VIEWPOINT

EXPLORING ESG:
A Practitioner's Perspective

JUNE 2016

BLACKROCK®

Barbara Novick
Vice Chairman

Deborah Winshel
Global Head of BlackRock Impact

Michelle Edkins
Global Head of Investment Stewardship

Kevin G. Chavers
Government Relations & Public Policy

Zachary Oleksiuk
Investment Stewardship

John McKinley
BlackRock Impact

Introduction

Investors consider a variety of factors when determining the long-term value of a company. Public records such as annual reports and earnings statements have served as the traditional source of this information, helping investors discern the effects of macroeconomic and company-specific issues on valuations. However, with the amount of and access to information expanding significantly in recent years, more and more investors have new types of data to glean investment insights.

Environmental, social, and governance (ESG) factors are one such type of information gaining in prominence and consideration among mainstream investors globally. ESG data spans a range of issues, including measures of company carbon emissions, labor and human rights policies, and corporate governance structures. Policy makers, asset owners[1], and the public at large are focused on ESG factors as a means to promote sustainable business practices and products. Investment professionals increasingly see its potential links to company operational strength, efficiency, and management of long-term financial risks.[2] Nonetheless, there is still much ambiguity as to what exactly is meant by ESG, and how investors can gather relevant ESG data and apply this information in the investment process.

This *ViewPoint* sets out BlackRock's views on ESG issues from the perspective of a fiduciary investor acting on behalf of asset owners, in this particular instance focusing specifically on corporate equities and debt. We define three areas in which investment managers integrate ESG factors, and our views on how ESG factors contribute to long-term value. We move to describe the current landscape of ESG disclosure initiatives across organizations and regulatory bodies. As a result of the challenges associated with assembling and evaluating ESG information, we conclude with our recommendations for policy makers to promote the standardization of ESG metrics and disclosure requirements.

SUMMARY OF POLICY RECOMMENDATIONS

Policy makers should focus on establishing a framework that enables stakeholders and market participants to develop detailed ESG standards and best-practice guidelines.

1. Encourage standardized ESG disclosure within a consistent global reporting framework, similar to international accounting standards, by:
   a. Recognizing the importance of identifying and managing ESG risks and opportunities as a component of investment analysis.
   b. Understanding the distinction between social, mission or "values" driven goals and investment ("value") goals.
   c. Promoting clear and consistent definitions of ESG and developing a common lexicon.
   d. Providing guidance that recognizes the need to tailor reporting to industries.
2. Establish safe harbor provisions that ensure companies who initiate ESG factor reporting do not face retrospective litigation.
3. Ensure regulation is designed and implemented to achieve policy objectives, rather than result in unnecessary disclosure.
4. Review, understand, and remove barriers to ESG factor integration and reporting by investors and companies.
5. Clarify how ESG considerations are part of investors' and companies' fiduciary duties.
6. Require investors to report whether they integrate ESG factors in their investment analysis and, if so, their approach to integrating them as well as stewardship activities.

The opinions expressed are as of June 2016 and may change as subsequent conditions vary.

The ESG Lexicon

The term ESG has become a catchall phrase that often means different things to different stakeholders. This has created the need to better define what is meant by ESG with respect to investing. Broadly speaking, ESG refers to the integration of environmental, social, and governance factors in the investment process. Today, investors can integrate ESG factors in three primary ways: (1) traditional investing, (2) sustainable investing, and (3) investment stewardship:

1. ESG integration in **traditional investing** is the inclusion of environmental, social, and governance factors into financial analysis to evaluate risks and opportunities. The intended purpose is not to apply social values to investment decisions, but to consider whether ESG factors contribute to or detract from the value of a given investment opportunity.[3] An example of integration entails a fundamental active equity portfolio manager evaluating various ESG risks of their portfolio, such as the risk of regulatory action due to a company's environmental track record, to inform their investment views and positioning.

2. **Sustainable investing** refers to the explicit incorporation of ESG objectives into investment products and strategies. The spectrum of sustainable investment strategies has evolved over several decades and can be defined by three core segments, which reflect the wide range of investors' objectives from removing specific sectors to targeting positive social and environmental outcomes. ESG factors can inform the construction of sustainable investing product in a number of ways (see Exhibit 1). Investment managers can apply ESG screens, or remove a particular ESG factor from a portfolio at a client's request. This can include screening out companies that have significant labor law violations, for example. Another common approach to incorporate ESG into sustainable investment product is to maximize exposure to highly-rated ESG companies, which can be done through a broad or narrow approach. A broad approach would attempt to maximize a fund's average ESG score while maintaining characteristics of a traditional market-cap weighted benchmark, while a narrow approach may focus specifically on companies that have low carbon emissions.

3. **Investment stewardship**, or corporate governance, is engagement with companies to protect and enhance the value of clients' assets. Through dialogue and proxy voting, investors engage with business leaders to build a mutual understanding of the material risks facing companies and the expectations of management to mitigate these risks. Hence, identifying and managing relevant ESG risks are an important component of the engagement process and to encouraging sustainable financial performance over the long-term.[4]

EXHIBIT 1: ESG FACTORS IN SUSTAINABLE INVESTMENT PRODUCT CONSTRUCTION

	Description	Example
Exclusionary Screens	Removing specific companies or industries not aligned with investors' values or mission	Religious institution excludes tobacco, weapons, alcohol and gambling across its portfolio
ESG Investments	Evaluating companies along ESG measures and weighting portfolios to increase exposure to best-in-class companies	Pension fund optimizes for high ESG exposure while minimizing tracking error to a standard benchmark
Impact Investments	Targeting specific social or environmental outcomes alongside financial returns	High-net worth investor seeks to reduce carbon emissions through investment in renewable power fund

BLACKROCK INVESTMENT STEWARDSHIP, ESG AND LONG-TERM PERSPECTIVE

As a fiduciary to our clients, BlackRock has a responsibility to protect and enhance the value of assets entrusted to us. The Investment Stewardship team contributes to this by engaging in thousands of conversations with companies each year on factors that are relevant to long-term economic performance.

Environmental, social, and governance issues are integral to our investment stewardship activities, as the majority of our clients are saving for long-term goals. It is over the long-term that ESG factors – ranging from climate change to diversity to board effectiveness – have real and quantifiable financial impacts. Our risk analysis extends across all sectors and geographies, helping us identify companies lagging behind peers on ESG issues. We seek to engage companies on these issues on behalf of our investors, irrespective of whether a holding is held in an active or a passive portfolio.

Engagement allows us to both share our philosophy and approach to investment stewardship and understand how a company's governance and management structures support operational excellence. As a long-term investor, we are patient with companies, giving them time to change on their own terms, but also persistent to ensure they adopt sound practices that in our view support long-term value creation.

Our View of ESG Factors

When determining the long-term value of a company's security, an enterprising investment analyst will often ask: what factors will differentiate this company's performance from its peers? How does the company earn the trust and support of customers, employees, regulators, and other stakeholders? Does the company ensure efficient production processes that minimize or optimize the use of scarce (and expensive) natural resources? How do management and the board maintain credibility with investors to ensure reliable and affordable capital?

While ESG information alone will not answer these questions, it can be meaningfully accretive to fundamental financial and investment analysis. How a company manages the environmental (E) and social (S) aspects of its business – those that are relevant to performance and value creation – is a signal of how well the company is run and its long-term financial sustainability. Corporate governance (G) – including board composition and its role in shaping and overseeing strategy – is another signal of the quality of leadership and management. Examining ESG factors can therefore support and enhance traditional financial analysis.

The best companies strategically manage all aspects of the business and ensure that their investors, as well as other constituents of the company, have enough information to understand the drivers of, and risks to, sustainable financial performance. For example, a beverage company might manage, measure, and report on its access to clean water – an input to production as well as a social and environmental factor. Companies that manage relevant ESG issues well tend to quickly adapt to changing environmental and social trends, use resources efficiently, have engaged (and, therefore, productive) employees, and can face lower risks of regulatory fines or reputational damage.

In fact, an analysis of more than 160 academic studies demonstrates that companies with high ratings on ESG factors have a lower cost of capital,[5] while separate research finds that greater transparency of public companies in disclosing non-financial (ESG) data results in lower volatility.[6] Hence, investment managers that have examined and integrated this information into their processes have benefited. 2014 Research in the *Journal of* Investing points to advantages of ESG integration in the investment process, finding that active managers can utilize the association between corporate ESG ratings and stock return, volatility and risk, to enhance their stock-picking and portfolio construction ability. [7]

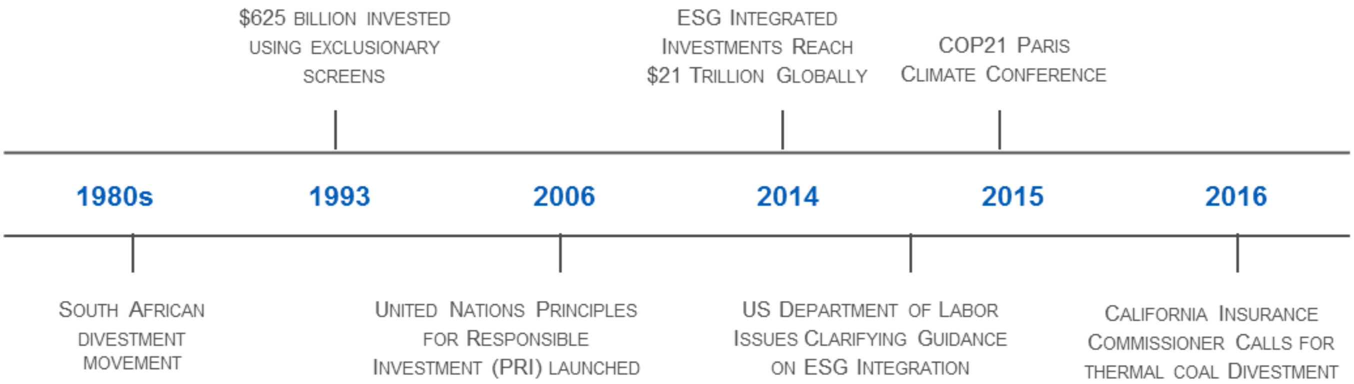
But relevance is key. Recent work suggests that firms with good ratings on material sustainability issues significantly outperform firms with poor ratings on these issues.[8] In contrast, firms with good ratings on immaterial sustainability issues do not significantly outperform firms with poor ratings on the same issues. Thus, there are no standard ESG factors that apply universally across companies, just as there are no universal non-ESG management factors that indicate potential performance – ESG factors need to be considered for their relevance to specific industries and companies.

INTEGRATING CARBON RISK FACTORS

Amongst the array of ESG issues, climate change has emerged as a mainstream investment consideration. Following the COP21 Paris climate conference, more and more investors are integrating carbon emissions data across their traditional investing, sustainable investing, and investment stewardship functions. This year, 10% of the world's 500 biggest investors reported measuring the carbon footprint of their portfolios in an effort to manage risk, up from 7% in 2015. Over the same period, dedicated low carbon investments by this group grew 63% to $138B, and investors voting in favor of at least one shareholder resolution on climate change grew to 12%, up from 7% the year prior.[9]

Integration of emissions data reflects the growing desire to better understand and manage climate-related risks. Although increasing in popularity, investor challenges remain, as the ability to assess relevant carbon risk factors is dependent on forecasting the risks imposed by new climate-related policies and the availability and quality of data. A number of industry bodies have emerged to measure and collect material climate information, but large gaps remain. In the following section we examine the current state of carbon, in addition to broad ESG data disclosure and collection.

Exhibit 2: HISTORY OF ESG INTEGRATION AND INVESTMENT



Source: "Ethical Screening in Modern Financial Markets" Michael Knoll, UN PRI https://www.unpri.org/, Global Sustainable Investment Alliance 2014 Review, United States Department of Labor https://www.dol.gov/ebsa/, COP21 UNEP http://www.cop21paris.org, California Department of Insurance http://www.insurance.ca.gov/.

The Current State of ESG Disclosure

After decades of increasing interest in ESG from various stakeholders (see Exhibit 2), a critical mass of data and practitioner experience are emerging. The landscape has shifted such that some companies are now explicitly identifying, managing, and reporting on ESG issues, with various market participants collecting and disseminating the data. The practitioner-led efforts to establish ESG reporting frameworks and analytical guidance are becoming more refined given years of collective, practical experience within the market. Third party investment research providers are expanding their offerings to include ESG alongside more traditional investment analysis – all with a view towards economic materiality.

Despite progress, these efforts are working against long-established corporate disclosure practices. Companies do not typically talk in terms of "ESG;" they have their own terminology. Corporate social responsibility (CSR), corporate citizenship, and sustainability are a few commonly used terms in the corporate world. Companies face a distinct challenge in that different issues will be important to different stakeholders. In our experience, current corporate sustainability reporting often includes disclosure about factors that, while honorable, are less relevant to investment decision making (e.g., corporate philanthropy). As a result, current reporting practices may make it difficult to identify investment decision-useful data (e.g., water usage and risks in the aforementioned beverage company example).

To facilitate the consistent disclosure and integration of material ESG factors by companies and asset managers, a number of organizations have emerged. Below we provide a brief summary of select major ESG standards initiatives:

Principles for Responsible Investment (PRI): an investor-sponsored initiative in partnership with UNEP Finance Initiative[10] and UN Global Compact.[11] Sets forth six voluntary and aspirational investment principles that offer possible actions for incorporating ESG issues into investment practice. Launched in 2006.[12]

CDP (formerly the Carbon Disclosure Project): an NGO that collects company-reported climate change, water, and forest-risk data. Works with global institutional investors holding $95 trillion in assets, thousands of companies, and local and national governments to address related risks and opportunities.[13]

Global Reporting Initiative (GRI): an international independent organization that helps businesses, governments, and other organizations understand and communicate the impact of business on critical sustainability issues such as climate change, human rights, corruption and many others.[14] The GRI in 2013 released its fourth generation of reporting guidelines (G4), listing over 400 indicators on corporate sustainability performance.[15] The GRI serves a broad range of stakeholders and includes factors that go beyond investment-related issues.

International Integrated Reporting Council (IIRC): a global coalition of regulators, investors, companies, standard setters, the accounting profession, and NGOs. The coalition is promoting communication about value creation as the next step in the evolution of corporate reporting.[16]

Global Impact Investing Rating System (GIIRS): a project of the non-profit B Lab, assesses the social and environmental impact of companies and funds. Each company receives an overall score and two ratings; one for its impact models and one for its operations (ESG standards).[17]

Sustainable Stock Exchanges (SSE): a peer-to-peer learning platform for exploring how exchanges, in collaboration with investors, regulators, and companies, can enhance corporate transparency – and ultimately performance – on ESG issues and encourage sustainable investment. The SSE is organized by the UN Conference on Trade and Development (UNCTAD), the UN Global Compact, the UN Environment Program Finance Initiative (UNEP FI), and the Principles for Responsible Investment.[18]

Ceres: a non-profit organization advocating for sustainability leadership, comprising a network of investors, companies, and public interest groups. Seeks to accelerate and expand the adoption of sustainable business practices and solutions to build a healthy global economy.[19]

Financial Stability Board (FSB): comprised of G20 members and chaired by Mark Carney, has established an industry-led Task Force, chaired by Michael Bloomberg, to report by the end of 2016 disclosure standards for companies on climate-related issues. This is to enable investors and policy makers to better incorporate this into their long-term decision-making.[20]

Sustainability Accounting Standards Board (SASB): an independent non-profit whose mission is to develop and disseminate sustainability accounting standards that help US public corporations disclose material, decision-useful information to investors. Standard setting occurs through evidence-based research and broad, balanced stakeholder participation.[21]

SUSTAINABILITY ACCOUNTING STANDARDS BOARD (SASB)

The SASB in the US is a preeminent example of an industry body seeking standardized ESG disclosures that are relevant to business performance. SASB is an independent non-profit whose mission is to develop and disseminate sustainability accounting standards that help public corporations disclose material, decision-useful information to investors. That mission is accomplished through a rigorous process that includes evidence-based research and broad, balanced stakeholder participation.

- Through 2016, SASB is developing sustainability accounting standards for more than 80 industries in 10 sectors.
- SASB standards are designed for the disclosure of material sustainability information in mandatory SEC filings, such as the Form 10-K and 20-F.
- SASB is an ANSI accredited standards developer.
- SASB is not affiliated with FASB, GASB, IASB or any other accounting standards boards.

See Exhibit 3 for the SASB Materiality Map, an interactive tool that identifies and compares likely material sustainability issues across different industries and sectors.

In addition to industry bodies, market data providers have entered the space, seeing a competitive opportunity to develop ESG assessments of companies and investment funds. MSCI ESG Research[22] and Sustainalytics are two of the more prominent providers of ESG performance evaluation. This year, both MSCI ESG and Morningstar, in partnership with Sustainalytics, published ESG and sustainability scores on over 20,000 mutual funds and ETFs. In addition to differences in data coverage (e.g., by asset class and market capitalization), they and other sources of company ESG ratings measure different aspects of company sustainability, including through sometimes conflicting evaluation methodologies and data inputs. Just as the range of investment research philosophies demonstrates there is no single way to predict company financial performance, no single approach to evaluate the ESG performance of companies or funds has emerged.

From a public policy perspective, there has been increased focus encouraging the integration of ESG factors as a core part of investment processes. While ESG is clearly not new to the public policy arena, we have observed a new impetus to establish market-level policies that advance ESG practices, even at the regional and global level. The list of global initiatives set forth below and detailed in the Appendix highlights a number of the separate initiatives in place to address a breadth of ESG-related investment issues.

One catalytic public policy initiative was the build up to, and output of, the Paris Climate Conference (Conference of Parties 21 or COP21), held in December 2015. The goal of this meeting was to reduce greenhouse gas emissions in order to limit global temperature increases. The resultant COP21 Agreement[23], signed by over 170 nations, sets a goal of limiting average global temperature rise to 2 degrees C above pre-industrial levels while pursuing efforts to limit the increase to 1.5 degrees C. Achieving this requires national emissions reductions of increasing stringency and the monitoring and reporting of progress. Focus now turns to government plans to meet their respective goals, and the implications for carbon intensive industries. International organizations – namely the G20 and OECD – are examining the role ESG factors will play in financing broader climate change objectives. The OECD is looking specifically at investment governance, and whether existing fiduciary standards sufficiently incorporate climate-related risks.

INVESTOR STATEMENT ON CLIMATE CHANGE

BlackRock signed the 2014 Global Investor Statement on Climate Change. We believe that the emphasis on having a long-term, predictable policy framework is important to long-term investors seeking to incorporate environmental considerations in their analysis and decision-making. A more certain policy framework and long-term approach from governments is necessary for well-informed capital allocation decisions to be taken by investors and companies.

EXHIBIT 3: SASB MATERIALITY MAP

Identifies and compares likely material sustainability issues across different industries and sectors

	Health Care	Financials	Technology and Communications	Non-Renewable Resources	Transportation	Services	Resource Transformation	Consumption	Renewable Resources & Alternative Energy	Infrastructure
Environment										
GHG emissions			◐	●	●	◐	◐	◐	◐	◐
Air quality				●	●	◐	◐		◐	◐
Energy management	●		●	◐	◐	●	●	●	●	◐
Fuel management	◐			◐	●	◐		◐		◐
Water and wastewater management	●		●	●	◐	◐	◐	◐	●	●
Waste and hazardous materials management	●		◐	●	◐	◐	●	◐	◐	◐
Biodiversity impacts				●	◐	◐			●	◐
Social Capital										
Human rights and community relations	◐			◐					●	◐
Access and affordability	●	◐							◐	◐
Customer welfare	●	◐			◐	●	◐	◐		◐
Data security and customer privacy	◐	◐	●			◐	◐	●		
Fair disclosure and labeling	◐					◐		◐		
Fair marketing and advertising	◐	●				◐		◐		
Human Capital										
Labor relations			◐	◐	◐			◐		◐
Fair labor practices			◐		◐	◐		◐		
Employee health, safety and wellbeing	◐		◐	●	●	◐	◐		◐	●
Diversity and inclusion		◐	●			◐		◐		
Compensation and benefits		◐				◐		◐		
Recruitment, development and retention	●		●		◐	◐		◐		
Business Model and Innovation										
Lifecycle impacts of products and services	●	●	●	◐	◐	◐	●		●	●
Environmental, social impacts on assets & operations	◐	◐		◐		◐			◐	●
Product packaging	◐					◐	◐			
Product quality and safety	●				◐	◐	●	●		
Leadership and Governance										
Systemic risk management		●		●		◐				◐
Accident and safety management				◐	●	◐	◐		◐	◐
Business ethics and transparency of payments	●	●		◐	◐	◐	◐			◐
Competitive behavior		◐	●	◐	◐	◐	◐			◐
Regulatory capture and political influence				◐		◐	◐		◐	◐
Materials sourcing	◐		●	◐	◐		●	◐	●	
Supply chain management	●		◐	◐	◐	◐	◐	●	◐	

Sector Level Map Key

● Issue is likely to be material for more than 50% of industries in sector

◐ Issue is likely to be material for less than 50% of industries in sector

Issue is not likely to be material for any of the industries in sector

EXHIBIT 4: GLOBAL INITIATIVES COVERING ELEMENTS OF ESG INVESTING AS OF MAY 2016

ORGANIZATION	INITIATIVE
United Nations	UN Principles for Responsible Investment (UNPRI)
	UN Environment Programme (UNEP)
	UN Green Climate Fund
G20	G20 Green Finance Study Group
	Global Infrastructure Hub
OECD	High-Level Principles on Long-Term Investment
	Work stream on Governance and Fiduciary Duty
Financial Stability Board (FSB)	Task Force on Climate-Related Financial Risks
European Union	EU Energy Union
	EU Capital Markets Union
	European Find for Strategic Investments (EFSI)
	EU Non-Financial Reporting Directive
	ESG and Fiduciary Duty initiatives
	Product disclosure initiatives
Belgium	Vandebroucke Law (2003)
	Laws against financing of landmines and cluster munitions (2007)
Denmark	Amendment to the Danish Financial Statements Act
France	Grenelle Law II, Articles 224 and 225
	Energy Transition for Green Growth Law, Article 173
Germany	The Renewable Energy Act
	Amendment in regulations concerning pensions funds
Italy	Mandatory disclosure of ESG for pension funds
	New measure on pension funds' investment policy
Netherlands	Green Investment Directive
Norway	Norwegian Act on Annual Accounting
Spain	Sustainable Economy Law – Mandatory disclosure of ESG
	Law modernising Spain's Social Security System
Sweden	Mandatory Disclosure of ESG for pension funds
	Public Pension Funds Act
United Kingdom	Amendments to 1995 Pensions Act: Pension disclosure regulation
Hong Kong	Social Innovation and Entrepreneurship Development Fund (SIE Fund)
India	Indian Ministry of Corporate Affairs' new Corporate and Social Responsibility policy under the Companies Act 2013
Japan	Principles for Financial Action for the 21st Century
Philippines	National Renewable Energy Program 2011-2013
Vietnam	Climate Investment Funds' Clean Technology Fund
Thailand	Feed-in premium program

Looking regionally, Europe could be a bellwether for legislative action. On the company side, the EU's Non-Financial Reporting Directive provides a legislative framework to require public companies to disclose a range of information, including ESG factors. As part of the implementation process, the European Commission has sought the views of investors on what types of ESG information they find important to investment decisions. On the investor side, the EU Shareholder Rights Directive, currently under consideration, would mandate institutional investors to disclose more information on their investment stewardship and engagement policies, with some focus on ESG factors.

Policy makers in other regions are similarly active on ESG. As of January 1, 2016, in Canada, the amended Ontario Pension & Benefit Act requires certain pension plans to disclose whether ESG factors are incorporated in pension funds' investment policies and procedures. In the United States, publicly traded companies are required, as of 2010, to disclose material business risks that climate change developments may have on their business. The Dodd-Frank Wall Street Reform and Consumer Protection Act requires US companies also disclose information regarding mine safety and conflict minerals in supply chains. Finally, the Department of Labor in the US issued 2015 guidance stating, in part, that pension fund fiduciaries can consider ESG factors in their investment decisions, acknowledging that ESG factors may have a direct relationship to the financial value of an investment.[24]

Stock exchanges are often in a unique position at the intersection of public and private ownership to collaborate with their global peers to establish consistent guidance and structures across markets. Several have adopted listing rules on ESG or sustainability reporting. In South Africa, the Johannesburg Stock Exchange requires companies to comply with the principles of the King Code on Corporate Governance, including, as of 2010, a recommendation that companies integrate their approach to and reporting on risks and opportunities across financial and sustainability considerations.[25] Similar to the Brazilian BM&FBOVESPA exchange, the Australian Securities Exchange recommends, as of 2014, listed entities to disclose any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.[26] The Hong Kong Stock Exchange requires companies to report on ESG issues on a comply or explain basis.[27] The stock exchanges in Singapore and Malaysia[28] have indicated their intention to use listing requirements to improve sustainability reporting.[29] The World Federation of Exchanges[30] could play a role in coordinating peer exchanges to follow suit in order to avoid a patchwork of 100 different ESG reporting regimes.

Current Challenges

Despite the myriad of standards and initiatives, more work needs to be done. The variety of market data providers' methodology and the lack of ESG disclosure standards contribute to corporate complaints of survey fatigue and to investor challenges identifying the most material ESG issues. As an investor, we value the efforts to date to disclose and aggregate ESG data. However, we caution that the information is still in an early stage with discrepancies in quality and coverage, and the variety of providers may create more confusion than clarity. Three key challenges of the current state of ESG disclosure include:

1. **Reliance on self-reported data to questionnaires and industry bodies**
   Company disclosed information is sparse and disparate across industries and regions. The reliance on self-reported data to private aggregators allows companies to disclose favorable data or opt out completely. Furthermore, there is no accountability or overarching governing body ensuring accuracy of reported information.
2. **Inconsistent collection, management, and distribution of ESG data**
   ESG data is collected, managed, and dispersed by multiple data providers and is not easily accessible to all investors in a standard form. This creates a challenge for investment professionals attempting to systematically compare companies across industries and regions, either in real time or over historical time periods.
3. **Disparate approaches to measure and report ESG information to investors**
   Due to different methodologies and disclosures, index providers and asset managers report ESG considerations inconsistently, creating challenges for investors seeking to compare ESG investment strategies, objectives and outcomes consistently.

Policy Recommendations and Conclusion

There is a need for comprehensive, standardized, and comparable data to accurately measure how companies are managing relevant ESG issues. We note that although setting international reporting standards can be a generations-long process, the results can be meaningful and lasting for the investment industry. For example, efforts to drive convergence of international accounting standards that first arose in the late 1950s involved numerous standard-setting bodies that continue to this day.[31] However, now, if an investor wants to compare the financial performance of, for example, the telecom companies in Singapore, the US and Spain, they can rely on a set of those widely understood international accounting standards. This is not the case if they want to compare the carbon dependency, employee turnover levels, or the number of independent directors of those companies. Accordingly, it is necessary to coordinate and consolidate a standardized ESG factor reporting framework.

We see the potential over time for convergence towards a more holistic, integrated approach to managing, reporting, and analyzing business performance. Although some companies now issue a separate sustainability report, we believe that ESG issues of relevance to business performance **should be integrated into fundamental company communications, publication and disclosures.** In addition, some companies may find it useful to prepare sustainability reports addressing values-oriented stakeholders or employees wishing to understand their company's citizenship, however, that should not be confused with reporting on ESG issues of relevance to business performance.

Policy makers should focus on establishing a framework that enables practitioners to develop detailed standards and best practice guidelines.[32] As noted, considerable data is now available and progress continues to evolve at a rapid pace in response to market forces. Consistent, comparable, high quality data and information are key to ensure sound decision-making by investors, companies, regulators, and policy makers. To that end, we recommend that policy makers:

1. Encourage standard ESG factor disclosure by companies within a consistent global reporting framework (e.g. comparable to international accounting standards). ESG reporting should be relevant to operational and financial performance and their management to achieve long-term financial sustainability. Policy makers can encourage this by:
    a. Recognizing the importance of identifying and managing ESG risks and opportunities as a component of investment analysis, and understanding how practitioners use ESG data;
    b. Understanding the distinction between purely social, mission or "values" driven goals and investment ("value") goals;
    c. Promoting clear and consistent definitions of ESG, understanding the distinction between these factors driving long-term financial performance of companies from a values-driven approach taken by investors or companies;[33]
    d. Providing guidance that recognizes the need to tailor reporting across diverse industries, because relevant ESG factors can vary primarily by industry, and also by geography, and even by specific company;
2. Establish safe harbor provisions that ensure that companies which initiate ESG factor reporting do not face retrospective litigation, as the underlying ESG factors that may be material to the investment decision or relevant to business performance can be evolving quickly;
3. Monitor to ensure that, where regulation is in place, it is designed and implemented to achieve the actual prescribed policy objectives, and does not require or contribute to unnecessary disclosures or other compliance activities that do not add value to investment practitioners' abilities to use ESG information;
4. Review, understand, and remove barriers to ESG factor integration and reporting by investors and companies, such as conflicting ESG frameworks, ambiguous or competing definitions of materiality and fiduciary duty, lack of widely available globally standardized ESG data, and public policies that may not achieve prescribed policy objectives;
5. Clarify how ESG considerations are part of investors' and companies' fiduciary duties; and,
6. Require investors to report whether they integrate ESG factors in their investment analysis, and if so, their approach to integrating ESG factors in their investment processes and stewardship activities, including an explanation of specific policies, implementation guidance, and the resources deployed. Investors should also report the outcomes from engagements undertaken to protect and enhance long-term financial returns.

We anticipate that there will be consolidation amongst the practitioner-led policy initiatives in the near term. Policy makers and regulators can play a supportive, galvanizing, and potentially convening role. Given the increasing global significance of ESG amongst relevant stakeholders and the long-term nature of the investments necessary by companies – in innovation, reporting systems and, in some cases, physical assets – policy makers and regulators can play a vital role in establishing a long-term, standardized, focused, and predictable policy framework to encourage informed capital allocation decisions.

APPENDIX A: LIST OF GLOBAL POLICY INITIATIVES

ORGANIZATION	INITIATIVE	ACTION PLAN	YEAR OF INITIATION / PROGRESS
United Nations	UN Principles for Responsible Investment (UNPRI)	Voluntary initiative (currently with 1300+ signatories w ~$60tn in assets) to adhere to 6 principles to incorporate ESG issues into investment practices.	2005 *March 2016 consultation on additional accountability provisions
	UN Environment Programme (UNEP)	UNEP Sustainable Energy Finance Initiative (SEFI) is a platform to bring financiers and developers together to facilitate financing of renewable energy and energy efficiency investments.	2008
	UN Green Climate Fund	Fund's goal is to raise $100 billion annually by 2020 from both global public and private sectors (so far, only $10 billion pledged from developed nations) to help mitigate the effects of climate change in developing countries.	2010
G20	G20 Green Finance Study Group	Co-Chaired by Bank of England (BoE) and People's Bank of China (PBoC), with secretariat support from UNEP. Tasked with identifying institutional and market barriers to green finance, developing best practice to mobilize green investment.	Initial Report due by G20 Finance Ministers' meeting July 2016
	Global Infrastructure Hub	Global Infrastructure Hub works to better connect public and private sectors to increase the flow of funding to infrastructure projects.	2014
OECD	High-Level Principles on Long-Term Investment	High-level principles to help governments facilitate and promote long-term investment by institutional investors.	2014
	Work stream on Governance and Fiduciary Duty	OECD currently conducting research on investment governance and responsible investing. End result will be a report on whether current fiduciary standards amongst institutional investors are adequate with regard to ESG analysis and climate change risks.	Timeframe unclear
Financial Stability Board (FSB)	Task Force on Climate-Related Financial Risks	Chaired by Michael Bloomberg – TF will develop voluntary climate-related financial risk disclosures for use by companies to allow market participants and policymakers to better understand an manage climate-related risks.	Final Report due by end of Chinese G20 Presidency (end 2016)
European Union	EU Energy Union	Strategic initiative to create a single EU energy market – at the same time incorporating climate goals and financing low-carbon technology.	Framework in place by 2019 for Single EU Energy Market Reduction of energy usage by 27% by 2030 40% reduction of greenhouse gas emissions by 2030
	EU Capital Markets Union	Promoting increased markets-based finance. specific work on Green investment (e.g., green bonds), infrastructure investment	Framework in place by 2019
	European Find for Strategic Investments (EFSI)	€315 billion (public sector guarantees and private co-investment). Fund aimed at financing strategic infrastructure projects in EU (strong focus on sustainable energy infrastructure)	2015
	EU Non-Financial Reporting Directive	Legislation requiring disclosure of a range of ESG-related information by listed companies and other designated entities with 500+ employees.	Applies as of Jan 2017
	ESG and Fiduciary Duty initiatives	Promoting ESG factors as part of investor fiduciary responsibility and encouraging more disclosure of ESG information by companies. End result will feed into Guidelines supporting the Non-Financial Reporting Directive.	Currently under consultation: Guidelines due by end 2016
	Product disclosure initiatives	Various financial product (esp. funds) disclosure rules (UCITS and PRIPs KIIDs) include provisions on disclosure of ESG policy.	Various

APPENDIX A: LIST OF GLOBAL POLICY INITIATIVES *(cont'd)*

ORGANIZATION	INITIATIVE	ACTION PLAN	PROGRESS / YEAR OF INITIATION
Belgium	Vandebroucke Law (2003)	**Mandatory disclosure of pensions funds in their annual reports to which degree SEE criteria and considered in the investment strategy.**	2003
	Laws against financing of landmines and cluster munitions (2007)	Exclusion of investments in landmines and cluster munitions.	2007
Denmark	Amendment to the Danish Financial Statements Act	Mandatory ESG disclosure for companies and investors. Information must include: Mandatory reporting on human rights and/or climate change for organizations with policies referencing one or both of those issues. Applies to both institutional investors and corporates.	2012
France	Grenelle Law II, Articles 224 and 225	Public disclosure of open-ended investment companies and investment management companies (fund managers) how they integrate ESG objectives in their investment decisions, first on their websites, then in their annual reports.	2010 / 12
	Energy Transition for Green Growth Law, Article 173	Disclosure of how a wide range of investors integrate ESG issues into their investment policies and risk management (e.g. climate change-related risks), also incl. carbon reporting.	2016
Germany	The Renewable Energy Act	Tax advantages to closed-end funds to invest in wind-energy.	2010 / 12
	Amendment in regulations concerning pensions funds	Information of pension funds to clients how ESG issues are considered in the use of deposited funds when signing the contract, and in annual report.	2001
Italy	Mandatory disclosure of ESG for pension funds	Mandatory disclosure for pension funds of nonfinancial factors whether and to what extent ESG influencing the investment decisions and the exercise of their voting rights in their communication and in their annual reports.	2011
	New measure on pension fund's investment policy	Mandatory communication (if any) ethical, environmental and social criteria are in the statement of investment principles.	2012
Netherlands	Green Investment Directive	Tax reduction for green investments, such as wind and solar energy or organic farming.	1995
Norway	Norwegian Act on Annual Accounting	Annual reporting on business integration of corporate social responsibility, including human rights, workers' rights and social issues, the environment and measures against corruption. The report must contain information on policies, principles, procedures and company standards. Companies that do not have policies must disclose this fact. The company's auditor must assess the accuracy and consistency of the reporting. Companies that report within UN Global Compact or GRI are exempt.	2013
Spain	Sustainable Economy Law – Mandatory disclosure of ESG	Mandatory reporting for pension funds on an annual basis whether or not they use ESG criteria in their investment approach.	2011
	Law modernising Spain's Social Security System	Mandatory reporting for occupational pension funds in their annual reports on investment criteria in regard to SRI as well as how they implement, manage and monitor ESG issues.	2013

APPENDIX A: LIST OF GLOBAL POLICY INITIATIVES *(cont'd)*

ORGANIZATION	INITIATIVE	ACTION PLAN	PROGRESS / YEAR OF INITIATION
Sweden	Mandatory Disclosure of ESG for pension funds	Mandatory reporting requirements for private and public pension funds in the annual business plan how environmental and ethical considerations are taken into account in investment activities and the impacts of these activities for the funds performance and management.	2000
	Public Pension Funds Act	The seven AP funds must take environmental and ethical considerations into account without relinquishing the overall goal of a high return on capital.	2002
United Kingdom	Amendments to 1995 Pensions Act: Pension disclosure regulation	Pension funds are required to disclose in the Statement of Investment Principles (SIP) the extent (if at all) to which social, environmental and ethical considerations are taken into account in the selection, retention and realization of investment.	1999
Hong Kong	Social Innovation and Entrepreneurship Development Fund (SIE Fund)	Aimed at helping to overcome some obstacles in ESG investing in the region, such as the absence of a platform for investor-project matchmaking, limited information sharing and cross-sector learning, as well as incoherent policies and guidelines. ESG Reporting Guidelines have been published by the HK Stock Exchange as well.	**2012**
India	Indian Ministry of Corporate Affairs' new Corporate and Social Responsibility policy under the Companies Act 2013	Authorities in India have deployed multiple policy tools—such as Renewable Purchase Obligations and Renewable Energy Certificates—to close the demand gap by encouraging investment into renewable energy growth.	2013
Japan	Principles for Financial Action for the 21st Century	192 signatory financial institutions as of the end of October 2014 have joined for the aim of the principles to steer society toward sustainability by changing the flow of money to those activities which correspond to such sustainability goals.	2014
Philippines	National Renewable Energy Program 2011-2013	The Government of the Philippines, following on the Renewable Energy Act of 2008, set ambitious targets in the National Renewable Energy Program 2011-2013 to triple the country's current renewable capacity by 2030.	2011-2013
Vietnam	Climate Investment Funds' Clean Technology Fund	The government, in coordination with the Asian Development Bank, has developed a plan for low-carbon investments in the power, transport and industrial sectors, funded by the Climate Investment Funds' Clean Technology Fund.	
Thailand	Feed-in premium program	Thailand has more than doubled its installed clean energy capacity with the help of the feed-in premium program introduced in 2010.	2010

As of May 2016.

Notes

1. When we refer to asset owners, we mean the people and institutions whose capital is invested in global markets - including individual savers and households, as well as the institutions, like pension funds or insurance companies, who invest on their behalf. In this paper, we refer to the asset owner as 'investors' more broadly, and 'our clients' more specifically. Each type of asset owner has different needs, objectives and considerations that affect their investment objectives and considerations (and, if they delegate to asset managers, the mandates or funds in which they invest). *See* BlackRock, *ViewPoint, Who Owns the Assets?* (May 2014), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-who-owns-the-assets-may-2014.pdf.
2. 73% of global investors surveyed by the CFA Institute in 2015 indicated they take ESG issues into account in their investment analysis and decisions. Matt Orsagh, CFA Institute, CFA Institute Survey: How Do ESG Issues Factor into Investment Decisions? (Aug. 17, 2015), available at https://blogs.cfainstitute.org/marketintegrity/2015/08/17/cfa-institute-survey-how-do-esg-issues-factor-into-investment-decisions/.
3. It is important to note that ESG issues may often intersect with or be inseparable from deeply held personal or societal beliefs. As a fiduciary asset manager, BlackRock does not express value judgments or political views, but rather incorporates clients' stated investment objectives and constraints into portfolios. Sometimes, this means our clients explicitly identify sustainability objectives.
4. BlackRock and Ceres, 21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions (2015), available at http://www.blackrock.com/corporate/en-us/literature/publication/blk-ceres-engagementguide2015.pdf.
5. DB Climate Change Advisors, Deutsche Bank Group, Sustainable Investing: Establishing Long-Term Value and Performance (Jun. 2012), available at https://www.db.com/cr/en/docs/Sustainable_Investing_2012.pdf.
6. Teresa Czerwińska and Piotr Kaźmierkiewicz, ESG Rating in Investment Risk Analysis of Companies Listed on the Public Market in Poland, ECONOMIC NOTES, Vol. 44, Issue 2, at 211-248 (Jul. 2015), available at http://dx.doi.org/10.1111/ecno.12031.
7. Indrani De and Michelle Clayman, The Benefits of Socially Responsible Investing: An Active Manager's Perspective, Journal of Investing (Jul. 9, 2014), available at http://ssrn.com/abstract=2464204.
8. Mozaffar Khan, George Serafeim, and Aaron Yoon, Corporate Sustainability: First Evidence on Materiality, The Accounting Review (Mar. 9, 2015), available at http://ssrn.com/abstract=2575912.
9. Asset Owners Disclosure Project, "World's Biggest Investors Step Up Action to Protect Millions of Pension for Climate Risk" (May 2016), available at http://aodproject.net/worlds-biggest-investors-step-up-action-to-protect-millions-of-pensions-from-climate-risk/.
10. UNEP Finance Initiative is a global partnership between UNEP and the financial sector. Over 200 institutions, including banks, insurers and fund managers, work with UNEP to understand the impacts of environmental and social considerations on financial performance. UNEP Finance Initiative, http://www.unepfi.org/.
11. UN Global Compact is a voluntary initiative based on CEO commitments to implement universal sustainability principles and to take steps to support UN goals, with over 8,000 signatories in almost 170 countries. See United Nations Global Compact, https://www.unglobalcompact.org/.
12. BlackRock has been a signatory to the PRI since 2008. Being a signatory has not changed BlackRock's approach, as we have long been a strong proponent of active stewardship, including considering ESG factors as they pertain to long-term economic value creation. See Principles for Responsible Investment, available at https://www.unpri.org/.
13. About CDP, CDP, https://www.cdp.net/en-US/Pages/About-Us.aspx.
14. About GRI, Global Reporting Initiative, https://www.globalreporting.org/Information/about-gri/Pages/default.aspx.
15. Financial Services Council and Australian Council of Superannuation Investors, ESG Reporting Guide for Australian Companies (2015), http://www.fsc.org.au/downloads/file/PublicationsFile/2016_0302_ESGReportingGuideFinal2015.pdf.
16. The IIRC, Integrated Reporting, http://integratedreporting.org/the-iirc-2/.
17. B Analytics, Global Impact Investing Rating System (GIIRS) Company Ratings, http://b-analytics.net/products/giirs-ratings/company-ratings-methodology.
18. About the Sustainable Stock Exchanges (SSE) initiative, Sustainable Stock Exchanges Initiative, http://www.sseinitiative.org/about/.
19. Who we are, Ceres, http://www.ceres.org/about-us/who-we-are.
20. BlackRock is a member of the FSB Climate Task Force.
21. Sustainability Accounting Standards Board (SASB), http://www.sasb.org/.
22. BlackRock is a subscriber to MSCI ESG Research.
23. UN Climate Change Paris Agreement, available at http://newsroom.unfccc.int/paris-agreement/; United Nations Framework Convention on Climate Change, available at http://unfccc.int/resource/docs/2015/cop21/eng/10.pdf.
24. Department of Labor, Employee Benefits Security Administration, 80 Fed. Reg. 65135 (Oct. 26, 2015), available at https://www.gpo.gov/fdsys/pkg/FR-2015-10-26/pdf/2015-27146.pdf.
25. Regulator, Influencer, Advocate, Johannesburg Stock Exchange, https://www.jse.co.za/about/sustainability/regulator-influencer-advocate.
26. The World Federation of Exchanges Sustainability Working Group, Exchanges and ESG Initiatives (2015), and ASX Corporate Governance Council, Corporate Governance Principles and Recommendations (2014), available at http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf.
27. News Release, Hong Kong Exchanges and Clearing, Exchange to Strengthen ESG Guide in its Listing Rules (Dec. 21, 2015), available at https://www.hkex.com.hk/eng/newsconsul/hkexnews/2015/151221news.htm.
28. BlackRock, Comment Letter, Consultation Paper 1/2015: Proposed Amendments to the Listing Requirements Relating to Sustainability Statement in Annual Reports and the Sustainability Reporting Guide (Aug. 24, 2015), available at http://www.blackrock.com/corporate/en-us/literature/publication/sustainability-listing-requirments-bursa-malaysia-082415.pdf.
29. Christine Chow, Hong Kong Joins Push for Sustainable Stock Exchanges, South China Morning Post (Sep. 18, 2015), available at http://www.scmp.com/business/markets/article/1859225/hong-kong-joins-push-sustainable-stock-exchanges.
30. World Federation of Exchanges represents 64 regulated exchanges across the world, and acts on behalf of a total of 99 organizations including affiliate members and clearinghouses. WFE Mission & Vision, World Federation of Exchanges, http://www.world-exchanges.org/home/index.php/about/wfe-mission-vision.

Notes *(cont'd)*

31. Comparability in International Accounting Standards – A Brief History, Financial Accounting Standards Board, http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156304264.
32. See, e.g., International Capital Market Association, The Green Bond Principles, 2015: Voluntary Process Guidelines for Issuing Green Bonds (Mar. 27, 2015). http://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/GBP_2015_27-March.pdf.
33. B Corps, for example, are for-profit companies certified by the nonprofit B Lab to meet rigorous standards of social and environmental performance, accountability, and transparency. There are more than 1,600 Certified B Corps from 42 countries and over 120 industries. *What are B Corps?* B Corporations, available at http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-bonds/green-bond-principles/.

GOV-0093