new London Accord member Daiwa expects increasing emphasis on emission reduction, but budgetary control and corporate well being are likely to take short-term precedence. The Kyoto Protocol has been ratified by countries representing only around 30% of the world's greenhouse gas emissions and does not include the US or China, the two biggest emitters. Of those countries that have ratified the treaty currently about half are scheduled to miss their 2012 emission reduction targets.

Although EU ETS wide 2012 targets should be achieved, significant individual country divergence is noticeable. A large proportion of emission reduction is likely to derive from lower domestic emissions due to the impact of the European recession and a shift in emphasis to less costly international offsets. The Phase 2 EU ETS scheme is seen as oversupplied with carbon's international price remaining relatively low. Daiwa forecasts a 2012 EUA price of €16/tonne rising to €25/tonne in 2020, both below consensus.

*Carbon forecasts – ETS supply/demand and price forecasts to 2020. Ashley Thomas (Daiwa Institute of Research)*

## ... will the carbon price recover?

Since Daiwa's December 2008 Carbon Report above, the EUA December 2009 forward price has fallen from €16/tonne to €10/tonne as weakening economic conditions have reduced European industrial output and EU ETS industrials have sold forward allowances to raise finance at relatively attractive rates. Carbon price movements have become detached from oil prices. With around half of the EU ETS emissions accounted for by the non-power industrial sector (oil, building materials, metals and paper), industrial output from these sectors will in the short-term be a greater driver of emissions reductions than the power generation sector.

In their February 2009 report Daiwa now forecasts a 6.7% contraction in 2009 EU industrial output compared to a 2.7% decline forecast in their December report. Daiwa's forecast short position for the cumulative 2008-2020 period means the 2020 EUA forecast is marginally reduced from €25 to €24/tonne, driven by estimated summer fuel switching costs.

*Carbon outlook – recovery from oversold position or dead cat bounce? Ashley Thomas (Daiwa Institute of Research)*

## Decline in 2008 ETS emissions

After analysing the full-year fuel mix in the power sector in a number of key countries Deutsche Bank now expects a year-on-year decline of 5.2% in 2008 ETS emissions to 2,120Mt from pro-forma 2007 emissions of 2,237Mt. The very weak outlook for EU industrial output in 2009 and the ripple effect of this on 2010-12 forecasts means expectations of a slight surplus of EUAs over Phase 2 as a whole. The EU economy has deteriorated rapidly since late summer 2008. Industrial output for the Eurozone in January 2009 showed a year-on-year contraction of 17.3%, while EU steel output in February was down 42% against that of February 2008. A 3% contraction in the GDP of the EU's biggest economies in 2009 is forecast.

Market inefficiencies and negative sentiment will weigh on EUA prices over the next 12 months, and there could be short-term price pressure from the fact that the market will also have to absorb the allocation of EUAs from several Member States that have not yet issued to their installations. In total outstanding EUA allocation is estimated to be around 800Mt.

*Previewing 2008 ETS emissions: it's all about Q4. Mark C. Lewis and Isabelle Curien (Deutsche Bank AG/London)*

**For the full reports visit The London Accord  
website: [www.london-accord.co.uk](http://www.london-accord.co.uk)**

# Events .....

Conferences and events presented by The London Accord and other organisations. Coming up:

## *London Accord events:*

### **22 June: Gresham College, London**

#### **Metamorphoses – the Terrible Beauty of Change**

Monday, 22 June, 13.00, Barnard's Inn Hall, Holborn, London EC1N 2HH

A fusion of Benjamin Britten's *Six Metamorphoses after Ovid* (Op. 49, 1951) for solo saxophone with 'commercial musings' on sustainability

Speaker: Professor Michael Mainelli

Saxophonist: John Harle

In association with The London Accord and Gresham College

The lecture is part of a series of events to be held in collaboration with the City of London Festival (19 June – 9 July). This year's festival aims to reinforce links between the City of London and the Baltic and Nordic cities. There will be a special focus on the environment and sustainability in this year's festival, with which The London Accord community will be associated.

For further information visit: [www.gresham.ac.uk](http://www.gresham.ac.uk)

For more details about the City of London Festival visit: [www.colf.org](http://www.colf.org)

## *Events being held by other organisations:*

### **05 June: Policy Network, London**

#### **The Politics of Climate Change: from Economic Crisis to Business Revolution**

Friday, 05 June, 8.30-16.30, London

Organised by Policy Network in association with the London School of Economics, Centre for the Study of Global Governance

The aim of this high level conference is to discuss how the present economic crisis can lead to a business revolution in low-carbon industries and the role the state can play in incentivising and facilitating this process.

Also addressed are ways policy makers and business stakeholders can build long-term political support for a low-carbon transition process, mitigate energy security concerns and ensure a low-carbon society does not bring about new inequalities.

If you are interested in attending this event and require further information contact: [jgroves@policy-network.net](mailto:jgroves@policy-network.net)

A wider audience for your research? SRI Briefings and The London Accord welcome quality research and events listings from industry analysts, professional bodies and institutions in the sustainable investment field.

Contact: Editor, SRI Briefings at: [sdrury@srib.co.uk](mailto:sdrury@srib.co.uk) or visit: [www.srib.co.uk](http://www.srib.co.uk)

Interested in exploring participation and funding The London Accord?

Contact: Professor Michael Mainelli, Z/Yen Group at: [michael\\_mainelli@zyen.com](mailto:michael_mainelli@zyen.com)



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