Principles for Responsible Investment

ASSET OWNER STRATEGY GUIDE:

HOW TO CRAFT AN INVESTMENT STRATEGY

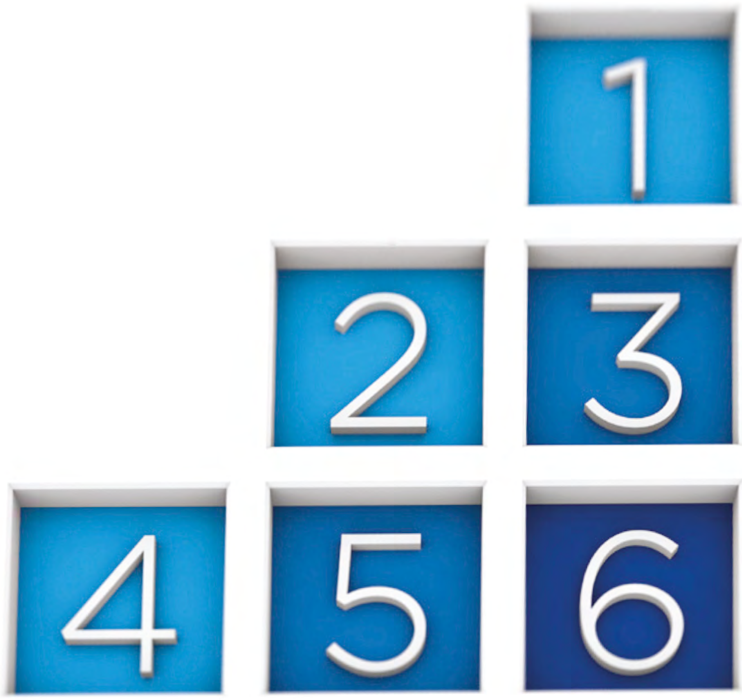
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

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

This document was created from a 2016 discussion paper on asset owner strategy. It was prepared by the PRI with support from a number of PRI signatories that shared their expertise in developing the discussion paper. The recommendations of this document are those of the contributors and the PRI. They should not be interpreted as representing views of individual PRI signatories. The PRI would like to thank all contributors for their valuable input to the project, in particular:

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Additionally, the PRI would like to thank the members of the [PRI's Asset Owner Advisory Committee]() for their advice in the development of this guide.

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FOREWORDS

LONG-TERM RESPONSIBLE INVESTMENT STRATEGIES ARE HERE TO STAY

When the PRI published its discussion paper on asset owner investment strategy— Crafting an Investment Strategy— they declared that even though many asset owners have made commitments to responsible investment, there is still insufficient work to embed sustainability into institutional investment strategy.

Asset owners need to get back on the "front foot" when it comes to their investment strategy. While the global macroeconomics and political economy continue to send mixed signals, it's more critical than ever that asset owners demonstrate a sound and considered investment strategy that takes environmental, social and governance (ESG) issues into account to maximise long-term investment performance and better manage risk and, often, beneficiary expectations.

Since the discussion paper was published, there have been new industry initiatives that support consideration of ESG issues. For example, asset owners now have guidance from the recommendations of the Financial Stability Board (FSB) Task Force on Climate-related Financial Disclosures (TCFD). The TCFD recommendations are designed to help companies and investors understand and manage climate-related risks.

When it comes to industry players leading by example, the world's largest asset owner GPIF recently announced that they had included ESG in their investment principles. Such an announcement sends a strong signal about the systemic importance of ESG as a creator and preserver of value.

Alongside these developments, the market momentum for a more long-term responsible investment approach seems unstoppable. Having followed the ESG / SRI market for more than a decade, the past 18 months has felt more like a tipping point, the time when responsible investment finally arrived onto the front pages of the financial press and became "mainstream."

Given the direction of travel, a sound investment strategy is one that assesses long-term sustainability issues and understands how global megatrends will shape our future investment environment. It is not a tick-box exercise but rather, a fundamental starting point to investment decision-making that improves risk management and maximizes returns for current and future generations of beneficiaries.

Xander den Uyl
Trustee, ABP

EVOLVING INVESTMENT STRATEGY CONSIDERATIONS FOR BOARD MEMBERS AND EXECUTIVES

Over the last few years, it has become obvious that taking material ESG issues into account in investment strategies, decisions and active ownership is not against, but an integral part of an investor's fiduciary duty, which requires investors to act in the interest of the ultimate beneficiary. This requires that responsible investment and incorporation of ESG issues is not a 'nice to have' overlay, but should be firmly integrated in an asset owner investment strategy.

Asset owners, who sit at the top of the investment chain, have it in their power to communicate to managers and other stakeholders how critical ESG is to addressing systemic risks such as climate change. Climate change presents serious material risks for investment portfolios, and, in the wake of the Paris Agreement, it's vital that investors engage with the companies in their portfolios to see how they plan to transition to a low carbon world.

The recommendations by the Financial Stability Board (FSB) Task Force on Climate-related Financial Disclosures (TCFD), announced last June, provide a framework for ensuring transparency on how companies are dealing with climate change. We urge all investors to adopt the recommendations.

Given their long-term investment horizon, asset owners are well placed to use ESG factors to build value for their beneficiaries. In order for this to happen, it is vital that asset owners develop clear ESG investment goals and ensure those goals are supported throughout their organisation. While progress on ESG-focused investing is not materializing as quickly as we would like, the signals that we are seeing in the market tell us that things are moving in the right direction.

At the same time new challenges arise. Increasingly, beneficiaries and society in general expect investors to contribute to 'broader objectives of society', as they were originally called in the PRI preamble. The UN Sustainable Development Goals, launched in 2015, provide a global framework for these broader objectives of society. Investment strategies move beyond incorporation of ESG in Risk and Return and include a third 'R': asset owner expectations of Real-world impact, aligned with the SDGs.

Kris Douma
Director, Investment Practices and Engagements, the PRI

We are living in exciting times, when asset owner strategies are required to focus on managing ESG-risks, seeking sustainable investment opportunities to create good financial returns and contribute to solutions for major problems in our global society. This Strategy Guide hopefully helps asset owners on that journey.

EXECUTIVE SUMMARY

Crafting an investment strategy is the first step within an asset owner's overall investment process. Asset owners should craft a clear and explicit investment strategy that comprehensively considers: all long-term trends affecting their portfolios, how the fund fulfils the asset owner's fiduciary duty and how it can operate as efficiently as possible for beneficiaries and other stakeholders.

A methodical approach is crucial. Common pitfalls include: skipping steps, lack of consensus/board-alignment, lack of detail/flexibility or creating a strategy without sufficient consideration of how it will be implemented.

The strategy process starts broadly, with a wide survey of the external and internal context in which it will be developed (Step 1). This is used to define the organisation's vision for the future and its mission (Step 2), followed by a more specific set of investment principles (Step 3). The process then narrows in on selecting executable strategies and strategically allocating capital (Step 4). Once completed, the investment strategy will be translated into initiatives for implementation.[1]

To be effectively embedded in the organisation, any responsible investment considerations must be part of the core investment strategy process.

Crafting an investment strategy

1 Context

- Gather fact base on **external trends** (e.g. social, technological, economic, environmental, political/regulatory).
- Assess your **organisation's capabilities** and position in the market.
- Understand the personal **investment convictions** of key players in your organisation (e.g. regarding impact).

2 Vision & mission

- Develop/realign **vision** of how society and investment will develop (e.g. demographic change, changing beneficiary/ customer needs/ expectations, regulatory change).
- Clearly specify/ reassert your **mission** (e.g. including the breadth/extent of your fiduciary duty).

3 Investment principles

- Develop specific **investment principles**/beliefs (e.g. on market efficiency, ESG incorporation, active ownership), for use in:
  - investment strategy selection;
  - investment decision-making

4 Invest. strategy selection

- Define medium- and long-term **ambitions** (e.g. on financial return, risk appetite, ESG considerations), and criteria to evaluate them by.
- Create strategy **scenarios**, combining options of where to focus (e.g. geographies, asset classes) and how to succeed (e.g. sourcing).
- **Evaluate and select** an investment strategy.

> Highly iterative step

5 Implementation

- **Plan and monitor**:
  - KPIs, incentives and organisation structures;
  - governance, culture, behavior and responsibilities
- **Revise** investment policy, tactical/ operational asset allocation and manager RfPs.
- **Adjust** strategy as needed.

Communication

Responsible investment considerations must be part of the core investment strategy process – not a separate, parallel effort.

1 See additional PRI resources for more detail on the implementation phase.

AN EVOLVING INDUSTRY: FUTURE-PROOFING THE INVESTMENT STRATEGY

There are a number ways in which the investment industry is evolving, and is likely to evolve in the coming years. How ready the organisation is for these changes can be measured through answers to a few key questions:

- Does your fiduciary duty extend beyond strictly financial benefits for stakeholders?
- Is positive real-world impact an explicit part of your primary objective for investment results?
- Do you view ESG factors as material (risks and/or opportunities)?
- Do you incorporate ESG factors into your investment analysis?
- Do you actively engage with your invested companies?

An asset owner answering yes to all of the questions above may consider their strategy highly likely to be future-proofed against a changing investment landscape, whereas answering no to everything above may be considered a warning sign that the strategy has a short shelf-life and will need to be re-evaluated as the operating environment evolves.

REAL-WORLD IMPACT

Answering yes to “Does your fiduciary duty extend beyond strictly financial benefits for stakeholders?” and/or “Is positive real-world impact an explicit part of your primary objective for investment results?” puts an asset owner in agreement with an emerging view that extends the traditional two dimensional view of risk versus return (which should already include *all material ESG factors*, based on current interpretations of fiduciary duty), with a third dimension that charts the real-world impact that investments can have, on the natural environment and/or society.

This transition is as important for the 21st century as the addition of risk to return was in the 20th.

Figure 1: For the investors that makes considerations beyond strictly financial benefits, real-world impact presents an order of preference not otherwise evident.

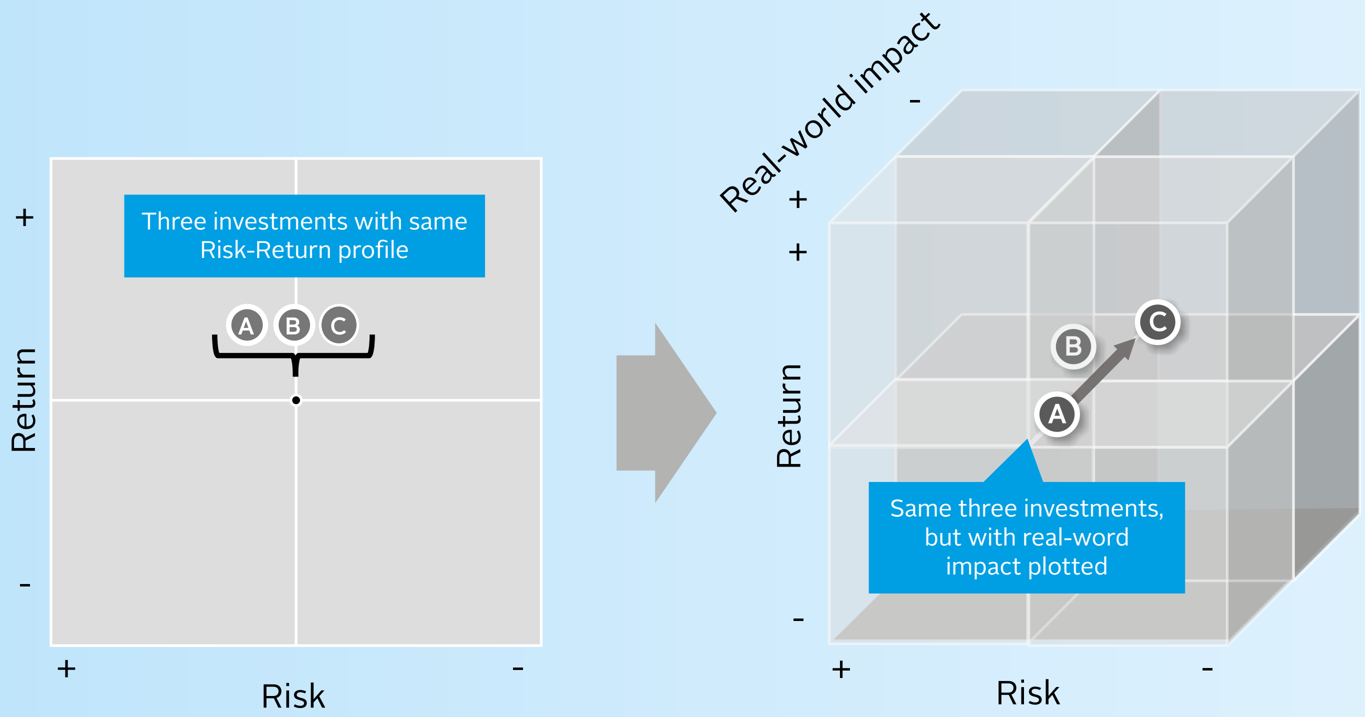
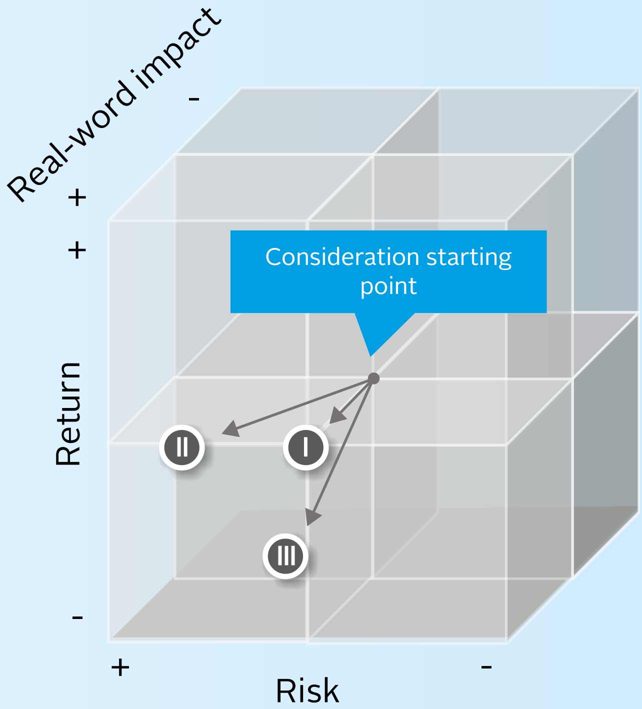


Figure 2: Investors that would consider real-world impact a primary objective would choose to prioritise it even at the potential expense of risk and return.



Each investor will decide what weight to give real-world impact in their choice of investment strategies and investment decisions.

A growing number of investors frame their real-world impact aspirations – as driven by long-term beneficiary considerations – in terms of the UN's Sustainable Development Goals.

For more on the PRI's work on the Sustainable Development Goals, see www.unpri.org/sdgs.

INTRODUCTION: THE INVESTMENT STRATEGY PROCESS

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The strategy process starts broadly, with a wide survey of the external and internal context in which it will be developed (Step 1). This is used to define the organisation's vision for the future and its mission (Step 2), followed by a more specific set of investment principles (Step 3). The process then narrows in on selecting executable strategies and strategically allocating capital (Step 4). Once completed, the investment strategy will be translated into initiatives for implementation.[2]

As in any change process, communication is a key aspect that should gather feedback from, and share progress with, the right people *throughout* the project.

The process is as much an art as a science and it is important to take ownership of making it work for your particular organisation. Although each step will start in the order set out, previous steps are likely to be revisited to iterate throughout the process, as new insights may call for reassessment of previous conclusions.

To be effectively embedded in the organisation, any responsible investment considerations must be part of the core investment strategy process.

Crafting an investment strategy

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Communication

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2 See additional PRI resources for more detail on the implementation phase.

KEY PLAYERS

Crafting an investment strategy will require many players at different points in the process. The process will take longer if there is any misalignment among key players, including within the board. More details on roles and responsibilities are provided at each relevant stage. Common roles involved in the process are:

- **Board**: It is critical that the board is involved in the process at all stages to ensure the investment strategy is right for the organisation, and implementable. The board should play a very active role in the process, such as interacting with external experts.
- **CEO/CIO/CFO and direct reports**: The C-suite need to be on side, and will eventually drive implementation.
- **Project sponsor/lead**: An executive-level individual should be in charge of the process: commonly a senior director/senior vice president from the investment function, or the director of the strategy department. A team will be tasked with executing the investment strategy (revision) project, led by an individual reporting to the project sponsor.
- **Investment committee**: They should give feedback throughout the project, especially on scenarios, and could have heavy involvement depending on the organisation.
- **Investment professionals**: They will provide perspective on how the strategy will affect day-to-day investment activities, and will need to be engaged in the process to establish buy-in. (However inertia resulting from an overly-pragmatic focus should not be allowed to dominate the process.)
- **Supporting departments**: Other departments around the organisation may need to be consulted.
- **External stakeholders**: If investments are indirectly managed it will beneficial to understand current managers' capabilities to execute future mandates.

APPROACH FOR RESOURCE-CONSTRAINED ASSET OWNERS

Organisations with limited resources are in particular encouraged to use the outlined steps as a guide. Organisations should focus on the aspects within each step that are most relevant to their organisation, including which internal and external stakeholders should be involved. Where some or all governance activities are outsourced (e.g. outsourced CIO, fiduciary management), create clarity around who is responsible for which aspects of the strategy development process.

TIMING

The process should be on the agenda of at least three board meetings, so will typically take at least nine months, depending on the prior state of the investment strategy and available resources. The strategy should be monitored and best practice is to re-run the overall process every two-to-five years.

COMMON ISSUES

Some common process or thinking traps to be aware of, and to consider mitigating from the beginning, include:

INVESTOR	HIGHLIGHTS
PROCESS ISSUES	
Skipping straight to selecting a strategy without going through the earlier steps (context, vision and mission, principles). Likely to lead to only an incremental change from previous investment strategy.	*Examine, understand and remove possible barriers to going through all steps e.g. organisational inertia, change resistance.*
Lack of robustness in steps or unwillingness to revisit previous steps if situation warrants.	*Provide the right expertise and resources (especially time) for all steps.*
Board not aligned due to partial engagement in process or unaddressed differences. Lack of consensus on need for change. Lack of listening to beneficiaries/customers. Failure to include investment professionals' perspectives.	*Implement a timely feedback loop.*
OUTCOME ISSUES	
Desire for speed/ease of process leads to cut-and-paste approach that does not tailor the strategy sufficiently.	*Identify what is unique about the organisation and emphasise this at the beginning of each step.*
The resulting strategy is so high-level that it does not drive change or provide direction on where to focus or how to succeed.	*Determine the desired level of depth at the scoping phase and monitor throughout.*
The resulting strategy is not sufficiently flexible to contextual changes, and is too prescriptive for investment professionals to operate within.	*Include optionality, e.g. potential responses to certain (external) scenarios, and incorporate feedback from investment professionals, e.g. capacity concerns.*
Weak supporting evidence and rationale make buy-in difficult during implementation.	*Ensure financial and risk modelling is thorough and that there is deep consensus on the inputs used. Perform appropriate stress tests – both contextual and quantitative. Note that supporting evidence may come outside the traditional finance reference environment.*
Strategy formulated without a view on how it will be implemented.	*Involve sufficient investment professionals in the process, asking what specific initiatives will result from each main point in the strategy.*

COMMUNICATION

Insufficient communication is a real risk during a strategy review or strategic change project. A communication plan is needed to cover internal and external communications: communicating progress and gathering feedback, from the right people, throughout the process. Experience shows that communication and information gathering is almost always underestimated.

In particular it is very important to communicate with external stakeholders including beneficiaries/customers, shareholders and outsourced asset managers. The topic of responsible investment can be a powerful tool for engaging with stakeholders.

The plan should be flexible, and adapt to changing circumstances. An initial communication plan should be agreed at the beginning of the process, and then revisited at least once per step to keep it aligned with the strides that are made and the feedback gathered (e.g. confusion from investment professionals, concern from beneficiaries/customers).

TOPICS TO CONSIDER

- Who will be responsible for communicating about the process? Who else will be involved in planning and then executing the communications?
- What are the current channels and processes for communicating with stakeholders (internal and external)?
- How is the internal audience segmented (e.g. board, executive team, several groups of employees, works council)?
- How is the external audience segmented (e.g. beneficiaries/customers, external asset managers, shareholders)?
- What are the communication plan's key objectives and key themes at each step?
- For each audience segment:
- What are the key messages? What is right frequency and length?
- Who is sending out the message(s)?
- What communication channels should be used, and for which purposes?
- What types of communication should occur early in the process? What should occur once an investment strategy is selected?
- What is likely to cause anxiety among which stakeholders? How will you relieve this anxiety?
- How will you collect feedback on the communication and from which groups? What type of feedback will be focused on?
- Other...

STEP 1: CONTEXT

A solid assessment of the external and internal context in which the strategy will be developed is needed to provide a strong, common point-of-departure for the process and ensure that discussion between all relevant parties (the board and executives in particular) are sufficiently based on facts to be fruitful. It is also important to assess how the context may change in the short, medium and long term.

The context may vary widely for different types of asset owner – defined benefit schemes, defined contribution schemes, insurance firms, foundations, endowments, etc. – which face differing liabilities (e.g. long versus short), regulatory context, obligatory solvency/coverage ratios, asset and liability management, etc.

TOPICS TO CONSIDER

EXTERNAL FUNDAMENTALS ASSESSMENT

Consider how these systemic developments (and others) will influence your portfolio in the short, medium, and long term, anticipate how stakeholders could react to these developments (e.g. beneficiaries/customers, employees, competitors, society at large) and consider how the impacts will vary by investment type e.g. asset class, geography, industry.

Social trends:

- Demographics (e.g. aging, millennials)
- Transparency demand (e.g. labour, tax, corruption, traceability)
- Consumer preferences (e.g. digital, sustainable products and services (e.g. fair-trade))
- Individuality vs community (e.g. personalised vs standardised, sharing economy)
- Poverty/inequality
- Food security
- Human/labour rights
- Diversity
- Other…

Technological trends:

- Big data
- Social media
- Cloud computing
- Connected world (e.g. mobile, internet of things)
- Cyber security
- Robotics (e.g. industrial, self-driving vehicles, drones)
- Renewable energy technology
- Biosciences
- Artificial intelligence
- Other…

Economic trends:

- GDP/productivity (by nation, by industry)
- Rise of emerging markets
- Capital flows
- Exchange rates
- Inflation/deflation
- Market performance/returns
- Market volatility over time
- Market efficiency
- Market risk and tail-risk
- Asset class availability
- Financial-economy effects from environmental impacts (e.g. resource scarcity) and other ESG concerns likely to become important in the markets
- Other…

Environmental trends:

- Global warming/climate change
- Resource scarcity/disruptions (energy, water, food, land)
- Deforestation
- Pollution (air, water, soil)
- Biodiversity
- Recycling/cradle-to-cradle (towards circular economy)
- Materiality of environmental risks and opportunities for markets
- Other…

Political and regulatory trends:

- Geopolitical shifts
- Increased regulations and soft law resulting from societal concerns (e.g. low-carbon goals, GMO concerns, health/safety, response to financial crisis)
- Changes in tax policies and tax transparency regulations
- Changes in governance regulations
- Central bank strategies and involvement
- Fragmentation/consolidation waves in politics and trade (e.g. TPP, EU expansion/withdrawals)
- Other…

Further considerations:

- What are more dramatic/disruptive shifts in trends that could occur broadly in the economy (e.g. dramatic lengthening in human lifespan, increasingly sophisticated artificial intelligence)? What would be the impact?
- Where and how is responsible investing manifesting most?

- What are the in-depth trends in themes such as global/regional/country inequality (e.g. income, opportunity, justice)? What trends are already being impacted by the investment community?
- Are the Sustainable Development Goals (SDGs) being considered by companies? To what extent do they influence behaviour?
- Other...

INTERNAL ASSESSMENT

It is also important to understand your organisation's position in the market, and your internal capabilities.

Organisational assessment:

- Is there a clear investment strategy already?
- What is the position relative to financial obligations, such as the asset and liability management profile? What liquidity requirements do you have? What other needs does the organisation have to maximise assets available to meet liabilities in the short, medium and long term?
- What is the organisation's general position in the market (e.g. size relative to others, asset allocation)?
- What capabilities and capacity does the organisation have to gather data and evaluate trends and investments within the organisation (vs. relying on the off-the-shelf analysis)?
- Are there sufficient in-house/available-to-hire investment/portfolio managers with deep understanding of the market and of sustainability in general?
- What is the operating model and organisation structure?
- What is the incentive structure? How is it aligned to the organisation's long-term goals?
- What potential new relationships and/or disruptions in the investment value chain are expected?
- What is your transparency process?
- What is the organisation culture and how easy will it be to evolve it? What is the track record on implementing changes in the organisation?
- Is there a clear position regarding impact investing?
- What access to/presence in relevant networks does the organisation have to source investment opportunities that will differentiate it?
- Other...

Personal investment convictions of key players:[3]

- What do you consider the responsibility and the purpose of the asset owner you are working at? Do you take a systematic/scientific or intuitive/heuristic approach to decision making?
- Do you expect resources to become more abundant or more scarce?
- Do you believe your industry is facing a sustained period of disruptive change or a stable future?
- What do you consider the main incentives driving individuals in the investment market? Is this aligned with what's important to you?
- Do you consider it to be a responsibility of any business to contribute solely/primarily to shareholder value or to contribute value more widely, e.g. to other stakeholders?
- How do you see your own personal responsibility for wider value creation? Do you think this deviates from the opinion of other key players?
- What would success look like for your organisation 10-15 years from now?
- How do you view stewardship?
- Other...

STEP 1: ACTIONS AND ROLES

1. Project lead ensures exhaustive list of:
   a) trends to be examined and sources to be checked;
   b) organisational assessment points available and gaps to be filled;
   c) stakeholders to interview on their personal investment convictions.
2. Project team collect reports on macro trends, to project the impact of these trends on portfolios, and assess internal capabilities of the organisation to address these issues.
3. Project sponsor holds initial meeting with the board, executives and project lead to assess current strategy, discuss systemic developments including potential influence on the risk/return profile and discuss further/future considerations.
4. Project lead conducts interviews with board members/trustees and executives on their personal investment convictions.
5. Project lead/team may engage (such as through surveys or focus groups) with wider stakeholders (such as beneficiaries/customers) to further identify inputs on external factors (including ESG) that may influence desired investment outcomes.
6. Board may engage with wider stakeholders to develop their own personal investment convictions, and potentially ask wider stakeholders about theirs.
7. Project sponsor holds additional workshops with the board/trustees, executives and project lead to present and share initial findings, and educate on relevant issues (such as responsible investment) if required.

3 See page xx.

STEP 2: VISION AND MISSION

Taking into account all the trends uncovered in *Step 1: Context*, the organisation can begin to determine or realign its vision of how the world will develop, and define or reassert its mission. By doing so, the investment strategy that is developed and the investment decisions that it drives will be aligned with a clearly articulated purpose, and a shared view of the expected investment environment.

> **BOARD-LEVEL INVOLVEMENT**
> Defining an organisation's mission and agreeing on the vision may require significant time, as it is critical to get full alignment from the board.

VISION OF THE FUTURE

Your vision of the future should encompass how traditional macroeconomic factors are reflected in your investments over time and your organisation's expectations on:

- society: an interpretation of broad trends from Step 1: Context, e.g. demographics, big data, rise of emerging markets, climate change, tax transparency;
- beneficiaries/customers evolution: how needs and preferences will change for your beneficiaries/ customers (e.g. changing expectations on flexibility of pension schemes (especially for defined-contribution plans), shift from demanding solely financial returns);
- asset owner industry: how the role of asset owners will evolve, e.g. changing conceptions of fiduciary duty, long-term vs short-term focus, impact of regulatory changes;
- investment environment transition: how global trends are shaping financial markets and investment expectations.

> **EXAMPLE**
> - *"We see the population becoming older, richer, and more focused on the long-term social and environmental impact of their actions. We see the asset owner industry dividing into concentrated big players on one hand and fragmented small players on the other. We see regulations evolving to encourage the asset owner industry to hold financial and other positive impacts for people and/or planet as dual objectives. We see the economy experiencing long-term stagnation as growth in China slows and climate change adversely impacts developing economy outlooks, leading to lower financial returns for extended periods."*

MISSION

A mission statement puts into words your organisation's reason to be. An asset owner's mission includes how the organisation will serve its stakeholders (e.g. beneficiaries/ customers, employees, society), as well as an explicit (or implicit) differentiator against industry peers. The freedom the organisation has to formulate a mission statement will vary, e.g. some defined-benefit funds including public pension funds can be tightly restricted and/or regulated, whereas other funds have a wide range of options.

> **EXAMPLES**
> - *"Securing the financial future and sustaining the trust of California's educators" (CALSTRS)*
> - *"We empower entrepreneurs to build a better world" (FMO)*
> - *"We have a strong focus on responsible and sustainable investment, as we consider environmental, social and governance factors create real risks and opportunities for the Scheme, particularly given its long term nature." (EAPF)*
> - *"Our overarching goal should be to achieve the investment returns required for the public pension system with minimal risks, solely for the benefit of pension recipients from a long-term perspective, thereby contributing to the stability of the system. [..] By fulfilling our stewardship responsibilities, we shall continue to maximize medium- to long-term equity investment returns for the benefit of pension recipients." (GPIF)*
> - *"Paying pensions today, preserving pensions for tomorrow." (OPTrust)*
> - *"Because pensions are very long-term investments, ERAFP has positioned two concerns at the heart of its governance: preserving intergenerational fairness and overseeing the sustainability of its management. ERAFP's board of directors therefore ensures that the benefits being paid out today are not detrimental to the interests of tomorrow's beneficiaries." (ERAFP)*

TOPICS TO CONSIDER

VISION OF THE FUTURE (SOCIETY):

- How is society evolving? What will be the high-level effect on your portfolio? What changes will occur to get to that expected future? How will these changes affect e.g. different asset classes?
- What ESG factors do you expect to be/not be materially important for which asset classes, assets, types of portfolios? How is it different to today and/or the past?

- You may want to focus more on portfolio-level impact or on individual asset classes, depending on whether the organisation manages assets in-house or outsources.
- What specific trends can the organisation most positively impact/benefit from?
- What will the role of investments be in the real economy?
- Other...

VISION OF THE FUTURE (BENEFICIARIES/ CUSTOMERS):

- How will the views/needs/desires of beneficiaries/ customers (and other stakeholders such as employees) evolve?
- What will beneficiaries/customers expect in terms of transparency?
- What will beneficiaries/customers expect in terms of incorporation of ESG factors?
- What will beneficiaries/customers expect in terms of positive impact by the asset owner?
- What are beneficiaries/customers' views on balancing purely financial with other objectives?
- Other...

VISION OF THE FUTURE (ASSET OWNER INDUSTRY):

- What changes will occur in the asset owner industry?
- What are the overall asset owner market dynamics?
- How do your existing investments align with your current vision of the future?
- Will automated systems displace asset owners or asset managers, or significant parts of their existing activities?
- Will asset owners be evaluated according to their level of focus on ESG factors?
- To what extent will fiduciary duty continue to include responsibility for broad societal interests such as combating climate change, social inequality, etc.? Is your current view aligned with the current understanding/ interpretation of fiduciary duty?
- Other...

VISION OF THE FUTURE (INVESTMENT ENVIRONMENT TRANSITION):

- Do you have organisational readiness to respond to global transitions (for example board expertise on low-carbon transition)?
- What macro trends can you influence?
- What regulatory developments are likely, or possible? Do you expect policy makers to require the investment management industry to consider ESG factors more?
- Do your actuaries account for transition risks?
- Is your portfolio in optimal condition for physical climate and weather-related events and/or liability risk arising from those disruptions?
- Is your portfolio discounting transition risks that could arise from adjusting to a low-carbon economy (changes in policy, technology, investor sentiment, etc.)?
- Other...

MISSION

- Do you have a mission statement? What role do you want the organisation to play in the world? What do you want the organisation to be known for?
- How do your existing investments align with your current mission?
- How much room does your mandate allow in crafting a mission statement?
- Does your mission distinguish you from your peers?
- Have you considered the extent of your fiduciary duty beyond providing strictly financial benefits to stakeholders?
- Are positive impact on people and/or the planet part of your primary objective?
- What added/societal value do you want to offer?
- In which areas of impact investing do you want to play a leading role, and in what way?
- How do your various stakeholders perceive your mission?
- Other...

STEP 2: ACTIONS AND ROLES

1. Project sponsor holds planning session with project lead and board/trustees.
2. Project lead collects (through interviews and focus groups) views on existing vision and mission, from board/trustees, C-level executives, stakeholders such as beneficiaries/customers and outside experts/ thought leaders.
3. Project team conducts a peer review of vision and mission.
4. Project sponsor may hold vision and mission workshop/s with key stakeholders. Project team should report on current vision, mission and input gathered.
5. Project sponsor holds sign-off meeting with board/ trustees where board is given opportunity to voice final input, questions, and thoughts regarding vision and mission, before approving.

STEP 3: INVESTMENT PRINCIPLES

Having determined its vision of the future and defined its mission, the organisation must underpin them with a set of more specific investment principles (also known as investment beliefs). The principles should be a set of clear, impactful statements that will help select your investment strategy, inform your asset allocation and align all investment decisions. These principles need to be well communicated, and accepted across the organisation.

The specificity and quantity of investment principles will vary between asset owners. Organisations may have as few as three-to-four high-level principles or a larger number of more specific principles. It is important to keep in mind that investment principles will subsequently inform the writing of your investment policy.[4]

EXAMPLES

- *"There are unique opportunities for long-term investors."*
- *"Markets are efficient and it is difficult to beat the market: therefore we focus on low-cost operation."*
- *"Diversification lowers risk and we will use diversification effectively to maximise return at the lowest possible risk."*
- *"We seek the most attractive investment opportunities that have positive ESG effects that do not require a financial trade-off."*
- *"By staying liquid we are able to take advantage of periods of market dislocation where markets are least efficient."*
- *"Complying with the Sustainable Development Goals will enhance returns in the medium to long term."*

TOPICS TO CONSIDER

- What is your guiding investment approach? Do you see the market as efficient or inefficient? What is your approach to market inefficiencies, e.g. do you seek to take advantage of inefficiencies or will you ignore them?
- What is your view on the value of diversification? What is your view on the impact of excluding certain investments?
- Is timing important to investing successfully?
- What types of risks do you incorporate (and to what extent) in your investment strategy (e.g. liquidity, volatility, regulatory, climate, technology)?
- Does active investing give returns exceeding the costs?
- Does active ownership give returns exceeding the costs?
- What is your appetite for risk and volatility in relation to your liabilities?
- Do you view ESG factors as material to investment returns (through risk or opportunity)?
- Do you incorporate ESG factors into your investment decision making? Does your organisation contain the competencies to do so?
- Are you willing/mandated to screen investments out or in regardless of financial attractiveness (e.g. tobacco, nuclear power)?
- Are there specific investment preferences driven by the nature of your beneficiaries/customers (e.g. specific regions, particular screening requirements)?
- Do you use best-in-class methodology?
- What is your view on the benefit of a long-term investment outlook?
- What standards do you want the portfolio to adhere to (e.g. UN Global Compact)?
- Are your principles applicable to the whole asset base? Will you make additional sets of principles for specific groups of assets?
- Will you invest thematically (e.g. low-carbon investing)?
- Do you consider impact on people/planet? How is this translated into investment decisions?
- What would lead you to change the principles?
- Other...

STEP 3: ACTIONS AND ROLES

1. The investment committee, CIO, and project lead develops or reviews (through workshops and/or discussions) a set of principles based on the vision and mission the board has approved.
2. Project sponsor presents draft principles at next board meeting for discussion and approval.

4 See Investment policy: Process and practice – A guide for asset owners

AN EVOLVING INDUSTRY: FUTURE-PROOFING THE INVESTMENT STRATEGY

As discussed in first three steps, there are a number ways in which the investment industry is evolving, and is likely to evolve in the coming years. Before proceeding to Step 4: Strategy formulation and creation, it may be useful to assess how ready the organisation is for these changes.

This can be measured through your answers to a few key questions. The answers should flow naturally from your vision, mission and investment principles – if they do not, it will be necessary to revisit those earlier steps as you start to evaluate potential investment strategies.

1. Does your fiduciary duty extend beyond strictly financial benefits for stakeholders?
2. Is positive real-world impact an explicit part of your primary objective for investment results?
3. Do you view ESG factors as material (risks and/or opportunities)?
4. Do you incorporate ESG factors into your investment analysis?
   There is range to which asset owners presently incorporate ESG factors, starting from basic performance and norm-based screening to integrating ownership activities and ESG factors within traditional investment decision-making criteria.
5. Do you actively engage with your invested companies?
   This relates to engaging with companies once an investment is made (e.g. voting at Annual General Meetings, or meeting with management to influence company strategy).

While there is a range of possible answers for each question (e.g. the degree to which you incorporate ESG factors into your investment analysis), answering in a yes/no format will build the clearest profile of the organisation's overall position on these issues. An asset owner answering yes to all of the questions above may consider their strategy highly likely to be future-proofed against a changing investment landscape, whereas answering no to everything above may be considered a warning sign that the strategy has a short shelf-life and will need to be re-evaluated as the operating environment evolves.

You should evaluate whether you are comfortable that the resulting profile is the right fit for your organisation, including whether that profile is compatible with your agreed vision, mission and investment principles. If your readiness profile is in line with your vision, mission and investment principles but you aspire to a different profile, it may be helpful to revisit those earlier steps.

FIDUCIARY DUTY IN THE 21ST CENTURY

Investor understanding of fiduciary duty continues to evolve. A full discussion of the issues, and current projects, can be found on the PRI's Fiduciary duty in the 21st century website.

REAL-WORLD IMPACT

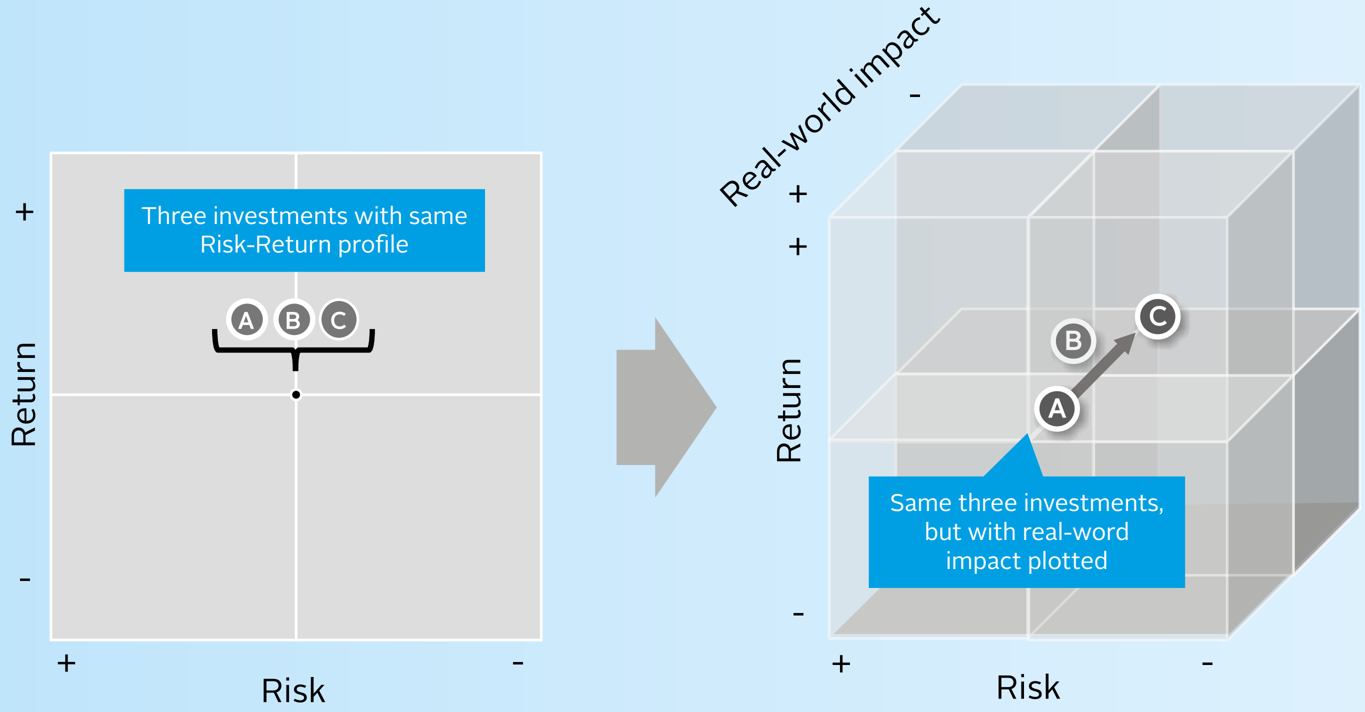
> This transition is as important for the 21st century as the addition of risk to return was in the 20th.

Answering yes to "Does your fiduciary duty extend beyond strictly financial benefits for stakeholders?" and/or "Is positive real-world impact an explicit part of your primary objective for investment results?" puts an asset owner in agreement with an emerging view that extends the traditional two dimensional view of risk versus return (which should already include all material ESG factors, based on current interpretations of fiduciary duty), with a third dimension that charts the real-world impact that investments can have, on the natural environment and/or society.

This transition is as important for the 21st century as the addition of risk to return was in the 20th. It takes investment strategies to the next level, explicitly creating a macroeconomic environment that supports long-term returns and a sustainable financial system.

For more on the PRI's work towards a sustainable financial system, see www.unpri.org/sfs.

Figure 1: For the investors that makes considerations beyond strictly financial benefits, real-world impact presents an order of preference not otherwise evident.

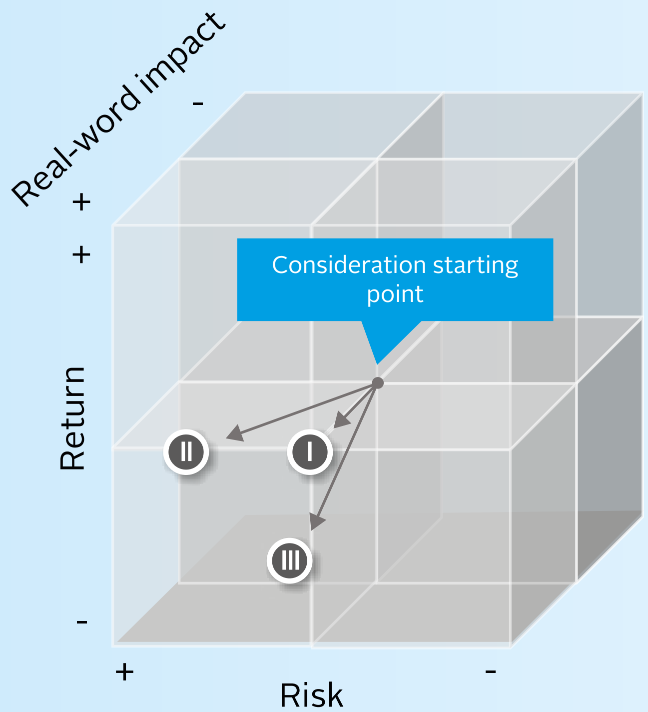


In Figure 1, on a 2D view (left) the three investments appear at the same point, as they are not differentiated on risk or return, but on the 3D view (right) they are differentiated along the real economy impact axis. For the investor that considers fiduciary duty to extend beyond strict financial benefits for stakeholders, there is an order of preference amongst the three investments that was not evident when evaluating them in the 2D view.

In Figure 2, where investment I offers improved projected real-world impact over the initial investment for the same projected risk and return, investments II and III should deliver greater real-world impact but at projected higher risk/lower returns respectively. As in Figure 1, any investor considering real-world impact would choose investment I over the initial investment, but only investors that have positive real-world impact as a primary objective would choose investment II or III over the initial investment (e.g. regulated development mandates with hard-coded ethical red flag rules, or thematic investment strategies targeting double bottom line companies).

Each investor will decide what weight to give real-world impact in their choice of investment strategies and investment decisions.

Figure 2: Investors that would consider real-world impact a primary objective would choose to prioritise it even at the potential expense of risk and return.



STEP 4: STRATEGY FORMULATION AND SELECTION

Step 4: Strategy formulation and selection builds specificity and substance to the investment principles created in step 3. It is a highly iterative set of three sub-steps:

1 AMBITIONS AND CRITERIA

Set specific ambitions, and define the criteria for evaluating whether they have been met.

2 SCENARIOS

Create scenarios describing potential strategies, by combining options of where to focus (e.g. which asset classes, industries, geographies) and of how to succeed (e.g. sourcing options, active vs. passive management).

3 SELECTION

Evaluate strategy scenarios against the ambition criteria, rank them, and when satisfied select an investment strategy. In many cases none of the initial scenarios will meet all criteria. This will lead to repetition and re-examination of earlier steps until a recommended investment strategy emerges.

SETTING THE AMBITIONS AND CRITERIA

Ambitions are derived from and underpin the principles (and in turn therefore, the mission). They provide the level of specificity required to set criteria against which potential strategy scenarios can be evaluated and ranked.

They will include terms that are financial (such as achieving a particular funding ratio or growth target) and, potentially, terms that lie beyond immediate financial considerations (such as providing wide beneficiary well-being satisfying long term societal as well as financial aspirations, or aligning the investment portfolio with the low-carbon future to ensure sustainability for beneficiaries).

EXAMPLES

AMBITION	CRITERIA
Target funding ratio	X
Outperform benchmark	X% above Index Y
Achieve growth target	X% per year
Increase economic development in our country/region	X%
Support younger generations	Top X for people under Y
Reduce carbon footprint	X%

Criteria should preferably be measurable, including those that relate to ESG considerations, and should have enough obtainable information to allow meaningful differentiation across scenarios. Where criteria reference a financial benchmark, the right benchmark will be needed for steering performance and reporting to stakeholders at a later stage.

Ambitions and their criteria may go beyond the direct outcome of the investments to include elements such as operational metrics and organisational capabilities (e.g. attractiveness of the strategy to talented professionals).

TOPICS TO CONSIDER

- What risk and return are you targeting? Absolute or relative to a particular benchmark?
- Do you want to outperform your peers? By what amount?
- What is your preferred investment horizon?
- What is the cost required to execute (e.g. is active management prohibitively expensive)?
- What is your ability to execute (e.g. fit with the skills/competencies of your organisation)?
- Is positive impact on people and/or the planet a primary or secondary objective?
- In which mainstream domains and which ESG or impact areas do you want to excel?
- What quantifiable benefits will you create for your beneficiaries/customers other than financial returns (e.g. regional development, CO_2 emission reduction)?
- Are you trying to align with any specific views from beneficiaries/customers (e.g. a healthcare pension screening out tobacco investments)?
- What level of investment in specific impact themes do you want to have?
- What is your timeframe for impact?
- Do you want to be a meaningful active owner?
- What stakeholder needs are you looking to address (e.g. being an attractive organisation for talented professionals)?
- How well aligned is the scenario your mission statement?
- How well aligned is the scenario with future compliance considerations?
- Other...

CREATING STRATEGY SCENARIOS

To create investment strategy scenarios to evaluate, you will select combinations of where you want to focus and how you plan to succeed, along with relevant metrics.

To illustrate the scale and complexity of creating scenarios, consider that the universe of options for where to focus is the full range of investment allocations across: asset classes, sectors, geographies, type of funds, fund strategies, time horizon, size of investment, size of stake relative to others and more. Your investment strategy considerations thus far should guide your thinking on what will be a manageable number of scenarios to consider.

Many scenarios will be immediately unsuitable due to your investment principles, and others will be rejected when further tested against your ambitions (e.g. an ambition to avoid carbon-intensive investments will most likely disqualify choices that has a significant asset allocation in the oil and gas sector; an ambition to avoid large volatility will disqualify any choice with significant VC-investment).

The remaining scenarios will be then be ranked. Ideally, each possible scenario will be run through an evaluation that will include a financial model, risk model, and, possibly, a real-world impact model. The depth and complexity of these models is an additional, important choice.

The result will be a final investment strategy that can be approved.

TOPICS TO CONSIDER

Where to focus

Below we've listed a suggested range of options to consider. Your criteria may restrict the choices under consideration, leading to some of the possibilities being immediately unsuitable.

- What is the range of investment opportunities to consider, and which options are favoured?
    - Asset classes (e.g. debt, equity, ETFs, currencies, alternatives like real-estate, infrastructure, commodities, private debt/loans)
    - Sectors (e.g. consumer goods, financial services, healthcare, energy, utilities, basic materials, industrials, tech, telecom) and sub-sector – which to overweigh, which to blacklist?
    - Geographies (region, country)
    - PE & VC funds (e.g. growth, early-stage, real-estate, mezzanine, LBOs, distressed)
    - Hedge funds and fund strategies (e.g. quant, arbitrage, event driven, global macro, directional)
    - Type of investment (e.g. fund of funds, multi-asset funds, targeted funds, individual equities, individual debt offerings, co-investment, strategic, direct ownership)
    - Time horizon (<5 years, 5-10 years, 10-20 years, >20 years)
    - Individual investment size ($M, % of portfolio)
    - Ownership stake (<1%, 1-5%, 5-20%, 20-50%, 50-100%)
- Which choices will contribute most to achieving your targets?
- What are the right attributes/characteristics (return, types of risks, etc.) for each investment opportunity?
- What are favoured options in the overall portfolio of various investment opportunities to be considered, and why?
- Which choices will contribute most to achieving your ambition? How are portfolio characteristics being valued (e.g. risk diversification)?
- Where are the largest capital needs, from an economic point of view and an impact point of view?
- Are there new vehicles that could be explored to expand the range of options (ESG-related examples: green bonds, equity linked to success on an impact theme)?
- Other...

Each scenario will include a combination of several asset allocations. The level of granularity required will vary, but should be sufficient for you to evaluate and compare the scenarios.

How to succeed

The appropriate operating model is critical and the organisation's internal capabilities (reviewed back in Step 1: Context) will guide your decisions here.

- To what extent will you out-source investment management or manage investments in-house, now and in the future?
- Active or passive management (for selecting investments)?
- Active or passive ownership (i.e. engagement with investee companies)? What level of engagement?
- What partnerships could be created to maximise returns?
- What is your approach to scale and cost?
- What are your objectives on transparency and/or reporting?
- How much innovation do you want to finance? How patient is your capital?

- What partnerships could be created to maximise the positive impact of an investment (e.g. other asset owners/investors, public/private groups)?
- What types of engagement are most suitable for you? In which situation will engagement be used to improve financial returns or to improve positive impact?
- Will the future asset owner professional combine both financial analysis and ESG analysis or are these separate skills?
- Other...

Example of a *How to succeed* consideration: comparing management options: in-house vs outsourced and active vs passive

	IN-HOUSE	OUTSOURCED
Active	▪ In the long run, active management outperforms passive management returns. ▪ I have the volume, expertise and capabilities to manage the required investments at a better cost than through a third party, for a comparable return	▪ In the long run, active management outperforms passive management returns. ▪ An experienced third party will provide me with the right performance at a better cost.
Passive	▪ In the long run, passive investment outperforms active management returns. ▪ I have the volume, expertise and capabilities to manage the required investments at a better cost than through a third party, for a comparable return.	▪ In the long run, passive investment outperforms active management returns. ▪ An experienced third party will provide me with the right performance at a better cost.

SELECTING AN INVESTMENT STRATEGY

Finally you will evaluate the scenarios against everything the organisation has learn about itself in the process. This is an intensive period where hypotheses are set and multiple analyses are done as the hypotheses are run through models to test the viability of outcomes.

Often one or more criteria will not be met by a scenario put forward and it may be necessary to move back a step, either creating a new set of scenarios to evaluate, or adjusting your ambitions or criteria. Each constructed scenario will be run through a financial model, a risk model and possibly an ESG impact model. You will need to decide the appropriate features, depth and complexity of the models based on your ambition and criteria.

BOARD-LEVEL INVOLVEMENT

The process is now moving towards implementation and execution mode, and the executive is likely to take an increasing role with the board's active participation pared back to oversight and governance. The board may retain a significant role, for example via specific sub-committees.

The scenarios will be ranked and those coming out on top may be further evaluated using more advanced tests, including stress tests covering deviations from expectations in the market, general economy, internal factors (e.g. capabilities for internal active ownership) and ESG trends, (e.g. climate scenario analysis as recommended by the Financial Stability Board's Task Force on Climate-related Financial Disclosures).

If this leads to an unacceptable outcome, another round of iteration may be required, until an investment strategy is established that fits your vision, mission and investment principles, qualified by your ambitions and criteria.

STEP 4: ACTIONS AND ROLES

1. Project sponsor to hold one or more workshops with the investment committee, CIO, and project lead to set ambitions and criteria from the approved investment principles.
2. Project lead to present the recommended ambitions and criteria for board approval.
3. After sign-off, the working group will prepare and evaluate scenarios.
4. Project sponsor and project lead present recommended scenario for board discussion.
5. At the next board meeting, board approves/signs off (or sends back to working group for further analysis).

STEP 5: IMPLEMENTATION (OPERATIONALISING THE STRATEGY)

While implementation is not part of crafting the strategy, most strategic failures occur during implementation, and it is therefore essential to hold implementation elements in mind during the investment strategy process, particularly when discussing organisational capacity/capabilities.

Typically, strong steering occurs on elements such as KPIs, incentives and organisation structures, with too little attention put on elements such as on-going governance, culture, convincing the respective audiences, role modelling by senior management, changing individual behaviour, clear responsibility for implementation of initiatives and capability building among employees.

Once completed, the investment strategy will be translated into initiatives for implementation, e.g. an investment policy, tactical and operational asset allocation and potentially a revised RfP for a new investment manager or renegotiating an existing manager's mandate. A monitoring plan also needs to be made.

The investment policy portion of the implementation phase is outlined in the PRI guide [Investment policy: Process and practice](#).

For more PRI resources on the implementation phase, see www.unpri.org/asset-owners.

CREDITS

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Special thanks to Michael Jongeneel and Zach Hogan from Bain & Company for their contribution to this guide

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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

United Nations 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