Principles for Responsible Investment

An investor initiative
in partnership with
UNEP Finance Initiative
and the
UN Global Compact

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Mr. David Sullivan
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600

By email corporations.joint@aph.gov.au

Dear Mr Sullivan,

Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Shareholder Engagement and Participation

As Executive Director of the UN Principles for Responsible Investment, I am pleased to be able to make the following comments to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Shareholder Engagement and Participation. These comments reflect the views of the PRI Secretariat and not necessarily those of the signatories to the Principles, though most comments are drawn directly from feedback from PRI signatories.

1. Background to the Principles for Responsible Investment

The Principles for Responsible Investment (PRI), a joint initiative of United Nations Environment Finance Initiative and the United Nations Global Compact, aim to find synergies between the goals of institutional investors and those of society at large.

The PRI is a set of aspirational guidelines for asset owners, managers and service providers that are designed to assist in the incorporation of environmental, social and corporate governance issues into mainstream investment processes and ownership practices.

One of the key principles commits signatories to being 'active owners', which includes engaging in dialogue with companies on environmental, social and corporate governance issues, voting shares and, where necessary, filing shareholder resolutions.

Concerns about failures in the market, including increasing short-termism, combined with a growing recognition of the importance of environmental, social and governance issues led the UN to initiate a dialogue in 2005 with group of 20 of the world's largest institutional investors to develop guidelines for how to integrate ESG issues into mainstream investment processes and ownership practices. This group, consisting mainly of large pension and superannuation funds, was backed by a multi-stakeholder expert group which included academics, mainstream fund managers and socially responsible investors, NGOs and service providers. In total, there were nine days of in-person meetings and numerous conference calls and online discussions. The process concluded with an agreement on the final text for the PRI in January 2006.

The Principles were subsequently launched at the New York Stock Exchange by former UN Secretary-General Kofi Annan on 27 April, 2006. They have since been endorsed by the current Secretary-General, Ban Ki-Moon. There are now more than 235 signatories globally, representing in excess of USD 10 trillion in assets.

There is often misunderstanding about the nature of the PRI and mainstream approaches to responsible investment in general. While the socially responsible investment sector has a rich history dating back to early last century, and remains an important contributor to what we refer to now simply as "responsible investment" (RI), the core objective of the PRI initiative is to enhance financial returns through the better management of environmental, social and governance risks and opportunities - not just through stock selection but also through active ownership. The focus is not on ethics, but on gaining a better understanding of companies' long-term prospects for growth (and enhancing that growth through shareholder engagement) in order to deliver better returns to beneficiaries. The Principles clearly state that they should not be interpreted in a way that is inconsistent with fiduciary duty.

2. PRI in Australia

Currently 34 institutions with an Australian head office have endorsed the PRI, including 16 superannuation funds, 13 investment managers and 5 service providers. In addition a number of significant multinational institutions that operate in Australia have endorsed the PRI. A full list of signatories is provided as an annex to this submission.

3. The Principles and their relevance to shareholder engagement

There are three main Principles particularly relevant to shareholder engagement.

Principle 2

We will be active owners and incorporate ESG issues into our ownership policies and practices.

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Develop an engagement capability (either directly or through outsourcing)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement

To be an active owner means engaging in dialogue with companies, voting shares, and when necessary, filing shareholder resolutions. It also means taking part in policy debates to ensure that regulatory frameworks facilitate rather than inhibit responsible investment practices.

The first survey of PRI signatories shows that the great majority are indeed engaging in dialogue with companies on ESG issues. As may be expected, it was found that corporate governance issues are the most commonly addressed issues in company engagement, but climate change is a close second.

While many PRI signatories in the US use shareholder resolutions regularly, signatories in other jurisdictions, including Australia, tend to engage in private dialogue, with the use of shareholder resolutions as a last resort. Voting against management resolutions is also a common way to send a signal to management that investors would like to see improvement in company performance in various areas. It has been suggested by some leading practitioners within the signatory body that the reason shareholder resolutions are more frequently used in the US is because the shareholder rights in that jurisdiction are weaker, with resolutions being non-binding. In addition, the right to call an Extraordinary General Meeting (referred to by one signatory as the 'nuclear option') in non-US jurisdictions ensures that companies take investor dialogue seriously. It is therefore likely that ensuring investors have robust shareholder rights will actually reduce the need for the exercise of those rights, as companies will make greater efforts to engage in productive dialogue. This ensures a more mature, sensible and cost effective way for investors and companies to interact.

Key point: Regulators should recognise that an environment with strong shareholder rights is likely to reduce the need for the use of those rights, and therefore the costs involved.

Principle 3

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
- Support shareholder initiatives and resolutions promoting ESG disclosure

Principle 3 recognises that without adequate disclosure by investors, it is not possible to analyse long-term risks and opportunities, nor is it possible to systematically evaluate which companies should be the targets of shareholder engagement to address those risks or encourage the taking up of opportunities.

This principle commits signatories to engaging with companies directly to encourage better ESG disclosure. We have already seen PRI signatories undertaking activities around disclosure initiatives:

- A number of shareholder resolutions have been filed in the US by PRI signatories over recent years asking companies to produce sustainability reports using the Global Reporting Initiative as a framework. The great majority of these resolutions were withdrawn after successful negotiations with companies.
- A number of PRI signatories have formed a coalition to focus on the UN Global Compact's reporting framework, call the Communication on Progress. These signatories are using a 'carrot and stick' approach by congratulating companies which have produced good reports and pressing those who have not reported to do so.

Key point: It is important that regulators support shareholder calls for greater ESG disclosure and ensure that shareholders have the legal tools necessary to elicit such disclosure from investee companies.

Principle 5

We will work together to enhance our effectiveness in implementing the Principles.

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

Principle 5 of the PRI recognises that shareholder engagement needs to be conducted in collaboration. It is expensive to develop the expertise to engage in systematic dialogue to improve the ESG performance of companies. Because of the common shareholdings between many PRI signatories, it makes sense to pool resources and influence in order to be most effective and efficient.

One of the ways in which the PRI assists signatories to collaborate is through the PRI Engagement Clearinghouse. The Clearinghouse is a password-protected online forum for signatories to post issues on which they would like to collaborate with other signatories. In addition to collaboration on company dialogue or shareholder resolutions, the Clearinghouse also provides a learning platform where signatories can seek out others interested in a particular topic or simply review what others are working on. The Clearinghouse was established in late 2006 and there have already been over 60 items posted on a broad range of issues, from corporate governance to climate change, ESG disclosure and human rights.

4. Universal owners and the link with the regulatory environment

The Universal Owner hypothesis[1], as adopted by a number of leading PRI signatories, states that it is in the interests of diversified investors for companies not to externalise costs onto the rest of the economy because those costs will ultimately be borne by the portfolio over time. Economic theory tells us that the optimal economic outcome is achieved when companies internalise their costs. For many large investors, their ability to fulfil their obligations to beneficiaries over the long term is more closely connected with the success of the economy than the share price of any one company. In this sense, the interests of diversified investors overlap with those of policy makers, and therefore it can make sense for policy makers and investors to work together to ensure that companies are not externalising costs.

There are opportunities for large investors to collaborate with policy makers such as various environmental regulators to ensure that companies and sectors are not externalising costs onto the rest of the economy. Shareholder engagement backed by non-regulatory policy maker support is an innovative use of the market mechanism to address ESG issues. The PRI, through the Clearinghouse, has partnered with the UK Government's Carbon Trust to fund an investor engagement program and associated research to address carbon emissions by UK companies.

Key point: Policy makers can work with investors to improve the ESG performance of companies in cost effective and economically beneficial ways.

5. Obstacles to Engagement

While the Engagement Clearinghouse has provided signatories to the PRI with a mechanism to collaborate to enhance the effectiveness of engagement efforts, there remain obstacles to effective engagement.

The greatest obstacle is resources, particularly for smaller shareholders. This points to the importance of groups such as the Australian Council of Superannuation Investors

[1] See Rory Sullivan and Craig Mackenzie, Responsible Investment, Greenleaf Publishing, 2006

(ACSI) providing collaborative engagement and voting services in addition to their representative roles.

Some companies are also resistant to investor input into their ESG strategies and approaches. It is important therefore that regulatory systems and policy makers acknowledge the legitimacy of shareholder engagement as an important link in the accountability chain within the economy, and ensure that the regulatory environment is supportive of engagement efforts. The most important way to ensure engagement is effective is to ensure that shareholders have robust rights that they can fall back on where shareholder dialogue fails.

6. Conclusion

There are a number of opportunities for policy makers, both at state and local level to promote shareholder engagement. These include:

- Ensuring robust shareholder rights so engagement is effective
- Promoting ESG disclosure by companies
- Ensuring government-controlled investment funds have shareholder engagement policies

The PRI Secretariat is currently working to develop the capacity to assist signatories in the region to engage. A PRI Asia-Pacific Working Group will shortly be established to provide signatories with the ability to collaborate on issues that are specific to the region.

The PRI would be pleased to support the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Shareholder Engagement and Participation in any further way that we can. We would be happy to speak further about some of the innovative shareholder/policy-maker collaborations that are being occurring in other jurisdictions.

If you have any questions, please feel free to email me at james.gifford@unpri.org.

Kind regards,

James Gifford
Executive Director
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Annex

Australian Signatories to the Principles for Responsible Investment

Superannuation Funds
ARIA
AustralianSuper
CARE Super
Catholic Superannuation Fund
CBUS Superannuation Fund
Christian Super
ESSSuper
Goldman Sachs JBWere Superannuation Fund
Hesta
Local Government Superannuation Scheme
Local Super
LUCRF
State Wide Superannuation Trust
UniSuper Management Pty Limited
VicSuper
Vision Super

Investment Managers
AMP Capital Investors
Australian Ethical Investment Ltd
BT Financial Group
Colonial First State Global Asset Management
Drapac
Five Oceans Asset Management
Foresters ANA Mutual Society Ltd
Herschel Asset Management
Indian Ocean Rim Asset Management Pty Ltd
Investa Property Group
JF Capital Partners Ltd
Portfolio Partners Limited
Victorian Funds Management Corporation

Multi-national investment managers with Australian presence
ABN Amro
Axa
BNP Paribas Asset Management
HSBC Group Investment Businesses Limited
JPMorgan Asset Management

Service Providers
Australian Council of Super Investors (ACSI)
Frontier Investment Consulting Pty Ltd
Monash Sustainability Enterprises - MSE
RepuTex Group
Sustainable Investment Research Institute Pty Ltd (SIRIS)