Principles for Responsible Investment

SUSTAINABLE FINANCIAL SYSTEM, PRINCIPLES, IMPACT

LITERATURE REVIEW

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INTRODUCTION

This document supplements the PRI's formal consultation document Sustainable Financial System, Principles, Impact, specifically the "Developing a sustainable financial system" section. It summarises the various analyses of the financial system by international institutions, academics, think tanks and investors that we used in preparing the formal consultation document.

In this report, we provide:

- A list of the main reports that we used as the core references for this part of our work (Appendix 1).
- A summary of the main objectives of these reports (Appendix 2).
- A consolidated list of the interventions and tools proposed by these reports reviewed (Appendix 3).
- A short summary of each report (Appendix 4).

Our Review of the Literature

Financial System

Since the 2008 global financial crisis, many reports and publications have analysed the causes of the global financial crisis and the impacts of the financial system on society, on the natural environment and on the wider economy. Many of these have offered recommendations on how another global financial crisis might be averted, on how the financial system may be made more stable and resilient and on how the contribution of the financial system to sustainable development might be maximised.

In late 2015, we conducted an extensive review of this literature, identifying over 100 relevant books and reports. To narrow this list down, we prepared a shortlist of the major reports produced by key international organisations (and potential partners) such as the OECD, UNEPFI, the UNEP Inquiry into the Design of a Sustainable Financial System and the World Economic Forum. We then discussed this list with the Sustainable Financial System Advisory Committee (see Box) and with key stakeholders, including asset owners, asset managers, PRI staff and external commentators and experts on responsible investment. They offered a series of suggestions on additional reports that we should consider in our analysis.

> The Sustainable Financial System Advisory Committee provides feedback to the PRI Executive on the sustainable financial system programme. The SFS is made up of twelve past PRI Board members plus the PRI Chair, Chair of PRI's Policy Advisory Committee and the PRI Managing Director (ex-officio).

Based on this feedback, we identified a shortlist of twenty reports and publications (see Appendix 1) that we used as the core references for this part of our work. The reports and publications comprised a mix of publications from practitioners, advocacy organisations and intergovernmental organisations. They had a variety of objectives (see Appendices 2 and 4) and provided an extensive set of recommendations for changes to the financial system of today.

Our Findings

Our initial expectation was that we would find a publication that provided a clear road map for the PRI and its signatories on the role that we might play in supporting the creation of a sustainable financial system. While the reports provided many valuable insights into the operation of the financial system and into the actions that might be taken to improve the operation of the financial system, we concluded that none offered a definitive analysis or a comprehensive set of recommendations that we could use. There are various reasons:

1. The reports had a variety of objectives (see Appendix 2). Some focused on the structure and operation of the financial system itself (covering issues such as competition, investor short-termism, resilience, trust), some focused on the wider economy (covering issues such as financing the green economy, environmental protection, stimulating innovation), and others focused on practices and behaviours within investment organisations. Recommendations therefore also varied between reports.
2. The reports focused on the financial system as it is presently constituted, rather than as it may be constituted or structured in 5, 10 or 20 years from now. There was limited discussion of how factors such as demographic change or technology change might affect the future structure of the financial system or the relationships between actors in the financial system.
3. The reports paid relatively little attention to the wider, knock-on or secondary consequences of the recommendations made, e.g. how the measures proposed might affect other actors or other behaviours in the system. For example, increasing transparency to savers and beneficiaries about fees and performance – and thereby increasing accountability and creating downward pressure on fees – was a common recommendation. However, there was limited discussion of whether greater transparency would lead to, for example, more (or less) switching between providers

or and lesser (or greater) willingness on the part of investment managers and asset owners to engage with the companies in which they are invested.

4. The reports tended not to differentiate between those recommendations that are already being addressed (by policy makers, by investors, by other actors) and those that are not being addressed. Furthermore, little attention was paid to the effectiveness of the interventions being made.

The publications were, however, extremely valuable in three regards. First, they provided us with an extensive longlist (see Appendix 3) of potential projects and interventions that investors could take.

Second, they identified the policy priorities of organisations that we may partner with as we develop our work on the financial system.

Third, the publications provided important insights into the work we needed to complete in order to develop a robust, credible and effective programme of work in this area.

Specifically, they pointed to the need for us to be clear about:

- Our objectives, both for the financial system as a whole and for our projects and interventions.
- What we see as the purpose(s) of the financial system.
- The key desired (or desirable) characteristics of the financial system.
- The relationships between actors in the financial system, and the impacts that these actors – individually and collectively – have on the financial system, society, the environment and the wider economy.
- The factors that will driver change in the financial system, and how these will affect the financial system.
- The underlying (or root) causes of risk and sustainability challenges in the financial system.
- The skills, competencies and capacities that the PRI will bring to these projects or interventions, and why the PRI and its signatories are best placed to deliver them.

LIST OF REPORTS

Short title	Full title
Aviva (2015)	Waygood, S. (2015), **A Roadmap for Sustainable Capital Markets: How can the UN Sustainable Development Goals Harness the Global Capital Markets?** An Aviva White Paper (Aviva, London).
Brown (2011)	Brown, G. (2011), "**Achieving Sustainable Growth, Wealth Creation and Poverty Reduction**". Presentation to the UN Secretary General's High Level Panel on Sustainability, 18 September 2011.
European Commission (2014)	European Commission (2014), "**Communication from the Commission to the European Parliament and the Council on Long-Term Financing of the European Economy. COM/2014/0168 Final**."
FCLT (2015a)	Focusing Capital on the Long Term (FCLT) (2015), **Long-Term Portfolio Guide. Reorienting Portfolio Strategies and Investment Management to Focus Capital on the Long Term**. March 2015.
FCLT (2015b)	Focusing Capital on the Long Term (FCLT) (2015), **Perspectives on the Long Term: Building a Stronger Foundation for Tomorrow**.
Future Fund (2015)	Neal, D. and Warren, G. (2015), **Long-Term Investing as an Agency Problem. Working Paper No. 063/2015**. June 2015 (Centre for International Finance and Regulation, Sydney).
G20/OECD (2013, 2015)	G20 and OECD (2013), **High-Level Principles of Long-Term Investment Financing by Institutional Investors**. September 2013 (OECD, Paris). G20 and OECD (2015), S**ummary Report on Effective Approaches to Support Implementation of the G20/OECD High Level Principles on Long-Term Investment Financing by Institutional Investors. OECD Report to G20 Finance Ministers and Central Bank Governors**. September 2015 (OECD, Paris)
IISD (2012)	International Institute for Sustainable Development (IISD), United Nations Environment Programme Finance Initiative (UNEPFI) and The Blended Capital Group (2012), **Financial Stability and Systemic Risk: Lenses and Clocks**. June 2012 (IISD, Manitoba, Canada).

ISA (2013-2015)	Industry Super Australia's (ISA's) reports on improving the efficiency of Australia's financial system at facilitating capital formation include: • **Finance and Capital Formation in Australia**. November 2013 • **Capital Formation and Productivity**. March 2014 • **Capital Formation and Australia's Banking System**. March 2014 • **Capital Formation and Australia's Capital Markets**. March 2014 • **Financing Australia's Growth. Submission to the Financial System Inquiry**. 31 March 2014 • **Dashboard of Financial System Efficiency**. July 2014 • **2015 Dashboard of Financial System Efficiency**. November 2015
Lake (2015)	Lake, R. (2015), **Financial Reform, Institutional Investors and Sustainable Development: A Review of Current Policy Initiatives and Proposals for Further Progress** (UNEP Inquiry into the Design of a Sustainable Financial System, Geneva).
Lydenberg (2015)	Lydenberg, S. (2015), **Portfolios and Systemic Framework Integration: Towards a Theory and Practice. Exposure Draft** (16 November 2015) (The Investment Integration Project (TIIP)).
OECD (2015)	OECD (2015), **Aligning Policies for the Transition to a Low-Carbon Economy** (OECD, Paris).
Parliamentary Commission (2013)	Parliamentary Commission on Banking Standards (2013), **Changing Banking for Good. Volume I: Summary, and Conclusions and Recommendations** (The Stationery Office, London). Parliamentary Commission on Banking Standards (2013), **Changing Banking for Good. Volume II: Chapters 1 to 11 and Annexes** (The Stationery Office, London).
Preventable Surprises (2015)	Covington, H. and Thamotheram, R. (2015), **Institutional Investors and Climate-Related Systemic Risk**. 26 October 2015 (Preventable Surprises, London).
PRI (2013)	Principles for Responsible Investment (PRI) (2013), **Overcoming Barriers to a Sustainable Financial System: Consultation Update**. 31 July 2013 (PRI, London).
Roosevelt Institute (2015)	Binder, C. (2015), **Rewriting the Rules of the Federal Reserve for Broad and Stable Growth** (Roosevelt Institute, New York).
UNEP Inquiry (2015)	UNEP Inquiry into the Design of a Sustainable Financial System (2015), **The Financial System We Need: Aligning the Financial System with Sustainable Development**. October 2015 (UNEP, Geneva).
WEF (2011)	World Economic Forum (WEF) (2011), **The Future of Long-term Investing** (WEF, Geneva).
WEF (2012)	World Economic Forum (WEF) (2012), **Measurement, Governance and Long-term Investing** (WEF, Geneva).
WEF (2015)	World Economic Forum (WEF) (2015), **The Global Financial System: Policy Recommendations for the Future** (WEF, Geneva).

REPORT OBJECTIVES

Objective	Aviva	Brown	European Commission	FCLT	FCLT	Future Fund	G20/OECD	IISD	ISA	Lake	Lydenberg	OECD	Parliamentary Commission	Preventable Surprises	PRI	Roosevelt Institute	UNEP Inquiry	WEF	WEF	WEF
	2015	2011	2014	2015a	2015b	2015	2013, 2015	2012	2013-2015	2015	2015	2015	2013	2015	2013	2015	2015	2011	2012	2015
FINANCIAL SYSTEM																				
Align the financial system with sustainability goals	X	X						X		X	X			X	X		X			
Strengthen financial system governance and regulatory oversight													X				X			X
Create better functioning and more competitive markets									X				X							
Correct agency problems and align incentives				X		X				X					X					
Correct market failures (externalities)	X				X															
Address inequality (income/wealth distribution)																X				
Stimulate demand for sustainability strategies and advice										X										
Lengthen investment time horizons (promote long-term investment)			X	X	X		X			X								X	X	
Strengthen resilience															X		X			
Improve the culture and behaviour of the finance sector													X				X			
Restore public trust in the financial system										X			X							
WIDER ECONOMY																				
Harness the public balance sheet for sustainability																	X			
Promote/stimulate innovation																	X			
Ensure policy coherence												X					X			
Mobilise capital for sustainability/green investment	X									X		X					X			
Protect environmental, societal and financial systems											X									
Increase economic welfare										X										
ORGANISATIONAL																				
Strengthen organisational practices (e.g. disclosure, risk management)	X												X	X			X			
Strengthen governance and capabilities on sustainability	X									X				X			X			
Ensure accountability for social and environmental impacts										X			X				X			
INDIVIDUAL																				
Ensure individual accountability for social and environmental impacts										X	X									
Improve culture and behaviours											X									

RECOMMENDED INTERVENTIONS AND TOOLS

Financial System Design

- Promote long-term investment and allocation to illiquid assets.
- Level playing field for new funding sources (e.g. peer-peer lending, crowdfunding).
- Reduce incentives for short-term speculation and excessive trading.
- Increase portability.
- Ensure that investment practices and instruments (e.g. derivatives, hedging, high frequency trading) do not adversely affect financial system stability.
- Mitigate the impact of capital protectionism on long-term investors.
- Provide regulatory and tax incentives for long-term investment.
- Promote interaction and engagement between companies/issuers and long-term investors.
- Support the growth and mainstreaming of responsible investment.
- Support the growth and mainstreaming of inclusive finance.
- Address practices (e.g. commodities trading) that enable the hoarding of physical assets or that create instability.
- Strengthen regulation of derivatives and of the shadow banking system.
- Clarify that fiduciary duty requires investors to take account of ESG issues and long-term performance and risk.
- Ensure that risk-based funding, solvency and accounting rules do not disincentivise infrastructure investment.
- Incorporate sustainability into the mandate of prudential regulators, including central banks and stock exchanges.
- Incorporate stability into the mandate of prudential regulators, including central banks and stock exchanges.
- Incorporate competition into the mandate of prudential regulators, including central banks and stock exchanges.
- Incorporate inequality (income/wealth distribution) into the mandate of prudential regulators, including central banks and stock exchanges.
- Integrate sustainability into risk management requirements.
- Stress test the impact of environmental shocks on assets and business models.
- Require minimum risk weighted standards for capital and liquidity, including counter cyclical margins and collateral requirements.
- Calibrate capital requirements to incorporate environmental factors and support long-term finance (e.g. through differentiating between assets that fund short term obligations and long-term liabilities).
- Require policymakers to consider the unintended consequences of regulatory decisions on investors' ability to make long-term decisions.
- Ensure that regulators are equipped to monitor and mitigate risks arising from technology-enabled innovation.
- Hold regulators to account for the decisions that they make.
- Require the directors of financial institutions to attach the utmost importance to the safety and soundness of the firm and to the duties owed to customers, taxpayers and others.
- Require directors to demonstrate that they took all reasonable steps to mitigate the negative impacts of a specified failure.
- Create criminal offence of acting in a reckless manner.
- Require key individuals within financial institutions to be licensed.
- Ensure that sustainability and/or long-term success are key elements of director and senior management remuneration.

- Encourage financial institutions to respect global standards of responsible conduct.
- Ensure that financial institutions are the "right size" to deliver sustainability outcomes (includes consolidating those that are too small and breaking up those that are too large).
- Provide incentives to reward long-term shareholders and reduce portfolio turnover.
- Introduce sustainable development performance into the procurement of financial services by the public sector.
- Establish liability regimes for lenders, fiduciaries and insurers to drive adequate due diligence for environmental damage.
- Restrict financial transactions with excessive societal costs.
- Adopt principles for a sustainable financial system to guide policymaking.
- Implement G20 Principles for Financial Inclusion.
- Consider impacts on sustainability when developing and reviewing financial regulations.
- Incorporate sustainability into financial sector development plans.
- Ensure that opportunities for financial system reform are included into sustainability policies.
- Introduce long-term strategies and roadmaps, supported by coordination mechanisms.
- Strengthen the legal and judicial system to aid enforcement.
- Monitor capital flows and stocks.
- Develop a performance framework to assess and guide progress in developing sustainable financial systems.
- Develop a performance monitoring and reporting framework to assess and guide progress in delivering social and environmental goals (e.g. SDGs, climate change).
- Require corporations to report on material sustainability issues (e.g. integrated reporting).
- Incorporate sustainability reporting into listing standards.
- Require corporations to report on specific sustainability issues.
- End quarterly reporting.

Financial Institutions

- Require finance sector actors to measure and report on their environmental and social policies, practices and performance (e.g. sustainability reports, carbon risk, carbon footprint).
- Require financial institutions to report on their long-term performance and long-term investments.
- Require the costs associated with switching funds or service providers to be explicitly identified and passed on as discrete fees to customers.
- Require investment institutions to have the skills and capabilities to reflect sustainability and long-termism in their investment strategies and risk management.
- Require investment organisations to set out their beliefs on the relevance of environmental, social and governance issues to their organisation.
- Require boards, trustees and senior management to demonstrate that they have appropriate knowledge of and training on sustainability-related issues.
- Introduce sustainability into the definition of a "fit and proper" person to be a governing body member.
- Ensure that risk, compliance and internal audit functions have direct lines of access and accountability to the board, and have appropriate levels of protection for their independence.
- Embed long-term investment in the mission and mandate of financial institutions.
- Build organisational understanding of long-term investment (beliefs, policies, mandates, governance, etc).
- Build agents' understanding of the organisation's views on long-term investment.
- Demonstrate commitment to long-term investment (e.g. through defined lock in periods, use of closed-end funds).
- Align incentives with agents, in particular through avoiding overemphasis on short term performance.
- Ensure fair treatment of customers and stakeholders.
- Develop performance measurement systems that capture long-term as well as short-term performance and impacts.
- Establish stable teams.
- Develop new/innovative products (e.g. concentrated portfolios).
- Integrate sustainability issues into equity research.

- Integrate sustainability issues into credit analysis.
- Integrate sustainability issues into the advice given by investment consultants.
- Integrate sustainability issues into the advice given by proxy voting agencies.
- Give long-term shareholders additional voting or other rights to strengthen incentives for long-termism.
- Remove barriers to exercising shareholder rights and responsibilities (e.g. inefficiencies in the voting system, share blocking, proxy access restrictions).
- Make stewardship activity mandatory on a comply-or-explain basis.
- Ensure that stewardship and corporate governance codes integrate sustainability considerations.
- Positively influence the management of investee companies in support of processes for long-term value creation.
- Ensure that the responsibilities of key individuals are clearly defined, and that regulators can hold them to account (e.g. through fines, bans) if they fail to deliver on these.
- Incorporate sustainability into professional investment training and standards.
- Improve the sustainability capabilities of financial regulators and policymakers.
- Ensure that individuals have strong commitments to ethical behaviour.
- Ensure that remuneration and incentives more closely reflect the longer run balance between business risks and rewards.
- Ensure that remuneration can be deferred or clawed back.

Public Policy and Wider Economy

- Integrate climate change and sustainability goals into public spending goals.
- Launch green investment bank or public-backed green funds.
- Integrate sustainability and long-term investment into the mission of development finance institutions and sovereign wealth funds.
- Enable development banks to build infrastructure and facilitate long-term growth.
- Integrate climate change and sustainability into public procurement and expenditure requirements.
- Integrate climate change and sustainability into all relevant policy areas, including development.
- Integrate sustainability requirements into asset purchase programmes.
- Develop national infrastructure policy.
- Develop instruments to incentivise and mobilise capital at scale for a green economy (e.g. first loss provisions, credit enhancements, insurance, financing schemes).
- Ensure that existing fiscal incentives for savings, investment, lending and insurance align with sustainability.
- Support the development of liquid markets for green infrastructure financing instruments (e.g. green bonds, yield cos).
- Address the liquidity barriers to long-term investment.
- Facilitate access to capital for green projects.
- Reduce transaction costs (e.g. planning, standards) for green investments.
- Facilitate the development of new instruments to support long-term investment.
- Support the development of micro-finance and micro-insurance.
- Establish a robust and credible price for greenhouse gas emissions and other externalities.
- Provide targeted technology support to develop, and lower the cost of, risky but potentially promising sustainable/low-carbon technologies.

- Clear commitment – nationally and internationally – to support the transition to a sustainable low-carbon economy.
- Ensure that the regulatory framework for investors and financiers is conducive to low-carbon, long-term investments.
- Develop national capital raising plans explaining how governments intend to finance the delivery of a zero-carbon economy and the Sustainable Development Goals.
- Include green assets in covered bond regulations.
- Develop standards on eligible project categories and transparency on the use of proceeds.
- Permit or require asset owners to make commitments to invest in green assets.
- Give green investment mandates to sovereign wealth funds (e.g. to facilitate access to long-term financing, to help reduce project and financial risks, to provide expertise to support low-carbon investments and market development).
- Adjust standards and rules to facilitate capital raising (e.g. green sukuks, green IPOs, yieldcos).

REPORT SUMMARIES

Aviva (2015), Aviva Roadmap for Sustainable Capital Markets

Full Title:
Waygood, S. (2015), A Roadmap for Sustainable Capital Markets: How can the UN Sustainable Development Goals Harness the Global Capital Markets? An Aviva White Paper (Aviva, London).

Scope:
Primarily listed equities (asset owners, asset managers, companies, stock exchanges, investment consultants) but with some reference to other classes.

Objectives:
To provide policymakers with specific suggestions on how they can make the capital markets more sustainable, with a particular focus on raising capital for sustainable uses, moving capital from unsustainable practices and harnessing the stewardship capabilities of investors.

Key Findings/Conclusions:

Aviva believes that the capital markets are of relevance to sustainable development policy makers for three reasons: (a) as a way of raising capital to enhance government spending on sustainable development projects; (b) as a target for systemic change given that the financial influence of the capital markets can enhance or undermine long-term sustainable development goals; and, (c) as an ownership mechanism for influencing corporate practices that policy makers can seek to harness to improve the sustainability practices of existing listed companies.

Aviva argues that there is clear tension between the short-term focus of the capital markets and policymakers' need to plan for the long-term and tackle a range of environmental and social issues, such as poverty, climate change and human rights. It argues that the primary failure of the capital markets is one of misallocation of capital, resulting from governments' failure to properly internalise environmental and social costs into companies' profit and loss statements. The consequence is that the capital markets do not incorporate companies' full social and environmental costs, leading to unsustainable companies having a lower cost of capital than should properly be the case.

Aviva believes that policy makers need to change the pricing signals within the market and improve the readiness of the supply chain of capital to integrate sustainability issues. Aviva proposes that governments should:

- Develop national capital raising plans explaining how they intend to finance the delivery of a zero-carbon economy and the Sustainable Development Goals.
- Provide financial incentives along the investment chain that are fully aligned with long-term sustainable performance.
- Integrate sustainable development factors into the mandates of the agencies charged with supervising or overseeing stewardship codes, listing rules and financial stability.
- Require institutional investors and their advisors to report on how they have integrated sustainability considerations into their investment practices and processes.
- Ensure that national corporate governance and stewardship codes integrate sustainable development.
- Incorporate sustainable development into the duties (e.g. fiduciary duty, duty of care) of asset owners, asset managers and investment consultants.

Brown (2011), Achieving Sustainable Growth, Wealth Creation and Poverty Reduction

Full Title:
Brown, G. (2011), "Achieving Sustainable Growth, Wealth Creation and Poverty Reduction". Presentation to the UN Secretary General's High Level Panel on Sustainability, 18 September 2011.

Scope:
Finance sector, global capital markets.

Objectives:
To offer policy recommendations on financial stability that enable the global economic goals of prosperity, fairness and environmental sustainability to be delivered, and ensure that the finance sector does not undermine progress towards these goals.

Key Findings/Conclusions:

The paper argues that the primary goals of global economic policy should be prosperity, fairness and environmental sustainability. In turn, this requires global policymakers to pay attention to climate change, to ensure that growth is sustained, to deliver inclusive growth, to eradicate poverty and to remove unacceptable inequalities.

Ensuring global financial stability is one of the keys to ensuring that these goals are achieved. The paper argues that global capital markets, and the investment and financing approaches these markets support, continue to remain wedded to an energy intensive business as usual model that results in a significant carbon footprint across many social, economic and industrial activities.

The paper offers 14 policy propositions directed at supporting the goals of achieving sustainable global growth, wealth creation and poverty reduction. It divides these into three broad areas:

- Monitoring the world economy and ensuring that there are appropriate and stable capital flows to meet the needs of sustainable development.
- Catalysing action which can ensure that global wealth is created and fairly shared.
- Ensuring that, at an individual level, all financial institutions behave responsibly and accountably.

European Commission (2014), Long-Term Financing of the European Economy

Full Title:
European Commission (2014), "Communication from the Commission to the European Parliament and the Council on Long-Term Financing of the European Economy. COM/2014/0168 Final".

Scope:
Banking, insurance, asset management, development banks, capital markets.

Objectives:
To strengthen the demand for and the supply of long-term financing, in particular for infrastructure investment and for SMEs.

Key Findings/Conclusions:

The European Commission notes that the economic and financial crisis has affected the ability of the financial sector to channel funds to the real economy, in particular to long-term investment. It notes that Europe's ability to make long-term financing available for new infrastructure and for small and medium enterprises (SMEs) is essential to reinforce the competitiveness of Europe's economy and industry. This financing is dependent on the ability to channel savings through an open, safe and competitive financial sector.

The Commission also sets out the wider case for long-term financing: it supports job creation, it is usually counter-cyclical, it ensures that longer-term aspects such as environmental, social, governance issues are properly taken into account in investment strategies, and it supports sustainable growth (e.g. high quality infrastructure improves the productivity of the rest of the economy).

The Commission acknowledges that developing and diversifying how long-term investment is financed is a complex and multidimensional task, requiring a range of responses and initiatives. It proposes action in six areas: (i) mobilising private sources of long-term financing, (ii) making better use of public finance, (iii) developing capital markets, (iv) improving SMEs' access to financing, (v) attracting private finance to infrastructure, and (vi) enhancing the overall environment for sustainable finance.

In relation to the finance sector, the specific measures proposed include capital and liquidity management requirements for banks and other financial institutions, supporting innovative financial instruments such as green bonds, improved transparency and disclosure, and analysis of the relationship between fiduciary duty and sustainability.

FCLT (2015a), Focusing Capital on the Long Term Portfolio Guide

Full Title:
Focusing Capital on the Long Term (FCLT) (2015), Long-Term Portfolio Guide, Reorienting Portfolio Strategies and Investment Management to Focus Capital on the Long Term. March 2015.

Partners:
FCLT was founded by the Canada Pension Plan Investment Board (CPPIB) and McKinsey & Company. The development of the Portfolio Guide was led by Caisse de dépôt et placement du Québec and CPPIB, supported by a working group with representatives of over 20 large asset owners and asset managers.

Scope:
Asset owners, asset managers.

Objectives:
To develop practical ideas for how institutional investors might reorient their portfolio strategies and management practices to emphasise long-term value creation, thereby promoting a long-term mind-set throughout the investment value chain.

Key Findings/Conclusions:

The FCLT report provides recommendations across five core action areas, namely:

1. Investment beliefs: Asset owners should clearly articulate their investment beliefs. These beliefs should provide a foundation for a sustained long-term investment strategy, and also help these asset owners to navigate short-term turbulence.
2. Risk appetite statement: Asset owners should develop a comprehensive statement of key risks, risk appetite and risk measures, appropriate to the organisation and oriented to the long-term. These statements should clarify the asset owner's willingness and ability to prudently take risks and accept uncertainties
3. Benchmarking processes: Asset owners should select and construct benchmarks focused on long-term value creation. When assessing performance, asset owners should clearly distinguish between the strategy itself and the asset managers' execution of the strategy.
4. Evaluations and incentives: Asset owners' evaluation of internal and external asset managers should emphasise processes, behaviours and consistency with long-term expectations. Asset owners should also design incentives with a greater weight on long-term performance, and that ensure alignment between the asset owner's and the asset manager's financial interests.
5. Investment mandates: Asset owners should use investment-strategy mandates not simply as a legal contract but as a mutual mechanism to align the asset managers' behaviours with the objectives of the asset owner.

FCLT focuses on areas where asset owners and managers have the ability to act immediately and change practices on their own initiative, although it acknowledges that there is only so much that asset owners and managers can do by themselves. It, therefore, argues that regulators and policy-makers need to move beyond their current emphasis on setting short-term accounting rules, funding requirements and required reserves for prudential purposes, and focus more on enabling long-term investment strategies that are appropriate to long-term liabilities.

FCLT (2015b), Perspectives on the Long Term

Full Title:
Focusing Capital on the Long Term [FCLT] (2015), Perspectives on the Long Term: Building a Stronger Foundation for Tomorrow.

Partners:
FCLT was founded by the Canada Pension Plan Investment Board (CPPIB) and McKinsey & Company.

Scope:
Asset owners, asset managers, companies.

Objectives:
To catalyse discussion about how to put the economic system on a more stable foundation and how to allocate resources in ways that provide the greatest value for the broadest range of stakeholders.

Key Findings/Conclusions:

Note: This publication is a collection of short essays, with views and opinions from a wide range of actors, including CEOs, board members, investors, and regulators. As such, it is primarily a reflection on the current state of play rather than a document that offers specific recommendations to investors or other actors.

A number of themes recur across the essays:

- The pressures on companies and on investors to deliver short-term profits and returns, often to the longer-term detriment of the businesses in question.
- The perverse effect of many regulations which prevent, often unintentionally, investors taking a longer-term approach to investment.
- The lack of attention paid by boards to long-term strategy, often as a direct consequence of the pressures to focus on shorter-term issues and on regulatory compliance.
- The need for transparency and disclosures that provide stakeholders (e.g. investors, employees, civil society) with the information they need to properly understand the company's activities, its strategy and its impact on the environment, the economy and wider society.
- The importance of robust governance processes (investment beliefs, policies, monitoring, remuneration) and of people and culture to investment organisations.
- The need for consistent, credible, long-term government policy, supplemented by appropriate policy instruments, to encourage investment in infrastructure and in activities that support the transition to the low carbon economy.

Future Fund (2015), Long-Term Investing as an Agency Problem

Full Title:
Neal, D. and Warren, G. (2015), Long-Term Investing as an Agency Problem. Working Paper No. 063/2015. June 2015 (Centre for International Finance and Regulation, Sydney).

Partners:
Future Fund.

Scope:
Asset owners and asset managers.

Objectives:
To address the agency problems that arise when investing for the long term.

Key Findings/Conclusions:

Long-term investing offers both public and private benefits. The public benefits relate to helping mitigate the effects of short-termism, while the private benefits include the potential to invest in unlisted and other illiquid assets, the capacity to pursue investments when payoff timing is open-ended, and the ability to exploit opportunities arising from the actions or aversions of short-term investors. Despite this, long-term investing is not widely practiced because of the practical challenges involved in predicting the distant future and because the agency problems that pervade delegated investment management are exacerbated when investing for the long term, where the payoff is distant and often highly uncertain. These factors compound the difficulty of aligning and monitoring the agents responsible for making investment decisions.

The report identifies four agency-related problems that are particularly important, namely

- The manner in which principals monitor agents, in particular the tendency to focus on short-term results and to rely on benchmarks to assess performance.
- Incentives, both the weighting of bonuses towards short-term performance and the fact that short-term performance is often linked to business (e.g. inflows) and personal success.
- Situations where investments do not turn out as expected, where principals react in ways (e.g. changing investment managers) that signal that short-term performance is of greater concern.
- The need for commitment, in order for the manager to feel they can follow long-term strategies through to their conclusion, however long it may take. From an asset owner perspective, committing funds may result in a loss of liquidity and can also increase exposure to agency risk.

Managing these agency issues requires organisations to not only have the capacity to be a long-term investor but to act like one. The report proposes a series of strategies for addressing these principal-agent problems. These include:

- Building a shared understanding around the intent of investing for the long term, and how it will be delivered. This includes building a long-term culture, setting clear objectives with a long-term focus, focusing on whether outcomes are on track to achieve long-term goals, and employing individuals who have affinity with long-term investing.
- Designing incentives that avoid attention being drawn to short-term performance, and reinforce the focus on long-term outcomes. This could be through the greater use of internal and co-investment or through the ongoing accrual of bonuses, with vesting conditional on performance being sustained.
- Committing to managers, e.g. through closed-end funds or other structures where the principal's ability to withdraw funds is constrained.

G20/OECD (2013, 2015), High-Level Principles of Long-Term Investment

Full Title:
G20 and OECD (2013), High-Level Principles of Long-Term Investment Financing by Institutional Investors. September 2013 (OECD, Paris).

G20 and OECD (2015), Summary Report on Effective Approaches to Support Implementation of the G20/OECD High Level Principles on Long-Term Investment Financing by Institutional Investors. OECD Report to G20 Finance Ministers and Central Bank Governors. September 2015 (OECD, Paris).

Partners:
G20, OECD.

Scope:
Pension funds, insurance companies, asset managers, sovereign wealth funds.

Objectives:
To help policy makers design and implement policy and regulatory frameworks which encourages institutional investors such as pension funds, insurers and sovereign wealth funds to provide a stable source of capital for the economy and which facilitate the flow of capital into long-term investments.

Key Findings/Conclusions:

The G20 and the OECD have developed high-level principles to assist OECD, G20 and other interested countries to facilitate and promote long-term investment by institutional investors. Of particular importance are institutions such as pension funds, insurers and sovereign wealth funds that typically have long duration liabilities and, consequently, can consider investments over a long period provided these are prudent and capable of producing a reasonable risk-adjusted return.

The G20 and OECD note that these institutions can be a significant source of long-term financing for physical and intangible investment needs across all sectors in the economy (in particular, for infrastructure, for SMEs, for renewable energy and for low-carbon technologies). These sectors are key drivers of growth, competitiveness and employment. Long-term investment horizons can also bring direct benefits to these institutions by allowing them to take advantage of long-term risk and illiquidity premia, reducing portfolio turnover and costs, and allowing them to follow a less cyclical investment pattern.

Governments and other competent authorities such as the regulators and supervisors of institutional investors play a key role in facilitating long-term investment. They can create appropriate and consistent policies and framework conditions for long-term investment. They are also important sources of long-term investment capital. The G20 and OECD identify a set of general recommendations to promote long-term investment by institutional investors and improve the functioning of markets while fulfilling prudential requirements and avoiding potential detrimental impacts on other investments.

IISD (2012), Financial Stability and Systemic Risk: Lenses and Clocks

Full Title:
International Institute for Sustainable Development (IISD), United Nations Environment Programme Finance Initiative (UNEPFI) and The Blended Capital Group (2012), Financial Stability and Systemic Risk: Lenses and Clocks. June 2012 (IISD, Manitoba, Canada).

Partners:
IISD, UNEPFI, The Blended Capital Group.

Scope:
Capital markets, institutional investors, stock exchanges, banking, insurance.

Objectives:
To promote the idea that markets need resilient institutions, strong business cases and robust values to flourish, and to ensure that sustainable finance and responsible investment principles inform the financial stability debate.

Key Findings/Conclusions:

The paper argues that markets need resilient institutions, strong business cases and robust values to flourish. It urges financial policy-makers to integrate measures that promote the values of transparency, accountability, responsibility and trust as they develop policies directed at delivering a more stable and resilient financial system that supports globalised markets.

The paper argues that, in a more stable and resilient financial system, all actors would benefit from "...the use of wider and better quality "lenses" that give greater depth, breadth and granularity to our vision and understanding of a wider range of risks", and that these "...should employ "clocks" that heighten their appreciation of the temporal nature of risk by neither over-emphasizing those short-term and apparently more easily quantifiable risks nor under-emphasizing the slow, creeping risks that destroy value over the long term."

It highlights six priority areas for action (dark pools, active ownership, stock exchange listing requirements, banking risk, credit ratings agencies and insurance) and proposes action in four areas:

- Building a deeper understanding of how policy-makers, market regulators and international financing institutions can support the growth and mainstreaming of responsible investment and inclusive finance approaches.
- Establishing a monitoring body which ensures that the global financial system is managed on sustainable fiduciary principles.
- Investigating why long-term pension investment has not resulted in a financial system that more obviously serves the interests of savers and supports global sustainability.
- Promoting transparency in the operation of financial and commercial organisations.

Industry Super Australia (ISA) (2013-2015), Facilitating Capital Formation

Full Title:
Industry Super Australia (ISA) has produced a series of reports on improving the efficiency of Australia's financial system at facilitating capital formation. The publications that have been reviewed in the preparation of this note are:

- Finance and Capital Formation in Australia. November 2013
- Capital Formation and Productivity. March 2014
- Capital Formation and Australia's Banking System. March 2014
- Capital Formation and Australia's Capital Markets. March 2014
- Financing Australia's Growth. Submission to the Financial System Inquiry. 31 March 2014
- Dashboard of Financial System Efficiency. July 2014
- 2015 Dashboard of Financial System Efficiency. November 2015.

Partners:
Fifteen (15) Australian Industry SuperFunds.

Scope:
Banking, asset management, superannuation (asset owners).

Objectives:
To improve the efficiency of Australia's financial system at facilitating capital formation.

Key Findings/Conclusions:

ISA's research suggests that the efficiency of Australia's financial system in facilitating capital formation appears to have fallen in recent decades. It argues that this can be attributed to government subsidising the banking sector, the increasing focus of the banking sector on financing the resale of existing housing stock rather than the creation of new housing or business capital, and the shift in focus of the capital markets from primary capital raising to trading in secondary markets and derivatives. ISA also argues that financial markets can be expensive (i.e. they consume private resources to operate and require government resources to police), and have levels of trading activity that exceed those necessary to support the core purposes of equity markets. Furthermore, the ability of the superannuation system to invest to a greater degree in long term capital is constrained by retailisation, portability, and investment option switching.

ISA's proposals to improve the efficiency of capital formation include:

- Reforming superannuation reporting requirements to members such that more information is provided on the long-term investments made by the fund and that this information is given a higher profile in communications.
- Informing members of the costs of liquidity and switching by requiring associated costs to be passed on as discreet fees to customers.
- Supplementing current reporting by superannuation funds with longer-term rolling averages.
- Addressing liquidity barriers to long-term investment.
- De-risking investment in early stage companies through a development bank or innovation funding agency.
- Facilitating the development of new instruments focused on long-term investing.
- Adjusting tax settings to promote long term capital formation.
- Reducing incentives for short-term speculation and excessive trading.
- Reforming infrastructure bid models to reduce bid costs and project time frames, with the aim of removing the barriers to long-term investors investing in greenfield infrastructure projects.

Lake (2015), Review of Current Policy Initiatives for Financial Reform

Full Title:
Lake, R. (2015), Financial Reform, Institutional Investors and Sustainable Development: A Review of Current Policy Initiatives and Proposals for Further Progress (UNEP Inquiry into the Design of a Sustainable Financial System, Geneva).

Partners:
UNEP Inquiry, UNEPFI, PRI.

Scope:
Asset owners, asset managers.

Objectives:
(a) To deliver resilient portfolios that allocate capital efficiently on the basis of sustainability factors and are supported by robust stewardship, (b) to mobilise capital to support the low-carbon transition and other sustainability objectives, (c) to increase economic welfare, (d) to restore public trust in investors and the financial system.

Key Findings/Conclusions:

The report states that policy reform is critical to align the activities of institutional investors with sustainable development. It also notes that previous interventions to promote the environmental and social dimension of investment have focused principally on disclosure of policies and formal statements of legal duties, and have largely taken fundamental features of the design and operation of the financial system as given.

The report argues that seven policy objectives hold the strongest potential for positive change: (1) aligning the institutional investment system design with sustainability; (2) removing barriers that hamper the integration of sustainability into the investment chain (e.g. in relation to investors' legal duties, solvency and risk management); (3) stimulating demand for strategies, advice, asset management, research and disclosures that integrate sustainability; (4) strengthening asset owner governance and capabilities; (5) lengthening investment horizons; (6) aligning incentives along the investment chain; and (7) ensuring investor accountability to beneficiaries, customers and society at large.

It identifies policy tools and interventions that can help deliver these objectives, including:

- Designing pension systems to balance the adequacy and reliability of outcomes for savers, the affordability for public and private sector sponsors, and sustainable development.
- Measuring performance in terms of environmental and social outcomes as well as in financial terms.
- Defining and interpreting the legal duties of investment institutions (e.g. fiduciary duty) to enable and encourage investors to take account of financially relevant environmental, social and governance (ESG) issues and to focus on long-term performance and risk.
- Imposing personal liability on the directors of financial institutions who take risks that could damage financial stability.
- Requiring prudential regulators to explicitly consider sustainability and resilience in their activities and decisions.
- Providing fiscal incentives to reward long-term shareholders, slow portfolio turnover, and mitigate risk in targeted green investments.
- Making stewardship activity mandatory on a comply-or-explain basis.

Lydenberg (2015), The Investment Integration Project

Full Title:
Lydenberg, S. (2015), Portfolios and Systemic Framework Integration: Towards a Theory and Practice. Exposure Draft (16 November 2015) (The Investment Integration Project (TIIP)).

Scope:
Asset owners, asset managers.

Objectives:
To help asset owners and managers better understand how systemic frameworks can be enhanced in order to improve investment performance, improve communication with corporations and other entities providing investment opportunities, improve the integrity of the financial community and encourage disclosure of social and environmental data relevant to investment issues.

Key Findings/Conclusions:

The report argues that investment theory encourages financial professionals to consider portfolio level decisions as if they did not impact on the environmental, societal and financial systems upon which investments are built. It states that this view of the impact of investment decision-making is too limited to protect asset owners and managers from systemic-level risks.

The report acknowledges the ongoing efforts to integrate environmental, social and governance (ESG) factors into portfolio-level decision-making, but concludes that little work is being done to determine how portfolio decision-making impacts positively or negatively on the systemic environmental, social and financial frameworks it operates in.

The Investment Integration Project (TIIP) aims to help asset owners and managers understand how systemic frameworks can be enhanced in order to strengthen their investments and to align their policies and practices with the maintenance of healthy social and environmental systems.

TIIP has two main areas of focus:

- A “case-building track” to document the collective effect of portfolio-level decisions on systemic frameworks, and to develop guidelines and practical steps that asset owners and managers can take to measure and manage systemic considerations in their portfolio level decision-making
- An “implementation track” where the project works with asset owners and managers to conduct market research, create and maintain a mechanism for asset owners and managers to engage in collective knowledge-sharing and problem solving, and devise formats for effective measurement and reporting on the integration of investment portfolios and systemic frameworks.

OECD (2015), Aligning Policies for the Transition to a Low-Carbon Economy

Full Title:
OECD (2015), Aligning Policies for the Transition to a Low-Carbon Economy (OECD, Paris).

Partners:
OECD, International Energy Agency (IEA), Nuclear Energy Agency (NEA) and International Transport Forum (ITF).

Objectives:
To mobilise capital for the transition to a low-carbon economy, and to ensure alignment between climate change and wider policy and regulatory goals.

Key Findings/Conclusions:

The OECD argues that aligning policies for a low-carbon economy can contribute to a broader reform agenda for greener, more resilient and inclusive growth, while also improving competitiveness and energy security. It concludes that this requires the scaling up of sustainable low-carbon investment and finance, changing the taxation system so that less carbon-intensive choices are favoured, stimulating low-carbon innovation on a large scale, addressing trade barriers to the low carbon transition, de-carbonising electricity, supporting sustainable urban mobility, strengthening incentives for sustainable land use and ensuring that all government ministries identify and address key misalignments with low-carbon transition in their portfolios.

The report argues that the low-carbon transition investment challenge requires both the scaling up of finance for long-term investment in infrastructure and the shifting of investments towards low-carbon alternatives. It identifies a series of barriers to low-carbon investment including weaknesses in fiscal incentives (e.g. insufficient carbon pricing, environmentally harmful subsidies and incentives), weaknesses in domestic and international climate policy frameworks, weaknesses in competition policies (e.g. market designs that favour carbon-intensive infrastructure investment in the energy sector) and weaknesses in financial market policies. It also notes that while strong, stable climate policies are necessary to adjust the return on investment of low-carbon infrastructure projects, these policies are not enough on their own; policy makers therefore need to address a range of policy misalignments in the overall investment framework that collectively favour investment in fossil fuel-intensive activities.

The report makes a series of recommendations on how to address the barriers to shifting investment to low-carbon assets. These include:

- Aligning investment (finance sector-related) policies with climate change policies, through making strong government commitments to action on climate change at both the international and national levels and through providing strong and stable carbon pricing policies or subsidies.
- Facilitating access to financing for green projects through measures such as developing liquid markets for green infrastructure financing instruments, creating risk mitigation and financing tools, reducing transaction costs, and promoting market transparency and standardisation.
- Ensuring that financial markets properly account for climate risks and liabilities.
- Strengthening climate risk and performance disclosures by corporations and investors.
- Mobilising public financial institutions to facilitate access to long-term financing, reduce project and financial risks and provide expertise to support low-carbon investments and market development.
- Making use of green public procurement and expenditure.

Parliamentary Commission (2013), Parliamentary Commission on Banking Standards

Full Title:
Parliamentary Commission on Banking Standards (2013), Changing Banking for Good. Volume I: Summary, and Conclusions and Recommendations and Changing Banking for Good. Volume II: Chapters 1 to 11 and Annexes (The Stationery Office, London).

Scope:
Banking.

Objectives:
To restore trust in the UK banking sector.

Key Findings/Conclusions:

The report argues that the UK banking sector's ability to perform its crucial role of supporting of the real economy and to maintain its international pre-eminence has been eroded by a profound loss of trust resulting from profound lapses in banking standards.

The Commission makes proposals to enable trust to be restored in banking. These proposals have five themes:

- Making individual responsibility in banking a reality, especially at the most senior levels. The report argues that too many bankers operated with insufficient personal responsibility, where remuneration incentivised misconduct and excessive risk-taking, and where there was little realistic prospect of financial penalties or more serious sanctions commensurate with the severity of the failures with which they were associated. The report proposes that accountabilities and responsibilities be much more clearly defined, that remuneration incentives and disincentives more closely reflect the longer run balance between business risks and rewards, and that strengthened enforcement processes for individuals be adopted.
- Reforming governance within banks to reinforce each bank's responsibility for its own safety and soundness and for the maintenance of standards.
- Creating better functioning and more diverse banking markets in order to empower consumers and provide greater discipline on banks to raise standards. The Commission argued that the creation of more competitive markets would ensure that customers have sufficient choice and access to information to exercise effective judgement. It also suggested that competition be an objective of the prudential regulator, subject to its overriding responsibility for financial stability.
- Reinforcing the responsibilities of regulators in the exercise of judgement in deploying their current and proposed new powers. The report cautioned that the fact that regulation is well-intentioned is no guarantee that it is a force for good, noting that misconceived and poorly-targeted regulation was a major contributory factor to many of the banking standards failings.
- Specifying the responsibilities of the Government and of future Governments and Parliaments.

The report also argued that shareholders are ill-equipped to hold bank boards to account, commenting that institutional shareholders have incentives to encourage directors to pursue high risk strategies in pursuit of short-term returns and to ignore warnings about issues such as mis-selling.

Preventable Surprises (2015), Institutional Investors and Climate Systemic Risk

Full Title:
Covington, H. and Thamotheram, R. (2015), Institutional Investors and Climate-Related Systemic Risk. 26 October 2015 (Preventable Surprises, London).

Scope:
Asset owners, asset managers.

Objectives:
To catalyse discussion about the contribution that 'forceful stewardship' can make to investor efforts to managing climate-related systemic risk.

Key Findings/Conclusions:

The report argues that climate change presents systemic risks to investors that cannot be controlled by hedging, diversification or other investment strategies. It, therefore, argues that, alongside other strategies such as engagement, divestment, preferential investments in areas such as climate bonds and portfolio carbon management, investors should adopt what it describes as 'forceful stewardship'. Forceful stewardship involves investors pressing the companies in which they invest to produce business plans consistent with the transition to a low carbon economy and with operating in a world where global average temperature rise does not exceed 2°C above pre-industrial levels. Forceful stewardship on climate change is seen as comprising the following actions by investors:

- Declaring their intention to vote in favour of prudently formulated shareholder resolutions that will help reduce systemic climate risk while protecting shareholder value in the long-term.
- Instructing their voting advisors to vote automatically in favour of such resolutions. If current voting agents are unable to support this obligation, investors should find agents who will.
- Voting in favour of resolutions that call for listed companies to publish robust analyses of their assessments of the physical, policy and economic impacts to their businesses of global warming of 2 and 4°C respectively.
- Declaring their intention to vote in favour of resolutions that call for listed companies to publish business plans ("2°C transition plans") that describe how, without damaging shareholder value, they can reduce their emissions each year by an appropriate amount for their industry; and/or how their business could adapt to a carbon price that rises to $100 per tonne of carbon dioxide by 2030; and/or how their business could adapt to regulations aimed at meeting a 2°C warming target and/or restricting atmospheric carbon dioxide to 450 parts per million (ppm).
- Considering, on a case-by-case basis, voting against the re-election of the chairman of the board, or against the report and accounts where there have been persistent and unacceptable practices related to climate risk.
- Engaging with credible and well-informed scientists, economists and civil society experts and wherever possible, in alliance with these and corporate business leaders, engaging with legislators and regulators.

In addition, asset owners should require their investment consultants to include these principles in their manager research, screening, selection and review processes, and investment managers should instruct their analysts and research providers to assess 2°C transition plans and adjust investment recommendations and ratings in accordance with these principles.

PRI (2013), Overcoming Barriers to a Sustainable Financial System

Full Title:
Principles for Responsible Investment (PRI) (2013), Overcoming Barriers to a Sustainable Financial System: Signatory Consultation Update. 31 July 2013 (PRI, London).

Scope:
Asset owners, asset managers.

Objectives:
To identify the key barriers to a sustainable financial system and the actions that might be taken to overcome these barriers.

Key Findings/Conclusions:

In 2013, PRI asked its members for their views on the key barriers to a sustainable financial system and to identify projects that PRI could implement to overcome these barriers. The PRI defined barriers as those '[characteristics of]... current market practices, structures and regulation that undermine the interests of investors and the systems within which they operate.'

The consultation identified seven key strategic barriers to a sustainable financial system, namely:

- Company short-termism and the lack of attention to ESG issues in company decision-making and investment practice.
- Investor short-termism, mandate design and alignment of interests [Note: This was identified as the single most important issue].
- Portfolio structure and strategic asset allocation.
- Externalities.
- Financial market stability.
- Company disclosure.
- Financing the sustainable economy.

A number of other barriers were also identified: fiduciary duty, the implications of existing regulatory frameworks for responsible investment, pension fund governance, the specific role played by actors such as credit rating agencies and investment consultants in the operation of the investment system, and the role that ethical failures played in causing the financial crisis.

In total, over 60 different potential project areas (or potential areas for research and investigation) were identified by respondents. However, there was no consensus on which of these were the most appropriate for the PRI to take forward.

Roosevelt Institute (2015) Rewriting the Rules of the Federal Reserve

Full Title:
Binder, C. (2015), Rewriting the Rules of the Federal Reserve for Broad and Stable Growth (Roosevelt Institute, New York).

Scope:
Central banks (Federal Reserve).

Objectives:
To require the Federal Reserve to place more emphasis on full employment, wage growth, financial stability, and fair credit access, and thereby support stronger and more broadly shared economic growth.

Key Findings/Conclusions:

The Federal Reserve has responsibilities to conduct monetary policy so that it maximises employment with stable prices, to maintain financial stability as a financial regulator and lender of last resort, and to provide financial services to banks and the government. The paper argues that the monetary, regulatory, and supervisory policy choices of the Federal Reserve shape macroeconomic and financial conditions in the United States and abroad and have long-term impacts on economic inequality. It highlights that the costs and benefits of the Federal Reserve's decisions (e.g. tightening/loosening monetary policy, responding to inflation, taking actions that affect asset prices) have asymmetric impacts on people at different points on the income and wealth distribution.

The paper argues that, by reforming Federal Reserve governance and policy, and by providing it with a broader arsenal of policy tools, the Federal Reserve could place more emphasis on full employment, wage growth, financial stability, and fair credit access. In turn, this would promote stronger and more broadly shared economic growth.

The paper therefore proposes expanding the Federal Reserve's toolset to include:

- Countercyclical margin and collateral requirements and stronger capital requirements to reduce destabilising swings in asset prices and to avoid the cycle of bubbles and busts.
- Stronger regulations on derivatives and greater regulatory attention to shadow banks to prevent or reduce the negative spillovers of disruptions in the credit system.
- International coordination to reduce imbalances in the international monetary and financial system and to avoid international spillovers of financial instability.
- An accessible communication strategy that listens and responds to the concerns of different demographic and socioeconomic groups.
- Continued and strengthened efforts by Federal Reserve economists to research the effects of economic policies on inequality and to promote these findings to academics and policymakers.

UNEP Inquiry (2015), UNEP Inquiry into the Design of a Sustainable Financial System

Full Title:
UNEP Inquiry into the Design of a Sustainable Financial System (2015), The Financial System We Need: Aligning the Financial System with Sustainable Development. October 2015 (UNEP, Geneva).

Scope:
Banking, insurance, institutional investment, equities, and bonds.

Objectives:
To explore how to align the financial system with sustainable development.

Key Findings/Conclusions:

The Inquiry argued that the full potential of the financial system needs to be harnessed to deliver the transition to sustainable development, and to direct capital towards critical priorities and away from assets that deplete natural capital. The Inquiry identified five areas where progress is needed to embed sustainable development into the financial system:

Enhancing market practice through measures such as:

- Clarifying that that the duties owed by financial institutions to their clients include sustainability factors.
- Strengthening prudential regulations through requiring the explicit assessment of sustainability in risk management processes, stress tests and capital requirements.
- Strengthening sustainability reporting requirements for financial institutions and corporations.
- Encouraging the integration of sustainability risk factors into financial analysis.
- Adjusting standards and rules to facilitate capital raising (e.g. green bonds).

Harnessing the public balance sheet through measures such as:

- Providing targeted fiscal support for green assets and investments
- Strengthening sustainability requirements for development finance institutions and sovereign wealth funds.
- Launching of new green investment banks and funds.
- Developing financial instruments to overcome barriers to private investment.

Reforming legal and market structures through measures such as:

- Establishing proportionate liability regimes for lenders, fiduciaries and insurers to drive adequate due diligence for environmental damage.
- Facilitating access to capital for critical sectors (e.g. SMEs, green assets)
- Incorporating environmental and social factors into priority lending programmes.
- Restricting capital to transactions with excessive societal or environmental costs.

Encouraging cultural transformation through measures such as:

- Building the sustainability skills of financial professionals, regulators and policymakers.
- Including sustainability in remuneration regulations.
- Encouraging financial institutions to respect global standards of responsible conduct.

Upgrading governance architectures, through:

- Adopting principles for a sustainable financial system to guide policymaking.
- Assessing sustainability impacts when developing or reviewing financial regulations.
- Incorporating sustainability into the mandates of central banks and financial regulators.
- Developing a framework to assess progress in developing sustainable financial systems.

WEF (2011), The Future of Long-term Investing

Full Title:
World Economic Forum (WEF) (2011), The Future of Long-term Investing (WEF, Geneva).

Scope:
Asset owners with some capacity to invest for the long term (e.g. life insurers, pension funds, sovereign wealth funds, endowments, foundations and family offices).

Objectives:
To explore the role of long-term investing and long-term investors in the global financial system and to understand how the barriers to long-term investing might be overcome and the benefits of long-term investing might be maximised.

Key Findings/Conclusions:

The report argues that long-term investment, when executed correctly by the right investor, can benefit three key constituencies:

- Investors who potentially enjoy better returns through accessing risk premia (e.g. for assuming liquidity risk) and avoiding the costs sometimes associated with short-term strategies (e.g. transaction costs, forced sales, short-term behavioural investor biases).
- Companies who can more easily pursue strategic initiatives with long-term potential and large up-front costs.
- Society which can gain from the stabilisation of financial markets by countercyclical investors and through the allocation of capital to projects where returns are generated over longer time horizons.

The report identifies the constraints on institutions as including their liability profile (and the degree to which the institution must service short-term obligations, such as upcoming payments to beneficiaries), investment beliefs (specifically whether the institution believes long-term investing can produce superior returns), risk appetite (and the ability and willingness of the institution to accept potentially sizable losses) and decision-making structures (i.e. the ability of the investment team and trustees to execute a long-term investment strategy).

The report makes six recommendations directed at easing the constraints on long-term investing and increasing the benefits that flow from long-term investing.

- Policy-makers should consider the unintended impact of regulatory decisions on investors' ability to make long-term investments.
- Policy-makers should mitigate the impact of capital protectionism on long-term investors.
- Long-term investors should develop performance measurement systems that balance a long-term perspective with short-term accountability.
- Long-term investors should implement compensation systems that better align stakeholders with the long-term mandate of the institution.
- Long-term investors should promote a better understanding of the implications of a long-term investing strategy among stakeholders.
- Policy-makers and long-term investors should encourage more engaged ownership by the shareholders of public companies.

WEF (2012), Measurement, Governance and Long-term Investing

Full Title:
World Economic Forum (WEF) (2012), Measurement, Governance and Long-term Investing (WEF, Geneva).

Scope:
Asset owners with some capacity to invest for the long term (e.g. life insurers, pension funds, sovereign wealth funds, endowments, foundations and family offices).

Objectives:
To improve the flow of long-term investments by mitigating obstacles related to measurement and governance.

Key Findings/Conclusions:

The report argues that long-term investment strategies in public and private assets present significant measurement issues. Inaccurate measurement of performance and risk can create substantial distortions, and have long-term implications for portfolio performance.

WEF concludes that the measurement tools currently available are not well suited to assessing long-term investments, and tend to misstate key risks such as market risk, illiquidity risk and liability risk. The traditional metrics for return calculations, such as internal rates of return, cash-on-cash calculations and public market equivalents have drawbacks. Furthermore, the methods of valuing portfolios such as mark-to-market and historical accounting approaches can introduce distortions when assessing long-term investments if their limitations are not understood.

WEF also notes that, as no measurements exist that perfectly balance short-term performance management with a long-term outlook, governance becomes extremely important. It argues that the best long-term investors supplement imperfect metrics with sound judgment by tightly linking measurement and governance frameworks; they encourage stable teams that provide familiarity and a track record of experience with difficult decisions; they have professional boards that provide adequate guidance while sheltering the organization from pro-cyclical pressures; they enforce incentive systems that encourage appropriate risk-taking by staff; and they create brands of being desirable investors, thus accessing expert networks that improve their investment due diligence.

WEF recommends that investors looking to adopt a long-term approach to investment should:

- Commit to a long-term programme and use long-term measurements.
- Focus on a limited number of metrics
- Choose metrics that are directionally correct.
- Adopt a critical perspective, where they periodically reflect on their activities, their processes and performance.
- Encourage stable teams.
- Design a system of rewards and protections for staff to encourage appropriate risk-taking.
- Create or attract a professional board, with a background suited to institutional investment management and with a solid long-term orientation.
- Be a desirable investor, which will help access desirable fund managers and attract talented people.

WEF (2015), The Global Financial System: Policy Recommendations for the Future

Full Title:
World Economic Forum (WEF) (2015), The Global Financial System: Policy Recommendations for the Future (WEF, Geneva).

Objectives:
To provide recommendations on how financial services actors and policymakers to can effectively manage the financial system's growth and rising complexity to ensure sustainable growth and financial stability.

Key Findings/Conclusions:

The report identifies five significant forces that are shaping the future of the global financial system:

- The increasingly important role occupied by emerging markets in the international financial system.
- The redrawing of the boundaries of the financial system as a result of technology, allowing new entrants that fall outside of the traditional domain of policy-making to emerge and fill gaps left by incumbents. These alternative providers of capital, payment platforms and automated investment solutions, among others, have the potential to transform the financial services landscape with possibly significant implications for risk management and systemic stability.
- The regulatory and monetary policies adopted since the financial crisis to better ensure the safety and soundness of the financial system and to support economic growth.
- The loss of trust loss in financial services as a result of the global financial crisis, with poorly designed incentive systems, insufficient risk disclosure, lax corporate governance, weak internal controls and illegal or unethical activities from some market participants all identified as root causes.
- The lack of financial inclusion for more than 2 billion adults globally.

The report argues that the future of the global financial system needs to be considered in the context of these driving forces, noting that sustainable growth and financial stability hinge on the collective efforts of financial services actors and policymakers to effectively manage the system's growth and rising complexity. The aim is to ensure that international financial system of the future will be in a stronger position to fulfil its mandate: connecting financial services providers, corporates, public institutions and households with access to a range of quality, affordable financial products and services that protect customers from risks, enable saving and investment, and supporting the creation of jobs and enterprises through the efficient allocation of credit and capital.

The report offers a series of recommendations including strengthening the governance legitimacy of international institutions that have financial oversight responsibilities (e.g. IMF, World Bank), enabling development banks to build infrastructure and facilitate long-term growth, establishing a global forum for public-private sector dialogue aimed at exploring technology-enabled transformation in financial services, assessing the economic impacts of regulatory reforms, building a culture of trust in the financial industry and implementing the G20 principles for financial inclusion to achieve universal financial access by 2020.

Credits

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The Principles for Responsible Investment (PRI) Initiative

The PRI Initiative is a UN-supported international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

More information: www.unpri.org

PRI Principles for Responsible Investment

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

United Nations Environment Programme Finance Initiative (UNEP FI)

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

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

UN Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

United Nations Global Compact