Considerations for ESG Policy Development

The practice of sustainable investing and the consideration of environmental, social, and governance (ESG) factors continues to grow. Concurrently, the demand for effective investment policies that facilitate exploration and integration of sustainable investment strategies with primary portfolio objectives is also increasing. However, actually arriving at an actionable policy statement that enjoys broad support and commitment has presented challenges for some investors.

Sound investment policy is important for all investors. The words on paper elaborate purpose of the organization, the objectives of its funds, the governance of decisions, and the most critical risk management beliefs and parameters. These words gain power through the process of policy development and stakeholder engagement on the intersections of these principles, rules, and strategies.

The objective of this document is to provide ideas and information that facilitate engagement on, and development of, policies that integrate sustainable investing thinking and criteria.

We also must acknowledge that investors pursuing sustainable goals have diverse motivations and operational circumstances. All of the priorities and principles of these institutions cannot be colored with the same brush. However, we can draw on decades of experience partnering with institutions to provide insights we believe are generally helpful for introducing ESG considerations to policy development.

THREE PILLARS OF INVESTMENT POLICY – PURPOSE, PRIORITIES & PRINCIPLES

At the highest level, investors with policies considered to be effective and broadly supported share some common traits. *They have articulated their purpose, priorities, and principles, and integrated these pillars within their investment policies and decision criteria*. One key to arriving at this point is the investment of time. Effective ESG policy creation requires a process of stakeholder engagement that includes education about and exploration of the sustainable investing thesis and opportunity set.

The following are descriptions of the key elements of purpose, priorities, and principles and some examples of language that may be useful for spurring dialogue, thinking, and policy development.

PURPOSE

The purpose of an institution typically refers to its mission, primary goals, and core beliefs. It is often articulated at a high level, describes a longer-term horizon, and is aspirational. Language for such statements is typically customized to an institution, and our general suggestion is to generate discussion on some form of the following three questions.

1. What is the primary purpose of our organization, or its “true north”?
2. What is the primary purpose of our investment fund(s), and how do they best serve the organizational mission and objectives?
3. Are there logical or possible points of integration between investment strategy and other institutional objectives we have not previously considered?

PRIORITIES

The statement of priorities helps define critical sustainable themes—typically in economic, demographic, and social terms—which enables mapping to investment opportunities. Some priorities may not be immediately investable, but the statement of these imperatives helps ensure that investors proactively explore potential avenues for activation or investment.

Some investors struggle to articulate these in policy discussion and language. Fortunately there are frameworks such as the: Paris Climate Agreement of 2015, UN Sustainable Development Goals, and UN Principles for Responsible Investment that can help inform dialogue and offer practical examples of language.

For example, we list three goals of the 2015 Paris agreement below and offer examples of language that may be included in a statement of priorities.

1. Holding the increase in the global average temperature to well below 2 °C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 °C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change.

   Sample language: We acknowledge the risk of global warming and commit to understanding how our activities and investments contribute to its causes, and determining what actions we can take to foster lower carbon emissions, enable the development of new industries and technologies that serve this priority, and do so in a manner that is consistent with our investment objectives.

2. Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production.

   Sample language: We believe that risk management is critical to investment success and acknowledge that the mitigation of climate risks is beneficial to both society and financial assets. Accordingly, we will study and incorporate these risk parameters within our investment criteria.

3. Making finance flows consistent with a pathway toward low greenhouse gas emissions and climate-resilient development.

   Sample language: We will actively seek and procure investments that are consistent with: the transition toward a global low-carbon economy, the cultivating of resilient enterprises and communities, and our high standards for investment rigor and diligence.

Similarly, one could explore the UN Sustainable Development Goals (SDGs)[1] for potential institutional alignment and adopt their language in whole or part to a statement of priorities. Some examples of the 17 SDGs include the following (see the next page for a complete list of the 17 goals):

- *Goal 8. Decent Work and Economic Growth* – promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all
- *Goal 11. Sustainable Cities and Communities* – make cities and human settlements inclusive, safe, resilient, and sustainable
- *Goal 12. Responsible Consumption and Production* – ensure sustainable production and consumption patterns
- *Goal 13. Climate Action* – take urgent and immediate action to combat climate change and its impacts

Stating priorities frames objectives along a continuum and institutions can discuss how they may be mapped, either today or in the future, to investment themes and opportunities. For example, in Cambridge Associates' paper about framing risks and opportunities associated with the changing climate,[2] we articulated several solutions-oriented themes that are endemic to many institutions' priorities, including: renewable infrastructure, clean transportation, smart energy management, energy efficiency in buildings, and water and agricultural efficiency. *In effect, the articulation of priorities can serve to widen the lens used to define the investment opportunity set.*

PRINCIPLES

The articulation of sustainable principles facilitates the integration of purpose and priorities within existing investment criteria. The principles ultimately help with the implementation of the overall investment program and reaffirm the importance of risk management, for the portfolio and the larger investment enterprise.

Sustainable investors frequently assess risks and opportunities beyond those affiliated with their financial assets alone. They may consider a wider range of societal and economic factors and how the deployment of their institutional capital (intellectual, philanthropic, operational, and investment) may either mitigate or elevate broader risks. In this sense, some investors may determine that a guiding principle is that all investments should be viewed through a sustainability lens.

One source for sustainability principles is the UN Principles for Responsible Investment (UN PRI), which provides examples investors can leverage when developing policy. For example, consider the first of the six principles:

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

[1] https://sustainabledevelopment.un.org
[2] Risks and Opportunities from the Changing Climate: Playbook for the Truly Long-Term Investor, 2015. https://www.cambridgeassociates.com/research/risks-and-opportunities-from-the-changing-climate-playbook-for-the-truly-long-term-investor/

This means what it says. The committed institution will actively work to understand ESG issues and determine how to best incorporate them with decision processes in a manner that is consistent with their governing principles. It does not mean that the institution must screen all of its investments or migrate all of its managers. Rather, the statement suggests that investors will add another layer of understanding and potential action to investment activities.

CONCLUSION

Ultimately, the key to successful policy development is effective engagement of stakeholders and building consensus on the pillars of purpose, priorities, and principles, and forging a commitment for how sustainable investments will be considered and integrated in a manner that aligns with the pillars.

THE SUSTAINABLE DEVELOPMENT GOALS

1. No Poverty
2. Zero Hunger
3. Good Health and Well-Being
4. Quality Education
5. Gender Equality
6. Clean Water and Sanitation
7. Affordable and Clean Energy
8. Decent Work and Economic Growth
9. Industry, Innovation and Infrastructure
10. Reduced Inequalities
11. Sustainable Cities and Communities
12. Responsible Consumption and Production
13. Climate Action
14. Life below Water
15. Life on Land
16. Peace, Justice and Strong Institutions
17. Partnerships for the Goals