



Today's social and environmental issues are tomorrow's key investment drivers. News, research and events from The London Accord and other organisations examine issues where finance and investment interact with ESG policies. The London Accord increases the social value of the existing investment research process, adding value for authors and their firms by enhancing policy recommendations.

News

On The London Accord front:

Index-linked carbon bonds catching on

Uncertainties surrounding government commitments to de-carbonising the economy create three key risks – missed carbon emission targets, low fossil fuel prices and low carbon prices. Such risks reduce the profitability of clean energy or cause losses that developers of low carbon projects and their investors are not willing to bear. How can these risks be hedged?

In April, two founding members of The London Accord, Professor Michael Mainelli and Jan-Peter Onstwedder, proposed that governments issue index-linked carbon bonds which investors could use to hedge government inaction risk (see *SRIB22*). This idea was published in Ecosystem Marketplace. A longer paper, co-authored with Dr Kevin Parker of ZYen and William Fischer of Natixis – *Index-Linked Carbon Bonds: Guilty Green Government* – was presented by Dr Parker at the World Bank Government Borrowers' Forum in Ljubljana in May. The audience included senior debt issuers from around the world and Dr Parker initiated discussion with organisations such as the Asian Development Bank, Inter-American Development Bank, US Treasury, UK Debt Management Office and the Bill & Melinda Gates Foundation. Also in May, Tomorrow's Company and UKSIF promoted the idea as one for serious consideration by policy-makers both for its simplicity and its directness. One major pension fund has praised the idea and governments in Europe, North America and the Caribbean have discussed its feasibility with The London Accord team. In June at the Stern Climate Finance Seminar, London, the idea of index-linked carbon bonds received positive interest from an audience composed of participants from government, academic institutions and the business world.

Clean tech projects, for example, face virtually the same risks as traditional energy projects, except for one thing – their competitiveness depends on government policy being enacted.

Investors cannot easily hedge emission target failure, low fossil fuel prices or low carbon price risks. But that is where government bonds come in – by issuing debt whose interest rate is linked to these risks. This debt provides investors with a risk profile that mirrors their clean tech investment risk, allowing them to hedge against governments failing to deliver. An investor would invest in a low-carbon project (either equity or debt), and simultaneously buy a proportion of index-linked government carbon bonds.

The authors consider this kind of index-linked gilt could easily be issued by any government (national, state, province) or multi-lateral agency without any need for a global initiative. Governments claim they are serious about meeting carbon emission targets and moving to a low carbon economy. If they do, they get cheaper debt. Moreover due to the credit crunch G10 governments are likely to issue about US\$9 trillion in bonds over the next few years and will need ways to distinguish themselves in a crowded market. "By issuing carbon bonds linked to independent, auditable index metrics such as emission targets, the price of fossil fuel and the future carbon price, governments would remove private investors' objections that their biggest uncertainty is government commitment. Likewise, given that failure to perform will cost, government would have a real incentive to meet its emission targets," argue the authors.

For further information visit: www.zyen.com

Newsflash: London Accord website has major revamp

The London Accord website (www.london-accord.co.uk) is undergoing a major upgrade, courtesy of the City of London Corporation. New functions give users the ability to search reports by author, research organisation, date and subject, making accessing content much easier. The new site will be community based, allowing users to register, interact with each other and offer their views on the content and articles. Users can also create their own content in a London Accord 'Wiki'. The appearance of the site has also been improved. All in all a more friendly and welcoming home for investment research to influence policy development.

New research: the influence of investment and economic research on policy development

Anna Gusel is leading a new piece of research for The London Accord on how policy development is influenced by investment and economic research. She seeks to understand the nature and effects of public-private information sharing practices in the realm of climate change policy. As this year marks a crucial point in the climate change arena, a time when the frameworks and legislation enacted at both national and multilateral levels will set the stage for action to come, sensible policy formulation is crucial. To ensure that policies incentivise and support the right adjustments and innovation for market and consumer behaviour, it is vital that policy-makers have access to broad and nuanced sources of information from all sectors.

Her inquiry will assess the efficacy of London Accord efforts to date, understand and document information gaps that policy-makers experience, and put forth recommendations that may enable The London Accord initiative to improve.

Anna Gusel will be contacting specific London Accord participants for their thoughts, but if anyone wishes to contact her directly about this work email: anna_gusel@zyen.com

News from other organisations:

New investment tools for a low carbon economy

FTSE Group, the global index provider has launched new capital investment tools to assist investors to identify and gain exposure to the rapidly growing environmental technology sector. This pioneering move comes at a time when climate change and environmental concerns are key items on political agendas across the globe and when clean technology opportunities are of growing interest to investors worldwide.

The FTSE Group's new tools aim to support global capital markets' response to developing a low carbon economy. They include the world's first global environmental markets industry classification system designed to allow companies to be classified by sector and sub-sector according to the environmental products and services they provide.

The classification system "allows those companies who provide essential environmental products, activities and services to be identified more easily, facilitating a peer to peer comparison on a global, regional and pan-regional basis." The system also provides a basis for the creation of sector based investment products such as mutual funds, derivatives and exchange traded funds.

Additionally, the new classification system is incorporated within seven new global equity indices, including two aimed at the UK market. The FTSE Environmental Opportunities UK Index is based

on the UK Main Market, while the second, the FTSE Environmental Opportunities UK AIM Index, is the first of its kind providing a new platform for entrepreneurial companies involved in environmental services in the UK.

"The London markets play a crucial part in the financing of a wide range of clean technology companies whether on AIM or on the Main Market. The indices will make it far easier for investors to identify new opportunities and benchmark existing investments, driving liquidity and investment. We are also delighted that AIM, the world's premier growth market, has its own environmental index, reflecting its success in helping environmentally focused companies raise capital from investors at an early stage of their development," said Xavier Rolet, chief executive of the London Stock Exchange Group commenting on the launch.

For further information email: media@ftse.com

Passive funds lack ESG risk management

A significant proportion of equity holdings managed within passive funds are not subject to high levels of ESG risk management, according to an audit commissioned by The Local Authority Pension Fund Forum (LAPFF).

The LAPFF, which represents 49 UK local authority pension funds with combined assets of over £75 billion (US\$122 billion) asked specialist ESG consultancy RImetrics to assess the ESG competencies of leading global passive asset managers, Legal & General Asset Management, State Street Global Advisors and UBS Asset Management, collectively responsible for around £700 billion of passive equity funds. Barclays Global Investors declined to participate.

Fund managers were evaluated and rated across five key responsible investment themes namely strategic orientation, engagement, research, proxy voting and transparency. The audit found:

- Managers vote proxies but not consistently across the world. An estimated £130 billion of assets are not regularly voted.
- Managers engage with companies to some degree, but again not consistently across the world. An estimated £350 billion of assets are rarely, if ever engaged.
- There are limited resources, 11 individuals in total were identified as responsible for the implementation of ESG policies for £700 billion of assets held in upwards of 3,000 companies around the world. In some cases, additional resources are provided by mainstream active management teams and managers use voting service providers. Inevitably asset managers must be selective in their approach, particularly regarding engagement. RImetrics estimates investment totalling less than 4/100th of one basis point

on responsible investment overall.

- Managers consistently voted proxies in the UK and US although elsewhere the pattern is more mixed.
- Managers tend to be most active in engagement terms either where their responsible investment staff are based or where they hold the bulk of their assets.
- Small cap stocks are rarely engaged, with managers tending to focus their engagement activities on their biggest holdings.
- Emerging market holdings are typically never engaged despite probable higher levels of ESG risk.

In conclusion, a significant proportion of equity holdings managed within passive funds are not subject to high levels of ESG risk management. "At the same time, managers profess a willingness to engage in dialogue with clients on these issues and all pointed to the fact that they had not, to date, seen any real client pressure or demand to increase capabilities or resources."

"Working with RImetrics has allowed us to construct a thorough picture of individual passive fund manager ESG competencies and practices. Following our meetings with the relevant passive managers, they have now received a clear message that their clients and our members do take the topic of ESG risk management very seriously," said David Sellors, chief operating officer at LAPFF.

For further information contact: info@rimetrics.com or visit: www.lapfforum.org

Managing emissions across the value chain

Greenhouse gas emissions from companies' value chains represent a material source of risk and opportunity for companies, according to a new report *Managing Greenhouse Gas Emissions Across the Value Chain: the New Agenda*, from Insight Investment in conjunction with international consultants Acona.

There are two reasons for companies to focus on value chain emissions according to the report:

- The increasingly compelling financial argument driven by current and potential legislation, increasing consumer interest in low carbon products and stakeholder pressure for credible and transparent information on greenhouse gas emissions.
- For many companies the value chain may be their most significant source of emissions and it is therefore prudent for companies to

focus their efforts in this area.

The challenge however is to establish a clear link between a company's business strategy and the management of greenhouse gas emissions. Focusing attention on these areas would greatly reduce the cost of data capture and reporting with the probability that real progress will be achieved.

For the full report visit: www.insightinvestment.com

Greater ESG disclosure demanded by emerging market investors

Seven out of ten major asset managers and institutional investors, representing a total of US\$130 billion of emerging market investment, cited lack of ESG disclosure as the key challenge to investing in emerging markets, according to a new report from the Emerging Markets Disclosure (EMD) Project.

The EMD Project is an international coalition of investors and organisations working to improve sustainability disclosure by companies in emerging markets. Analysis was undertaken by EIRIS, a global provider of independent research into ESG issues and the ethical performance of companies. The report was sponsored by the International Working Group of the Social Investment Forum based in the US.

The survey on which the report is based highlighted that during a period when there is an increasing demand from institutional investors for greater openness and transparency, weak ESG disclosure by emerging market companies threatens to undermine investor confidence and has the potential to reduce investment allocations to emerging markets.

Respondents commended Brazil and South Africa for making the most progress towards greater ESG disclosure. Both countries have developed a sustainability index to which their listed companies can aspire through improved disclosure.

Brazil was the top country allocation, followed by China, India, Mexico and South Africa.

The biggest challenge identified to emerging market investment was a lack of corporate disclosure on ESG issues. Key drivers for improved ESG disclosure included the development of national sustainability indices, ESG listing requirements and the influence of global standards. Improved corporate disclosure on ESG

issues could persuade more responsible investors to increase their allocation to emerging markets.

The survey revealed that European investment allocation to emerging markets is nearly double that of North America. Europeans are also more likely to focus on corporate governance criteria and corruption issues within their responsible investment approach, while North Americans favoured negative screening (e.g. screening out tobacco producers).

Three-quarters of respondents were members of at least one organisation devoted to corporate social responsibility or responsible investing issues, commonly the UN Principles for Responsible Investment, with almost two-thirds having at least six years emerging markets experience.

“Emerging markets hold significant opportunities for responsible investors. But if they are to better understand emerging market company ESG risks and opportunities, then corporate communication to investors clearly needs to improve. An engagement approach among emerging market investors should seek to improve the corporate responsibility and disclosure practices of companies,” said Sonia Wildash, report author and senior researcher at EIRIS.

For the full report: Emerging Markets Investor Survey Report: An Analysis of Responsible Investment in Emerging Markets visit: www.eiris.org

Simplifying emissions reporting

Recently the Confederation of British Industry (CBI) published a report on greenhouse gas emissions reporting, setting out “a simple and common method for businesses to report their emissions publicly.”

With emissions reporting likely to be made mandatory for UK companies in 2012, the CBI wants the UK Government to adopt this approach in its guidelines due to be released in October 2009.

“Greenhouse gas emissions reporting will be an important tool in making the shift to a low carbon economy, and measuring emissions is the first step towards managing and ultimately reducing them. But mandatory reporting will only work if there is a common method for firms to report their emissions,” said Dr Neil Bentley director, business environment at the CBI.

The CBI has developed a series of recommendations for how mandatory reporting can be implemented in the UK. The report sets out five key proposals to the Government:

- New emissions reporting guidelines should be based on the Greenhouse Gas Protocol.
- Companies should report emissions from industrial processes, refrigeration, fuel and electricity consumption.

- Government needs to establish what size of company will be mandated to report its emissions.

- Government should ensure reporting requirements align with existing compulsory schemes such as the EU Emissions Trading Scheme and Carbon Reduction Commitment.

- The UK should lead international discussions over a common global approach to emissions measurement and reporting.

At present “reporting protocols such as the Greenhouse Gas Protocol are not sufficiently specific to deliver consistent reporting across companies. The CBI’s proposals ... represent a critical step forward in addressing these problems. They seek to resolve some of the key issues in reporting around consistency and comparability,” said Dr. Rory Sullivan, head of responsible investment at Insight Investment and chair of the CBI’s Carbon Reporting Working Group.

The CBI report is based on the findings of its Carbon Reporting Working Group. For a copy of the report: All Together Now: a Common Business Approach for Reporting Greenhouse Gas Emissions visit: <http://climatechange.cbi.org.uk>

Migrant workers in the supply chain – the business responsibility

Migrant workers in the UK are vulnerable to very low wage rates, excessively long working hours, poor health & safety conditions, workplace discrimination and other injustices, according to a new report from the Ecumenical Council for Corporate Responsibility (ECCR). This can impact on the reputational risk of companies and their investors.

The ECCR is a church-based investor coalition and membership organisation working for economic justice, environmental stewardship and corporate and investor responsibility.

The report, *Vulnerable Migrant Workers: the Responsibility of Business*, analyses the distribution and role of migrant workers in areas of the UK and Ireland's domestic economies where low-skilled flexible labour is concentrated: care, cleaning, construction, hospitality & catering, and food production, manufacturing & retail.

The report then compares the policies and practices of nine UK and Irish food production, manufacturing and supermarket groups towards migrant workers, particularly in their supply chains. Companies surveyed were Associated British Foods, Greencore Group, Kerry Group, Morrisons, Northern Foods, Premier Foods, Sainsbury's, Tesco and Unilever.

The findings reveal that few food companies are explicit about the potential vulnerability of migrant workers or the additional support they may need. While most recognised some responsibility for workers in their supply chains, few "appear to

have mainstreamed considerations about labour conditions into their core business practice which may at times force suppliers to compromise labour conditions." Moreover weaknesses in the rights enforcement system mean that abuses may go undetected and unaddressed.

The report highlights the need for companies to:

- Recognise the potential vulnerability of migrant, temporary and agency workers
- Implement effective codes of conduct for suppliers
- Increase awareness of workers' rights
- Strengthen monitoring and audits.

The report provides a framework for investors to consider how companies perform with regard to migrant workers. ECCR argues that as many companies' profits benefit from the use of flexible labour in the supply chain, accepting moral responsibility protects companies against legal and reputational risk and improves workforce retention and supply chain security.

For the full report visit: www.eccr.org.uk

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 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

For the full reports visit The London Accord website: www.london-accord.co.uk This issue highlights:

Power sector remains key

ETS emissions data for 2008 confirms the key role of generators to prices. ETS data shows generators are very short but all the other sectors combined long. Having revised down their 2009 emissions forecast by a further 50Mt to reflect the continuing weak macroeconomic outlook Deutsche Bank considers EUAs will only really start to reflect fundamentals when generators' Phase-3 compliance buying begins in earnest: forecast for mid-to-late 2010.

Meanwhile EUAs could show a slow upwards trend over the next 12 months to €16-18/t (US\$22-24/t) but the EUA/CER price spread is expected to widen and increase in volatility in the short-term, with particular sensitivity to oil prices. Generators' hedging of 2013 power sales from 2010 however could provide an interesting development to an otherwise gloomy picture, considers the bank.

The Long and the Short of It: Power Sector Key to EUA & CER Prices. Mark C. Lewis and Isabelle Curien (Deutsche Bank AG/London)

For the full reports visit The London Accord website: www.london-accord.co.uk

Events

Conferences and events coming up:

16 July: Tomorrow's Company, London

Launch of Tomorrow's Climate – Beyond Peak Carbon

Thursday, 16 July, 18.00-20.30, Institution of Civil Engineers, One Great George Street, Westminster, London SW1P 3AA

What kind of climate deal will be reached at the Copenhagen Conference in December? This panel discussion looks at key questions for the business community in the run up to the conference and beyond, modelling some of the potential costs and setting out the opportunities of moving to a low-carbon economy.

Chairman: Tony Manwaring, Chief Executive, Tomorrow's Company

Keynote speaker: Lord Chris Smith, Chairman, The Environment Agency

Other expert speakers include:

David Vigar, Author, *Tomorrow's Climate*

Professor Michael Mainelli, Chairman, Z/Yen Group

Hosted by the Institution of Civil Engineers.

To reserve a place contact: katja@tomorrowscompany.com with "Tomorrow's Climate" in the subject header

15 October: The London Accord, London

Climate Change – New Financial Products and Indices

Thursday, 15 October, 14.30, Museum of London, 150 London Wall, London EC2Y 5HN

The London Accord Autumn Conference will consider the development of new financial products and indices in response to climate change issues, featuring a keynote address and two expert panels from The London Accord.

Co-Chairmen: Professor Michael Mainelli, Z/Yen Group and Jan-Peter Onstwedder, Head of Portfolio & Risk, 3i

Hosted by the City of London Corporation, Gresham College, Securities & Investment Institute, Tomorrow's Company, UKSIF and the Z/Yen Group.

Admission is free but reservations are required. For further information and to book contact: enquiries@gresham.ac.uk

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 or visit: 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



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