INVESTMENT POLICY: PROCESS & PRACTICE

A GUIDE FOR ASSET OWNERS

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

THE SIX PRINCIPLES

1 We will incorporate ESG issues into investment analysis and decision-making processes.

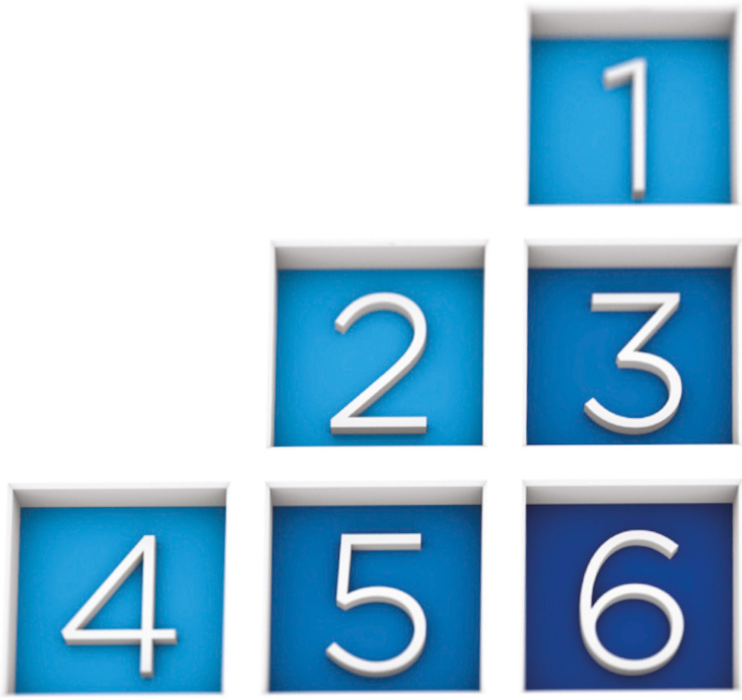
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

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

4 We will promote acceptance and implementation of the Principles within the investment industry.

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

6 We will each report on our activities and progress towards implementing the Principles.



PRI'S MISSION

"We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation."

ACKNOWLEDGEMENTS

Asset owner signatories contributed to this guide their first-hand experience of revising, and executing, investment policy. The guide incorporates the expertise of individual PRI signatories, without representing the views of specific asset owners.

The PRI would like to thank all contributors for their invaluable input, and the following individuals in particular for their sustained support during the process:

- Mr. Urs Bitterling, Head of ESG Office, Allianz Group
- Mr. Jon Duncan, Head of Responsible Investment, Old Mutual Group
- Ms. Anna Foller, Sustainability Manager, Sixth Swedish National Pension Fund
- Ms. Marie Giguère, Executive Vice-President, Legal Affairs and Secretariat, Caisse de dépôt et placement du Québec
- Mr. Andrew Gray, Manager, Investments Governance, AustralianSuper
- Ms. Katharine Preston, Director, Responsible Investing, OPTrust
- Ms. Jelena Stamenkova van Rumpt, Advisor Responsible Investment, PGGM

Additionally, the PRI would like to thank the PRI's Asset Owner Advisory Committee, whose members advise the PRI's Asset Owner Insight work, for their advice during the development of this guide.

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FOREWORD

At the PRI, we believe that asset owners are key to ensuring that sustainable investment strategies keep moving into mainstream investing.

We know that while there are some outstanding examples of leadership, some asset owners are still lagging when it comes to incorporating ESG considerations into their investment practices and ensuring that their approach to responsible investment is consistent with their wider investment and organisational objectives. Many are still grappling with the best way to incorporate ESG factors while also having effective oversight of their manager's responsible investment practices.

Earlier this year, the PRI issued How asset owners can drive responsible investment, which examined how asset owners can raise the responsible investment game by ensuring that the mandates they give to fund managers include requirements for analysing and reporting ESG factors.

Being a principle-led organisation with asset owners at its foundation, the PRI is committed to providing asset owners with the best possible guidance on ESG integration. To that end, we now present a new guide – Investment policy: Process & practice – An asset owner's guide to complete ESG incorporation – to assist asset owners (public and corporate pension funds, superannuation funds, insurance companies, endowments, foundations, family wealth offices) in revising their investment policy and incorporate all long-term factors, including ESG considerations.

The guide provides a best-practice model structure for an investment policy, including guidance on researching and revising an investment policy, on implementing an investment policy and on monitoring its efficacy.

This report makes three important contributions to the practice and, I hope, the implementation, of responsible investing. First, it explains why individual asset owners should take action, and how their actions can reinforce and amplify the actions of others. Second, it describes how asset owners can give real substance and effect to their responsible investment commitments, mapping the process from the development of investment beliefs, through to the establishment of effective governance processes, and ultimately to the integration of responsible investing into investment mandates. Third, it presents examples from asset owners, offering reflections on their processes, the lessons they have learned and the value that they have achieved through responsible investing.

Fiona Reynolds, Managing Director, *PRI*

Asset owners and investment managers are very important parts of the investment chain. By working together and implementing their commitments to responsible investment with sufficient scale and depth, asset owners can accelerate the development of responsible investment across the financial services sector and provide better outcomes for beneficiaries.

THE CASE FOR AN INTEGRATED INVESTMENT POLICY

By formalising an investment process in a policy, asset owners differentiate emotions from facts when making investment decisions, keeping a relentless focus on performing in line with their investment strategy in an evidence-based manner.

This guide helps asset owners to revise and develop their investment policy and incorporate all long-term factors, including ESG considerations, into their investment decisions, no matter whether these decisions are made directly or indirectly. It provides:

- A best-practice model structure for an investment policy;
- Detailed advice on researching and revising an investment policy;
- Guidance on how to implement an investment policy;
- What to consider when monitoring investment policy efficacy.

It has been written for asset owners – public and corporate pension funds, superannuation funds, insurance companies, endowments, foundations, family wealth offices (etc.) – and specifically the individuals in those organisations responsible for investment policy development, whether decision makers or project members.

Organisations that support the formulation of investment policies (investment consultants or asset managers that work directly with asset owners throughout the investment process) will also benefit from the guidance provided.

Advocating the highest standard of ESG incorporation, the guide provides asset owners globally with future-proof best practice. Investment policy that codifies strategic considerations into mainstream investment practices and organisational processes paves the way for a future where asset owner strategy and policy are formally intertwined – enabling a day-to-day, razor-sharp focus on achieving an organisational mission – and where all material factors are incorporated into investment decision-making, in the name of optimum performance and long-term value creation.

ESG INCORPORATION: A GROWING TREND

In 2012, the PRI published Writing a responsible investment policy, outlining how an organisation can develop a specific responsible investment policy to complement its main institutional investment policy. Since then, the investment market has matured due to growing evidence of ESG factors influencing long-term performance – the materiality of climate change, for example, is now clear as day. A number of leading asset owners have led the trend of ESG integration, to ensure their investment processes are understood and practiced by all stakeholders in a coherent and holistic manner. For example:

- PFZW (Netherlands) has identified 11 investment policy initiatives, five of which contain sustainability and/or responsible investment aspects;
- CalSTRS (US) has recognised that incorporating ESG issues is consistent with their fiduciary duty as a long-term investor, and has included an Investment Policy for Mitigating ESG Risks into their Investment Policy and Management Plan;
- OPTrust (Canada) has a statement of Investment Policies and Procedures, which holds that ESG factors have the potential to affect the Plan's long-term investment performance, and recognises that it is their fiduciary duty to identify and address each and every factor that could affect investment returns.

Today, side-lining ESG considerations into a separate policy is not comprehensive enough. Full integration of all material factors entails the alignment of ESG factors and mainstream policy considerations, and makes for a sound investment policy.

TAILORING YOUR POLICY

The ideal form and substance of an investment policy relies on many internal and external factors. With regards to ESG issues, some are global – climate change, demographic shifts, and resource scarcity affect all asset owners across the board, influencing activity and price discovery in most financial markets. The best way to account for these issues during policy development, however, differs from asset owner to asset owner. A tailored approach led by a robust investment strategy will produce the best outcome.

Regional requirements will further differentiate best practice asset owner policies. For example, in France, the French Energy Transition Law (2015) requires institutional investors to disclose how ESG criteria is considered in their investments decisions, which will shape investment policy for asset owners in that region.

GETTING STARTED

Figure 1. Asset Owner Investment Process: Topline Overview

Investment Strategy

A full account of the investment strategy formulation process is given in PRI's discussion paper Crafting an investment strategy: A process guidance for asset owners. It outlines a six step process that asset owners can follow to revise and develop their strategy. The resulting strategy forms the foundation for revising your investment policy, which will allow for the optimum construction of your investment portfolios.

Investment Policy

Revise & Formalise Investment Policy

KEY POLICY COMPONENTS

1. Introduction
2. Definitions
3. Purpose & Scope
4. Investment Objectives
5. Governance
6. ESG Incorporation
7. Active Ownership
8. Reporting

EXECUTION

Implementation

Monitoring

Asset Allocation

- Asset class, strategy & mandate
- Risk management, monitoring & compliance
- Active Ownership
- Reporting & transparency

Investment policy is instrumental to achieving an organisation's vision and mission, and for it to be effective, it needs to be aligned with investment strategy (a high-level strategic plan for achieving your investment objectives). An investment policy should:

- Outline your investment objectives;
- Give specific guidance to investment processes;
- Give specific guidance on your standards for measuring success/performance.

Staying within ESG, a policy revision can highlight the predominant ESG issues influencing your investments / portfolios at large, the appropriateness of skillsets and capacity of actors involved in carrying out the policy, and overall direction where work can be done to improve.

Figure 2 provides a process overview of steps to be considered during your investment policy revision and development process. It assumes that your organisation has already reviewed its investment strategy and all material long-term factors (including ESG) within it. Investment strategy will form the highest order guidance for the revision of your policy and therefore the construction of your investment portfolios. However, if your organisation has yet to consider and incorporate ESG factors at the strategic level, an increased awareness of critical factors in your current policy can be a sufficient temporary solution.

Figure 2: Asset Owner Investment Policy Development/Revision Process Overview

A. REVIEW EXISTING INVESTMENT STRATEGY

Before undertaking policy revision, review your organisation's strategy to make sure any resulting policy development is aligned with organisational purpose and beneficiary interests.

If your organisation hasn't yet developed an investment strategy, the policy revision process can still be an important step in identifying how your organisation will seek to address ESG factors, as well as trigger the organisational review of key strategy inputs.

ACTION POINTS

Organise a board/investment committee discussion to kick off the your strategy revision work, which will address the following issues.

- Does your organisation have a comprehensive investment strategy which accounts for long-term trends? PRI's Crafting an Investment Strategy guidance on investment strategy development highlights key aspects to consider.
- How does your organisation view ESG factors? Are you conducting this review for risk-management purposes, to unlock new opportunities, or a combination of both?
- What is your rationale for updating your policy? And why now? Is it a best practice requirement?
- What considerations must your policy include to meet your organisation's investment strategy and objectives?

Publish your investment strategy and/or principles. If your organisation has yet to undergo a formalised investment strategy review process which considers long-term trends, at a minimum, issue a statement committing to responsible investment practices and describe your organisational approaches to them.

If internal resources are limited, contact the PRI or consider working with an external advisor/investment consultant to help you develop your strategy process and investment principles, to open the door to new considerations which may not be immediately obvious to internal investment committees, executives, and/or board members.

B. ALIGN STAKEHOLDERS

To start, engage executives so there is sufficient support in the organisation (including the board) to execute the policy revision process. Involvement, or at least support, of the organisation's highest governing bodies is critical for your policy to be effectively developed, applied and implemented. The policy's cultural fit to your organisation and formal governance structure 'buy-in' is also a crucial ingredient for an effective policy.

Before any revision occurs, your institution must be clear on who holds ownership of the policy and who will administer it. With these cornerstones in place, writing is made easy and collaborative, with input from mainstream investment and responsible investment/ESG experts, as well as management, board members, and potentially other stakeholders.

ACTION POINTS

Conduct an organisational SWOT analysis or assessment exercise: where are you currently, what are your organisation's ambitions in terms of future investment practices? Areas to consider include:

- Current investment policies and processes regarding both investment and ownership decisions;
- Governance structure and management systems;
- Resources and skillsets;
- Performance and reporting metrics.

Establish and clearly define responsibilities in the organisation for the policy revision process. For example:

- Board of trustees: validation of investment strategy; approval and sign-off of policy;
- Investment committee: oversight of investment policy development and review;
- Chief Investment Officer: development and formulation of investment policy;
- Project teams: policy revision process and project management;
- ESG specialist: responsible for ESG-relevant input.

Create a stakeholder matrix in which key stages of policy revision/development are identified and the roles and responsibilities of all relevant internal and external stakeholders are plotted.

If possible, set deadlines for key stages such as the next board meeting or your PRI reporting cycle, etc. This will hold key policy stakeholders accountable and prevent key staff from getting lost in the project process.

C. REVIEW RELEVANT LEGISLATION

This guide focuses on the incorporation of ESG into investment policies, as their separation does not allow for a holistic consideration of long-term factors. Relevant ESG regulation and public policy frameworks should not be a blind spot, but rather provide the backbone for your policy. Asset-owner-specific regulations and wider public policy framework regarding issues (such as fiduciary duty, ESG transparency and reporting requirements, environmental regulations, pension fund regulations) should not be overlooked. Additionally, national stewardship codes and corporate governance codes such as the G20/OECD's Principles of Corporate Governance can bring to light further policy considerations.

To start, refer to the PRI's Regulation Map, which is an interactive database of policy initiatives from across the globe that support or encourage responsible investment.

ACTION POINTS

Discuss relevant ESG legislation at board/trustee meeting. At a board meeting, consider holding a discussion with board members, the project team, and the compliance team on the ESG frameworks your organisation must adhere to, so everyone is aware of relevant legislation.

Establish a process for tracking and monitoring legislative developments. Review and define organisational capacity for following ongoing regulatory developments to make sure all stakeholders are up to date on relevant framework.

D. REVIEW ESG INVESTMENT GUIDANCE, TERMINOLOGY AND DEBATE

Getting familiar with investment trends that incorporate ESG considerations is crucial because a broad spectrum of reference materials and intellectual capital will help you to create a best in class policy.

All investment and policy review stakeholders, from board members responsible for policy approval to investment staff responsible for the day-to-day management/allocation of funds, should familiarise themselves with factors able to influence policy (including ESG) and their possible effect on the ability of your assets to deliver expected financial and real economy influence outputs.

To start, look through the PLSA (formerly NAPF) document ESG made simple guide or PRI's How asset owners can drive responsible investment. Additionally, asset owner specific literature, including the PLSA's Responsible Investment guidance for pension funds, the EUROSIF's Corporate Pension Fund Sustainable Investment Study, EUROSIF's PRIME Toolkit and USSIF's Unleashing the Potential of US Foundation Endowments, will also prove to be helpful.

Once relevant ESG areas have been understood and covered, take your understanding a step further by considering asset class specific issues using advanced guidance from the PRI (found here). Furthermore, educational institutions (like the CFA Institute or PRI Academy), ESG data, and research providers can offer insight into trends you may want to consider.

ACTION POINTS

- Review existing literature. In addition to resources mentioned above, take a look through additional resources in appendix B for guidance on general ESG topics.
- Contact the PRI, access resources on the Explore page of the PRI website, or enrol in courses offered by the PRI Academy for additional insight and guidance on ESG issues within specific asset classes, responsible investment best practice, and stewardship activities.
- Consider contacting your local responsible investment organisation some of which are found in appendix A, for additional guidance pertaining to your local market.
- Conduct a materiality analysis: identify, define, and assess key ESG factors for your organisation and stakeholders (KPMG's Sustainable Insight: The Essentials of Materiality Assessment may be useful here).

E. UNDERTAKE A PEER REVIEW

Understanding what your peers are doing will spur high level investment policy discussions and even help the drafting of the policy itself. Some responsible investment practices may not be addressed with the same structure and rigor as more traditional items of an investment policy statement; others may feature holistically in investment policy structure and broader practice. Consider the pros and cons of the approaches you encounter.

- How does your investment policy structure compare to your peers?
- How are stakeholders involved into the policy revision approach?
- How are ESG risks or opportunities defined and identified?
- How are ESG issues weighed and valued in investment decisions?
- What, if anything, has the organisation done to effect 'positive real economy influence' through their portfolio?

Peer reviews shine light on how investment policies were formulated and the outcomes they produced. Going further than a 'policy format' only review shows how different approaches/strategies deliver value to different organisations.

ACTION POINTS

Consult policy examples from PRI signatories in appendix C, as well as the Strategy & Governance module of the PRI Transparency Reports for insight on what others are doing to incorporate ESG considerations.

Contact your local responsible investment organisation to identify more peers with policies that address ESG and long-term investment considerations.

Conduct a peer analysis consisting of:

- Which stakeholders were involved with policy development? How were they involved and at what stages?
- How were ESG risks or opportunities defined and identified, and how are they weighed and valued in investment decisions?
- How were specific processes and practices used to reflect ESG factors within investment processes?
- How are outcomes and results monitored, reported, and disclosed?

1. INVESTMENT POLICY SECTIONS

POLICY INTRODUCTION

An introductory section sets out the context and objectives of the policy. It communicates the background for your policy revision, and sets expectations on how the policy will be adopted.

An introduction will typically include:

- The motives behind a new/revised investment policy – link the new/existing policy to:
  - Your organisation's overarching investment strategies and targets;
  - Underlying beneficiary needs and objectives;
  - Expectations of staff behaviours, practices and duties.
- Setting the context – your organisation's previous policies and their compatibility with the new policy:
  - Has an investment policy merged with a responsible investment policy?
  - Is the new policy replacing or complementing existing policies?
- Principles, codes, or regulations which influenced your investment policy:
  - Has your organisation based your policy on the six Principles for Responsible Investment, or the ICGN's Guidance on Institutional Investors' Responsibilities?
  - Has your policy been developed due to new legislation?
- Process background:
  - Who was responsible for developing the policy (e.g. a working group), what was their brief and which individuals were involved? Were stakeholders engaged, and if they were, which exact stakeholders? Does the policy have broad stakeholder acceptance?
  - Who approved the policy?

EXAMPLE INVESTMENT POLICY INTRODUCTION: AN EXCERPT TAKEN FROM CALPERS

CalPERS' (US) Total Fund Investment Policy sets the organisation's investment beliefs, overarching investment purposes, and objectives for all its investment programs. The purpose of the policy, and other investment policies is to provide the framework for the management of CalPERS' assets by outlining their objectives, benchmarks, restrictions and responsibilities "so that the Committee, staff, consultants, managers, members, and beneficiaries, and all other CalPERS stakeholders, clearly understand the objectives and policies of the CalPERS investment program. The Policies also encourage effective communication, facilitate transparency and compliance, and provide a framework for reporting back to the Committee, as appropriate". Access the full policy

DEFINITIONS

This section includes key terms as well as your view on how factors influence your investments. The clarity provided here forms the backbone of policy execution. Importantly, your organisation's ability to monitor and control compliance will largely be set in this section. Definitions also establish policy credibility.

The most relevant ESG definitions are listed below. There will be other non-ESG-related definitions you will also need. Consider what additional items will add essential value. In ESG, definitions from widely accepted initiatives like the PRI are a good place to start, and local responsible investment organisations may have terminology in your local language.

ESG areas to cover include:

- **Your organisation's definition of ESG and/or responsible investment.** The PRI defines responsible investment as an approach to investing that incorporates environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns.
- **Your ESG objectives/measures/impact**. If you've set objectives for measuring ESG risk factors in your portfolio, how does your organisation define such factors? What will ESG strategy success look like? How do you approach the performance contribution of your responsible investment strategies?
- **Processes for incorporating ESG**. How does your organisation address ESG factors? The PRI Reporting Framework: Main Definitions identifies common approaches to incorporating ESG factors into investment decisions.
- **Your definition of ESG factors in relation to your investments**. What ESG factors are, or should be, taken into consideration when constructing portfolios? For example: if carbon is seen as an important driver for your portfolio, how should it be managed?

PURPOSE AND SCOPE

The purpose and scope of your organisation's policy entails a high-level overview of:

- What the policy aims to achieve
- To whom (or to what part of the organisation and the investment chain) is the policy binding? For example: the policy could cover a specific legal entity, region, department, etc.
- What specific asset classes, investment styles, regions, and markets does the policy apply to?
- What ownership activities does the policy govern, and what are the implications on those involved?

EXAMPLE INVESTMENT POLICY PURPOSE AND SCOPE, TAKEN FROM UNIVERSITIES SUPERANNUATION SCHEME

In outlining their approach to responsible investment, **The Universities Superannuation Scheme** (UK) believes it's their duty to protect and enhance the value of their investments over the long term, and to provide secure pensions to their members. In doing this they are active, long-term investors and consider extra-financial factors. Their commitment is then further elaborated in their Statement of Investment Principles, Investment Beliefs and Stewardship Code statement and a Responsible Investment Strategy which covers all asset classes they invest in. Access the full policy

INVESTMENT OBJECTIVES

This section stipulates the core objectives of and guidelines for your investment process, and how your organisation will incorporate ESG considerations within them. Their format may differ, depending on an organisation's mission, geography, focus, resource availability, and internal competencies. Consider the following:

- **Incorporating ESG considerations and overall investment objectives:** What place do ESG considerations have within your portfolio objectives? Do you have ESG-specific objectives for your overall portfolio (e.g. on climate proofing or contributing to the Sustainable Development Goals)?
- **Examining your organisation's risk/return profile, including:**
  - **Risk budget:** Address your overarching risk philosophy and tolerance, which should incorporate all risks including those linked to ESG considerations. How will it be reflected in asset allocation decisions? Regularly stated risks (like liquidity, legal, political, regulatory, etc.), may not cover all areas. Consider the metrics for measuring specific risks, as well as policies and practices for addressing risk.
  - **Return objectives:** Identify how ESG factors are currently being reflected in your portfolio and in specific asset classes. Determine performance targets and integrated benchmarks which focus on long-term returns for each individual factor. Define the reporting/tracking process, and how success will be measured.
  - **Hedging:** Outline your organisation's policy on hedging and develop a framework or set of guidelines for it. This could include a list of usable instruments, desired hedging ratios for specific asset classes, and how ESG considerations were valued.
  - **Leverage:** What is your organisation's policy on leverage? Determine maximum levels for each asset class, and clarify how you identify, measure, and monitor different forms of leverage. Additionally, you could outline expectations of how leverage can be used to mitigate ESG risks.
  - **Derivatives:** How should derivative instruments be used by investment managers? Include criteria and framework (such as the management of counterparty risk) that should be covered in IMAs, and identify how these instruments can reflect organisational ESG considerations.
  - **Other risk/return policies:** Are ESG factors considered in securitisation and collateral management, etc.?
- **Asset allocation:** Outline exactly how asset allocation decisions help meet investment objectives. For example, how will asset allocation maximise the likelihood that an investment portfolio's assets will fund plan benefits over the planning horizon?
  - **Asset allocation** can include projected ESG impacts/risk accumulation: what minimum ESG requirements entail, as well as the expected real economy influence target within an asset. While standard approaches to asset allocation rely heavily on historical quantitative analysis, much of the investment risks around ESG issues require future-oriented inputs, both quantitative and qualitative. Additionally, diversifying assets across a broad consideration of risks can be done, for example, by means of a risk factor approach to allocation decision making (CalPERS explores this during a 2013 risk factor based asset allocation and future portfolio consideration workshop).
  - **Scenario analysis.** In order to anticipate systemic risks and opportunities, your organisation may consider scenario analysis and/or modelling specific factors, and calculate the risk profile of future ESG trends at portfolio level (for example: climate change). Macroeconomic, environmental, social and governance trends can be plotted and calculated with the help of determined factors, thereby anticipating future scenarios, and their systemic impact on asset returns.

EXAMPLE INVESTMENT POLICY SCENARIO ANALYSIS: CALSTRS AND THE ENVIRONMENT AGENCY PENSION FUND

CalSTRS and the **Environment Agency Pension Fund** partnered with Mercer and 16 other industry participants to conduct scenario analysis considering several future climate change pathways, and how they might impact their portfolios. The resulting reports can be found online (the CalSTRS report and the EAPF report).

CLIMATE CHANGE AND ASSET ALLOCATION DECISIONS

Resources like Climate Change Scenarios – Implications for Strategic Asset Allocation from Mercer/IFC and Unhedgeable Risks from the University of Cambridge Institute for Sustainability Leadership provide analysis of how climate change might impact asset allocation decisions.

- Time horizon: Incorporating ESG considerations into specific portfolio requirements (such as asset and liability profiles or liquidity requirements) will determine your investment time frame. An organisation can set relatively short periods for ongoing monitoring of performance, with longer horizons providing more stability for achievement of financial and ESG performance objectives (Focusing Capital on the Long Term explores this issue further). It is vital to connect long-term investment objectives and governance to day-to-day practices and execution. Our discussion paper on Long-term mandates outlines current asset owner practices used to achieve these objectives.
- **Further considerations regarding objectives:**
  - The relative amount of active and passive management, and how ESG considerations are incorporated in both.
  - The relative amount of internal and external management, and how ESG considerations are incorporated in both.
  - The appropriate direct and indirect costs of each asset category, and how ESG factors can contribute to management fees and trading costs.
  - Different investment approaches (such as fundamental, technical, quant) within asset classes, and their interplay with ESG factors.

EXAMPLE INVESTMENT OBJECTIVES: CALSTRS

CalSTRS' (US) Investment Policy and Management Plan outlines the general objectives for the fund, as well as specific investment performance objectives. Additionally, they establish their asset allocation process, identify relevant benchmarks, and outline a set of risks (including ESG-specific risks) that can influence investment outcomes, specifying how these risks are addressed. Access the document.

GOVERNANCE

ESG governance should be as rigorous as any other governance under investment policy. A fully integrated policy calls for a robust governance approach. Governance upholds accountability, which makes the policy an effective tool for incorporating and mandating all investment considerations (including ESG) throughout your investment chain. Every responsibility needed to implement the various aspects of your policy must be accounted for, whether internal or external.

- **Internal governance**. Having identified the responsibilities involved in your revision process, your policy should also outline the governance duties of all stakeholders. Responsibilities should be split into oversight duties, as well as the day-to-day execution and management of the investment policy, and might include:
  - Board of Trustees: Responsible for high-level assessment – is the investment policy working to meet the objectives expressed in the investment strategy?
  - Investment Committee: Responsible for overseeing investment policy execution and implementation.
  - Chief Executive Officer: Responsible for policy approval; monitors policy execution.
  - Chief Investment Officer: Responsible for the development and implementation of investment policy throughout the investment chain.
  - Chief Financial Officer: Responsible for executing risk management and measuring ESG risks in applicable portfolios.
  - Investment teams: Responsible for executing investment policy in every investment decision.
  - ESG specialist/compliance team: Responsible for ESG input and reviewing all stages of the investment process.
- **External governance.** Consider any work with external partners, which includes relationships with external managers and/or other third party stakeholders. In terms of ESG integration, key considerations include:
  - A clear process on how to develop investment mandates that are aligned with beneficiary interests.
  - A set of criteria for manager selection (alignment, fund of fund, fee structure, governance structure, active ownership, conflict of interest, related party transactions etc.). The PRI will be publishing further guidance on this in 2016.

- A due diligence process (further work from PRI's Investment Practices team, such as the Limited Partners Responsible Investment Due Diligence Questionnaire may be helpful in this regard)
- A requirement that external managers have a responsible investment policy in place, or that they adopt yours for relevant assets or otherwise clearly demonstrate their competency in ESG incorporation.
- Further guidelines on manager selection, monitoring, and reporting requirements (for example: ESG issues should be included in RFPs or IMAs; reporting on ESG issues should be included in regular reporting). You can find more guidance on this topic in the PRI's Aligning Expectations publication.
- Establishing oversight guidelines for external advisers which comply with your responsible investment guidelines and include ESG considerations
- Requiring an asset manager to globally promote responsible investment, for example by signing the six Principles for Responsible Investment.
- Risk management, and compliance roles and responsibilities.

EXAMPLE OF AN INVESTMENT POLICY'S GOVERNANCE SECTION: THE PENSION PROTECTION FUND

The Pension Protection Fund (UK) has included an annex on their Statement of Investment Principles which outlines their governance structure. Roles and responsibilities are set for the board, investment committee, asset and liability committee, investment advisors, fund managers, custodians, and transition managers. Access the document.

ESG INCORPORATION APPROACHES

The ESG approaches outlined here are in addition to those already incorporated in other sections of your policy, thereby ensuring that all ground is covered. They are not stand-alone approaches but rather a means to achieving the investment objectives outlined in section 5. If other sections are providing sufficient ESG cover, there may be no need for this section.

- **Integration**: outline the framework for integrating ESG factors into investment decisions. This includes ESG integration in investment processes, portfolio construction, and investment valuation. For example: What techniques will you employ to integrate ESG considerations and passive investments? The PRI publication A practical guide to ESG integration for equity investing provides comprehensive guidance and case studies on how to integrate ESG considerations into investment processes regarding listed equities.
- **Screening**: outline your organisation's investment screening policy, which addresses both positive and negative screening approaches applied to sectors, industries and/or individual companies. The CFA Institute's Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals may be helpful in this regard.
- **Impact investing/thematic investing**: although a majority of responsible investors do not fall in this category, for those who do, an outline of the share (such as percentage, or total capital) allocated to sustainable investment themes (such as green technology, renewable energy, or sustainable forestry) would be helpful. Consider resources from the Global Impact Investing Network for further guidance.
- **Position statements**: If your organisation is committed to a specific stance, for example on climate change, human rights or sector-wide initiatives, or if your organisation's policy complies with conventions or guidelines such as the OECD Guidelines for Multinational Enterprises or UN Global Compact, these should be outlined or referenced here.

If any approach is not applicable to all your asset classes or asset class specific strategies, make this clear.

EXAMPLE INVESTMENT OBJECTIVES: CALSTRS

The Church Pension Fund's (Finland) Guidelines to Responsible Investing includes a responsibility analysis, which addresses several ways to measure ESG criteria including: norm-based screening, ESG integration, best-in-class analysis, thematic investing, and exclusion. Access the full policy.

ACTIVE OWNERSHIP AND ENGAGEMENT

For many responsible investors active ownership is central to their practices. The second Principle for Responsible Investment isolates active ownership as a means to incorporating ESG issues into ownership policies and practices. By securing the alignment between investment decisions and active ownership activities, active ownership can be leveraged to improve the risk/return profile of the portfolio, to as great a degree as possible.

Your investment policy is key to defining your organisation's active ownership approach. It should not be seen as a stand-alone approach but rather a means to executing the investment objectives of section 5, and hence is best understood in the context of a central investment policy. Active ownership should swiftly feed into investment decision making, and vice versa, to make the most effective use of new information.

This section should cover guidelines for different types of engagement your organisation will employ. Such as:

(Proxy) voting
How does your organisation use its AGM voting rights? Incorporating ESG issues within voting guidelines and disclosing how your organisation will vote is essential, whether voting responsibilities are seen to internally or are outsourced. By publicly stating how your organisation will vote on issues such as board structure and executive remuneration, or at the very least stating the factors you will bear in mind when voting, you will ensure voting practices are aligned with organisational investment objectives. Additionally, the voting section of your policy should cover how voting is monitored and recorded, and whether you will disclose voting intentions and outcomes publicly.

Individual engagement
What is your approach to directly engaging with companies in which assets are directly or indirectly invested? Key aspects to address include:

- Your expectations and objectives for engaging;
- The process for identifying ESG risks and opportunities to prioritise in dialogue with companies;
- ESG interests/concerns you will engage on;
- How you measure engagement activity success;
- Escalation strategies in case of non-satisfactory responses by companies;
- Transparency – the level of reporting for these activities.

Collaborative engagement
What is your approach for ensuring that collaboration with other investors achieves your overall investment objectives? Collective engagement can leverage the knowledge and experience of peers and upskill your organisation on specific ESG topics. Successful collaborative engagement sees investors banding together in a relationship of mutual trust by agreeing on objectives, sharing information and coordinating activities. Your policy should outline:

- Expectations regarding collaborative engagement;
- Selection criteria for which initiatives to get involved in;
- And how much time and resources you have available.

The PRI's Introductory Guide to Collaborative Engagement is a good place to start.

THE PRI'S COLLABORATION PLATFORM

The PRI's Collaboration Platform is an online tool for global PRI signatories – a private forum to pool resources, share information, enhance influence and engage with companies, stakeholders, policymakers and other actors in the investment value chain.

Service provider/investment manager engagement
How does your organisation work with service providers and investment managers to execute active ownership activities? If engagement/voting responsibilities are outsourced, it is important to specify external parties' expectations in your policy in order to ensure actions taken on your organisation's behalf are aligned with your objectives and beliefs. Key points to identify include the ESG voting and engagement standards/frameworks you would like third parties to follow, and the level of information you would like to receive in order to periodically monitor their performance.

Your active ownership and engagement section should also include the following:

- Any stewardship codes or guidelines that must be adhered to;
- The aspirations for activities outlined;
- Criteria to prioritise resources and efforts;
- ESG expectations for companies engaged with;
- Measures of success;
- Course of action in case of unsuccessful dialogue;
- The relationship between activities and investment decision making;
- The commitment to disclose relevant information to the public and beneficiaries.

For organisations who outsource their active ownership activities, this should outline key considerations and obligations to be included in service or investment management agreements. It should also cover your expectations of external managers, consultants and fiduciaries, including:

- Their role in implementing your active ownership policy;
- The degree and frequency of information you expect to receive;
- How they will be monitored.

The PRI will be publishing guidance on the second Principle of Responsible Investment in the first quarter of 2017.

EXAMPLE APPROACHES TO SHAREHOLDER ENGAGEMENT: CAISSE DE DÉPÔT ET PLACEMENT DU QUÉBEC

Caisse de dépôt et placement du Québec's (Canada) Policy on Responsible Investment identifies shareholder engagement as one of three principles for approaching responsible investment, and outlines several methods used by the organisation:

- Communication with companies (done both bilaterally and in collaboration with other investors);
- Active engagement through initiatives such as the PRI, CDP, CDP Water Disclosure Project, EITI, and PIAC;
- Exercising voting rights.

Access the full policy.

REPORTING

Full integration means including ESG considerations in your regular reporting framework. Reporting should be prepared for stakeholders, covering policy results and impacts. This means beneficiaries, trustees, and the public can help hold your organisation accountable to a newly incorporated policy.

This section should outline your approach to reporting:

- How, when and to whom you will report
- The level of transparency (e.g. public availability, or selected stakeholders only)
- Internal review processes (e.g. what reporting is expected of portfolio managers, external engagement and proxy voting providers; what review processes should be put in place by the board/investment committee/responsible investment committee to ensure objectives will be met?)
- Guidance on key performance indicators which measure the impact of activities resulting from the policy
- Compliance with transparency/reporting requirements within relevant regulatory frameworks (see the PRI's Regulation Map for more on this).

EXAMPLE REPORTING SECTION: CANADA PENSION PLAN INVESTMENT BOARD

The Canada Pension Plan Investment Board (Canada) has included sustainable investment considerations as part of their financial report which is available online. Additionally, CPPIB also publishes a Sustainable Investment Report which highlights sustainable investment policies, practices and approaches in public, private, and real estate markets. Access the report.

2. IMPLEMENTING THE INVESTMENT POLICY

An investment policy guides an organisation on investment decisions, asset allocation, ESG incorporation, how asset managers are selected and appointed, how active ownership is carried out, and how an organisation reports on its activities.

However, implementing a policy is the only means of harnessing the theoretical powerhouse that is the policy itself. Hence, successful implementation should be prepared for as part of the policy revision process. Consider the following:

Strategic asset allocation
Outline your organisation's target asset allocation and the benchmarks for meeting your objectives, such as meeting long-term liquidity needs. Key aspects include asset classes your organisation will invest in, a holistic consideration of the risks within these asset classes, acceptable ranges, the levels that will trigger rebalancing, as well as what your rebalancing procedures are.

Asset class strategy and mandates
It is critical to make sure your asset-class-specific strategies do not overlook ESG factors and that they are aligned with your strategic asset allocation. Asset-class-specific guidance from the PRI may be helpful in outlining approaches:

Listed Equity
- A practical guide to ESG integration for equity investing
- Integrated Analysis: How investors are addressing ESG factors in fundamental equity valuation

Debt
- Fixed Income Investor Guide
- Corporate Bonds: Spotlight on ESG Risks

Alternative Investments
- Responsible Investment and Hedge Funds
- Responsible Investment in Private Equity: A Guide for Limited Partners
- Private Equity LP's Responsible Investment Due Diligence Questionnaire
- Responsible Investment in Infrastructure
- Implementing Responsible Property Investment Strategies
- Sustainable real estate investment, implementing the Paris Climate Agreement: An Action Framework
- Integrating ESG into fund documentation – PE LP guide (late 2016)

Stakeholder engagement
Communicate criteria and expectations to all stakeholders responsible for investment decisions, through dialogue with existing stakeholders, or through RFPs, IMAs and external mandates. The PRI's How Asset Owners Can Drive Responsible Investment and Long-Term Mandates: A Discussion Paper can help in determining how your organisation communicates its asset allocation strategy.
Risk management, monitoring, and compliance: Appropriately prioritise ESG considerations in risk management decisions and establish clarity regarding the policies and your processes for evaluating them. Stakeholders should be made aware of:

- How your organisation views ESG factors;
- How that will impact your asset allocation and investment decisions;
- What criteria you require to monitor them;
- The process for taking corrective action.

Active ownership
Using criteria outlined in your policy, identify key ESG issues that influence your portfolio – what are the weakest performing investments in light of those issues? Investment teams communicating with those engaging on the firm's behalf is critical to making sure your proxy voice is correctly allocated, to producing outcomes from ownership actions and to ensuring they are incorporated into investment decisions. All stakeholders within your investment chain should be aware of activities in order to make sure ownership/engagement outcomes are reflected in investment decisions, and vice versa. The PRI will be publishing a guidance document in early 2017 to support asset owners in adopting more comprehensive active ownership approaches.

Manager selection, appointment and monitoring
Key ESG considerations should be reflected in policies and practices regarding selection, appointment and monitoring of investment managers. The PRI's A Practical Guide for ESG Integration in Equity Investing and Aligning Expectations outline best practice for asset owners and investment managers regarding material ESG factors and how they are monitored. Additionally, the PRI will be publishing further guidance for asset owners on the manager selection, appointment, and monitoring processes in late 2016.

Reporting and transparency
Incorporate investment policy updates into your reporting framework. Folding aspects of the PRI Reporting Framework or the standards of the Global Reporting Initiative into your framework can help to achieve responsible investment best practice. Additionally, your organisation could publish an annual responsible investment report which addresses how ESG factors have impacted your portfolio, or quarterly reports on voting and engagement outcomes.

An extensive list of useful resources for responsible investment implementation by asset class can be found in appendix C.

3. MONITORING AND REVIEWING YOUR INVESTMENT POLICY

All aspects of your newly forged investment policy need to be monitored periodically in order to evaluate success and identify underperforming areas. Defining your policy review process is hence part and parcel of reworking the investment policy itself.

A clearly developed review process should answer the following questions:

- How well is the policy being implemented? Are the goals that were formulated in theory being achieved in practice? Do specific investment practices need to be developed further?
- Are investment policies remaining consistent with investment strategies?
- Do any internal/external factors require you to change how you incorporate ESG considerations into your investment policy? Are you expanding how you incorporate certain issues into your investment process? Have you expanded into new asset classes that are not yet covered by your policy?
- Are there any new legal requirements that you must follow?
- Are there any other influences that should be considered? For example, should recent peer activity lead to discussions regarding your own policy?

Best practice is to make ESG a component of board meetings. Investment manager reports on the most important current issues, and accounts of how these issues have been incorporated into the investment process, help update trustees on progress.

Set the timeframe for board/trustee policy review, which can be anywhere from 1 to 3 years. This will keep board members up-to-date on current ESG trends and how they affect the organisation's investment performance, thereby allowing them to determine whether investment policy should be adjusted in light of these trends.

APPENDIX A: RESPONSIBLE INVESTMENT ASSOCIATIONS AROUND THE WORLD

GLOBAL

- Global Sustainable Investment Allicance

EUROPE

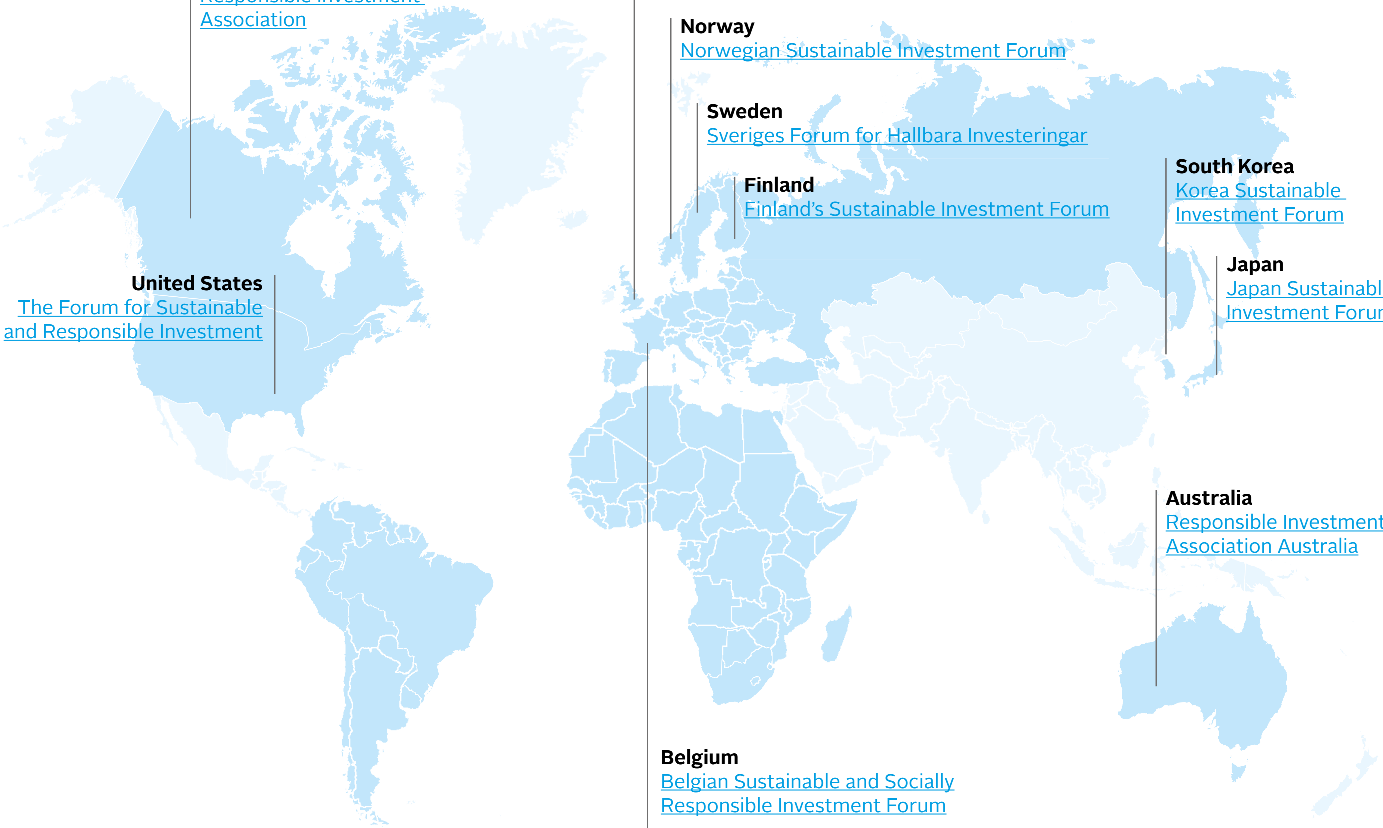
- European Sustainable Investment Forum

AFRICA

- Africa Sustainable Investment Forum

LATIN AMERICA

- LatinSIF



Canada
Responsible Investment Association

United States
The Forum for Sustainable and Responsible Investment

United Kingdom
UK Sustainable Investment and Finance Association

Norway
Norwegian Sustainable Investment Forum

Sweden
Sveriges Forum for Hallbara Investeringar

Finland
Finland's Sustainable Investment Forum

South Korea
Korea Sustainable Investment Forum

Japan
Japan Sustainable Investment Forum

Australia
Responsible Investment Association Australia

Belgium
Belgian Sustainable and Socially Responsible Investment Forum

Denmark
Danish Social Investment Forum

France
French Social Investment Forum

Germany, Austria and Switzerland
Forum Nachhaltige Geldanlagen

Italy
Italian Forum for Sustainable Finance

Netherlands
Dutch Association of Investors for Sustainable Development

Spain
Spain Social Investment Forum

Switzerland
Swiss Sustainable Finance

APPENDIX B: FURTHER RESPONSIBLE INVESTMENT RESOURCES

INTRODUCTORY MATERIAL

- PRI's Building the Capacity of Investment Actors to use Environmental, Social, and Governance (ESG) Information
- PRI: Understanding the impact of your investments
- PRI: How asset owners can drive responsible investment
- PLSA: ESG Made Simple Guide
- RIA: Guide to Responsible Investment
- CERES: Blueprint for Sustainable Investing
- Sustainable Returns for Pensions and Society: Responsible Investment and Ownership
- USSIF: The Impact of Sustainable and Responsible Investment
- Willis Towers Watson: Sustainable investing – we need a bigger boat.
- World Economic Forum: Accelerating the Transition towards Sustainable Investing
- World Economic Forum: Global Risks Report 2015

ASSET-OWNER-SPECIFIC GUIDANCE

- PRI: Investment Practices, Asset Owner Insight
- NAPF: Responsible Investment Guidance for Pension Funds
- EUROSIF: Corporate Pension Fund & Sustainable Investment Study
- EUROSIF: Primer for Responsible Investment Management of Endowments (PRIME Toolkit)
- USSIF: Unleashing the Potential of US Foundation Endowments
- EIRIS: Responsible investment in pooled funds: A guide for charity trustees

ASSET-CLASS-SPECIFIC GUIDANCE

- PRI: A practical guide to ESG integration for equity investing
- PRI: Integrated analysis: How investors are addressing ESG factors in fundamental equity valuation
- PRI: Fixed income investor guide
- PRI: Corporate bonds: Spotlight on ESG risks
- PRI: Responsible investment and hedge funds
- PRI: Responsible investment in private equity: A guide for limited partners
- PRI: Limited partners' responsible investment due diligence questionnaire
- PRI: Responsible investment in infrastructure
- UNEP FI: Implementing responsible property investment strategies
- INCR, IGCC, IIGCC, PRI, UNEP FIand RICS:sustainable real estate investment, implementing the Paris Climate Agreement: An action framework
- PRI Integrating ESG into fund documentation – PE LP guide (late 2016)

INITIATIVES

- Principles for Responsible Investment
- Global Investor Coalition on Climate Change
- International Corporate Governance Network
- Focusing Capital on the Long Term
- UN Framework Convention on Climate Change
- UN Guiding Principles on Business and Human Rights

APPENDIX C: ASSET OWNERS' INVESTMENT POLICIES FROM AROUND THE WORLD

PRI signatories have provided the following asset owner investment policies, based on public availability and regional spread. All elements of all policies do not necessarily represent best practice.

AFRICA

ORGANISATION	COUNTRY	TYPE	DOCUMENT
Government Employees Pension Fund (GEPF)	South Africa	Non-Corporate Pension Fund	Investment Policy Statement
Sasria (SOC) Ltd	South Africa	Insurance Company	Investment Policy

ASIA/OCEANIA

ORGANISATION	COUNTRY	TYPE	DOCUMENT
Australian Catholic Superannuation Retirement Fund	Australia	Non-Corporate Pension Fund	Responsible Investment Policy
CBUS	Australia	Non-Corporate Pension Fund	Investment Policy Statement Summary with ESG Policy
Foundation North	New Zealand	Foundation	Statement of Investment Policies and Objectives
Hesta Super Fund	Australia	Non-Corporate Pension Fund	ESG Policy
New Zealand Super Fund	New Zealand	Non-Corporate Pension Fund	Responsible Investment Framework
StatewideSuper	Australia	Non-Corporate Pension Fund	Environmental, Social & Governance (ESG) Investment and Proxy Voting Policy
VicSuper	Australia	Non-Corporate Pension Fund	Investment Policy Statement

EUROPE

ORGANISATION	COUNTRY	TYPE	DOCUMENT
Allianz SE	Germany	Insurance Company	ESG Integration Framework
AP2	Sweden	Non-Corporate Pension Fund	Corporate Governance Policy
AXA Group	France	Insurance Company	Group Responsible Investment Policy
Church of Finland	Finland	Non-Corporate Pension Fund	Responsible Investment and Ownership Policy
Church of Sweden	Sweden	Non-Corporate Pension Fund	Financial Policy and Policies and Instructions for Responsible Investment
Environment Agency Pension Fund	UK	Non-Corporate Pension Fund	Statement of Investment Principles and Responsible Investment Policy
PFZW	Netherlands	Non-Corp Pension Fund	Investment Policy
FRR	France	Non-Corporate Pension Fund	Responsible Investment Strategy
West Midlands Pension Fund	UK	Non-Corporate Pension Fund	Responsible Investment Framework

NORTH AMERICA

ORGANISATION	COUNTRY	TYPE	DOCUMENT
Caisse de dépôt et placement du Québec	Canada	Non-Corporate Pension Fund	Policy on Responsible Investment
CalPERS	US	Non-Corporate Pension Fund	Total Fund Investment Policy
CalSTRS	US	Non-Corporate Pension Fund	Investment Policy and Management Plan
OPTrust	Canada	Non-Corporate Pension Fund	Statement of Investment Policies and Procedures

CREDITS

- Authors: Don Gerritsen and Tim Wyand
- Editor: Heidi Aho
- Designers: Alessandro Boaretto and Thomas Salter

For questions or feedback, please contact Don Gerritsen at don.gerritsen@unpri.org

The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with **UNEP Finance Initiative** and the **UN Global Compact**.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

UN Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact