PRI Principles for Responsible Investment

UNDERSTANDING THE IMPACT OF YOUR INVESTMENTS

MEASURING ENVIRONMENTAL AND SOCIAL PERFORMANCE

UNEP Finance Initiative
Changing finance, financing change

United Nations Global Compact

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

THE SIX PRINCIPLES

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

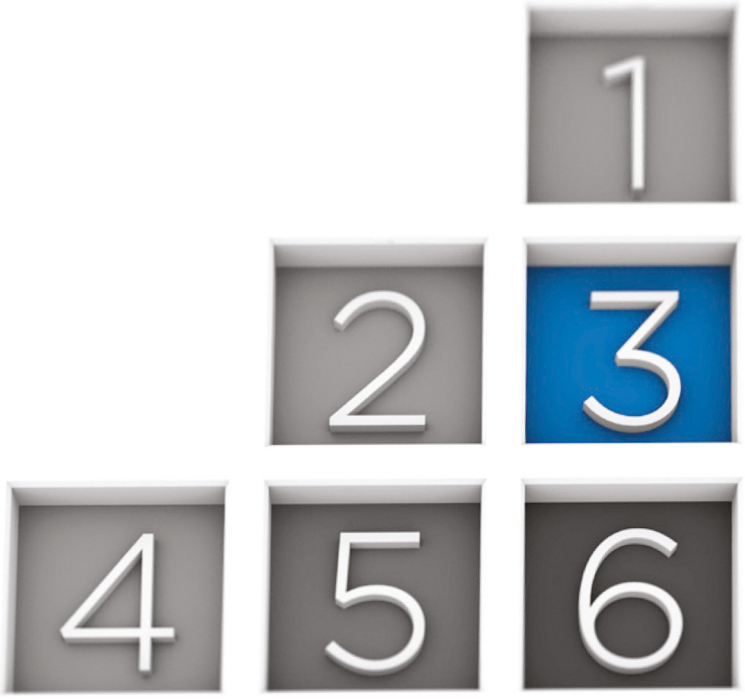
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

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

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

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

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



This publication is intended to promote the application of Principle 3 of the Principles for Responsible Investment (PRI). The PRI Initiative was launched by the United Nations in 2006 after former UN Secretary-General Kofi Annan brought together a group of the world's largest institutional investors, academics and other advisors to draft a set of sustainable investment principles. At the heart of the six Principles for Responsible Investment is the premise that investors have a duty to act in the best long-term interests of their beneficiaries and this means taking into account environmental, social and governance factors.

This document was prepared by the PRI Secretariat with support from the PRI E&S Asset Owner Working Group.

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CONTENTS

This paper provides an introduction to environmental and social impact performance measurement and reporting. It is primarily aimed at investors who are new to this area – particularly those investing indirectly via funds.

The paper first attempts to explain the value in measuring environmental and social performance, what investors should be tracking and some of the publicly available tools and techniques that can help. As a point of comparison, the appendix highlights similarities and differences between these systems and those used for measuring environmental and social risks.

OVERVIEW OF ENVIRONMENTAL AND SOCIAL PERFORMANCE MEASUREMENT

FROM RISK MITIGATION TO IMPACT

Many responsible investors seek information on environmental, social and corporate governance (ESG) performance from the funds and companies in which they invest. From an investment perspective, analysis of ESG issues is required to:

- assess fully the risks and opportunities associated with particular investments;
- help investors make better investment decisions; and
- generate more accurate valuations of businesses.

Understanding ESG issues can help mitigate the risk of potential negative outcomes that can affect a business. For example, fair pay and good working conditions may reduce the risk of high staff turnover and strikes; good water management can help avoid local water contamination and the possibility of associated fines.

Greater investor focus on ESG issues can also lead to a higher quality dialogue between companies and their investors on creating long-term value. It can motivate companies to improve their governance and management, and encourage investors to proactively seek out opportunities presented by these issues. For example, fair pay and good working conditions can result in higher employee productivity and retention; good water management can result in cost savings in times of water scarcity. These actions should help direct capital towards better governed and better managed companies, and towards companies that are better positioned to contribute to the goals of a sustainable society.

"Investors are actively looking to the environmental and social impact that may be felt locally, regionally or even globally".

Some investors are actively looking beyond the positive impact for the company itself to the environmental and

Figure 1: The spectrum of investment approaches.
Source: Adapted from Bridges Ventures (2012)

	Traditional	Screening	ESG integration	Themed	Impact-first	Philanthropy
		Responsible investment		Impact investing		
	Competitive returns			Targeted social and/or environmental impact		
FOCUS	Limited or no focus on ESG factors of underlying investments	Negative or exclusionary screening and positive or best-in-class screening, based on criteria defined in a variety of ways (i.e. by product, activity, sector, international norms.)	The use of qualitative and quantitative ESG information in investment processes, at the portfolio level, by taking into account ESG-related trends, or at the stock, issuer or investee level.	The selection of assets that contribute to addressing sustainability challenges such as climate change or water scarcity.	Environmental or social issues which create investment opportunities with some financial trade-off.	Focus on one or a cluster of issues where social and environmental need requires 100% trade-off.
EXAMPLES		■ Ethically-screened investment fund ■ Best-in-class SRI fund	■ Long-only public equity fund using ESG integration to create additional value	■ Clean energy mutual fund ■ Emerging markets healthcare fund ■ Microfinance structured debt fund	■ Fund providing debt or equity to social enterprise or trading charity	

social impact that may be felt locally, regionally or even globally. Continuing the labour conditions example, beyond understanding the risks of strikes or high workforce turnover, and the opportunities for increased employee productivity and retention, such investors may focus on changes in the standard of living for the workforce. Typically, such investors are investing in environmental and social (E&S) themed areas[1] where the investee companies provide a product or service that is expected to result in environmental or social benefits.

These evolving approaches to incorporating ESG issues in investing are summarised in the previous page (Figure 1).

WHY INVESTORS LOOK AT IMPACT

Investors who make E&S themed investments will want to measure the social and environmental impact of their investments, for a number of good reasons:

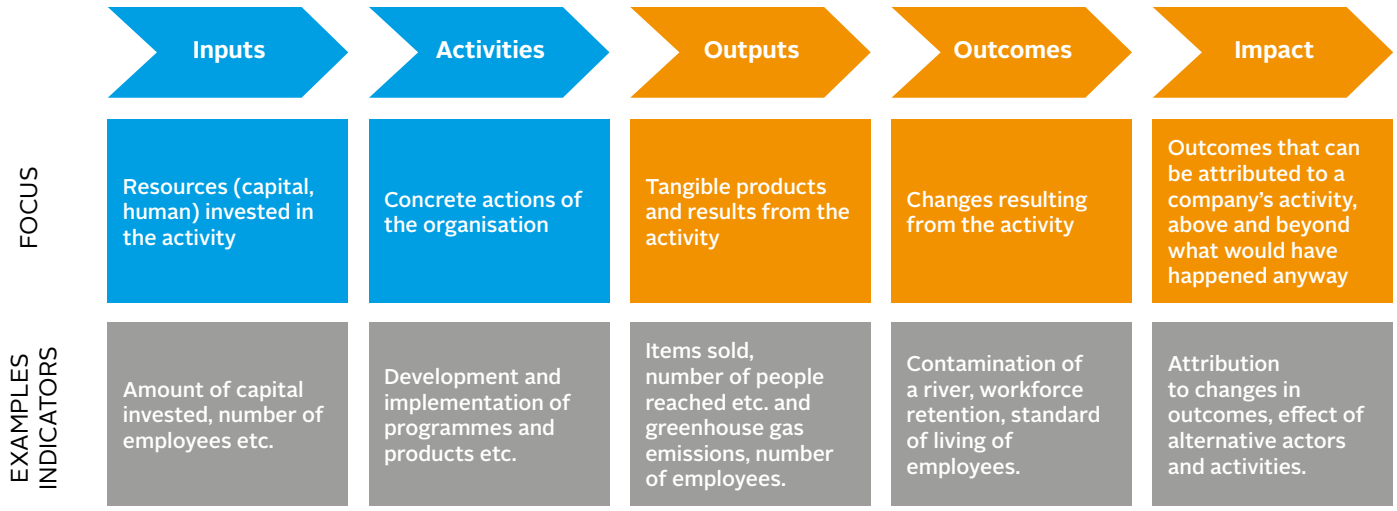
- **To communicate the social or environmental performance of investments to external stakeholders**. For example, investment managers may need to respond to reporting requirements from clients with specific preferences regarding the use of their capital. Asset owners may want to respond to interest and demand from their beneficiaries and external stakeholders.
- **To ensure their funds are not supporting poor practices that could lead to reputational risk**, for example, over-indebtedness among end users of microcredit.
- **To improve the environmental or social impact of their investments**. Measuring impact enables investors to set targets for the companies or funds in which they invest, providing a basis for engagement to improve performance over time.
- **To create positive social or environmental impact as an integral part of their mission**. Such investors may want to evaluate the social and environmental impact of their investments to assess and improve their performance against these objectives.

OUTPUTS, OUTCOMES AND IMPACT

Investors interested in understanding the environmental and social impact of their investments will require additional information from the companies or funds in which they invest. The impact chain shown in Figure 2 below is commonly used to frame the different stages of measuring environmental and social performance, for which data could be collected.

- **Inputs** are the resources, both human and capital, that are invested in the company's activities.

Figure 2: The impact chain.
Source: Adapted from European Venture Philanthropy Association (EVPA) (2013)



1 See PRI's Environmental and Social Themed Investing paper for more information.

- **Activities** relate to the core product or service of the company, or to the company's policies and procedures, such as staff training or water management. Activities lead to *outputs, outcomes* and *impact*.
- **Outputs** are the directly measurable results arising from a company's activities. These could include greenhouse gas emissions, water consumption, number of employees or workplace training programmes.
- **Outcomes** are the ultimate changes in a system, intended and unintended, that result from these outputs. For example, the contamination of a river, workforce retention or an improvement in the standard of living of employees.
- **Impact** is the proportion of the total observed outcome that can be attributed to a company's activity, above and beyond what would have happened anyway. For example, to show an improvement in employees' standard of living would require evidence that this is due to employment with the company and not a result of other factors.

Measuring impact requires counterfactual analysis and is therefore rarely feasible for investors. It is more common to track outputs and outcomes, using indicators that imply rather than prove impact. This is a justifiable way of simplifying the process and making it manageable, particularly where there is evidence that such indicators relate to the desired impact.

"It is more common to track outputs and outcomes, using indicators that imply rather than prove impact."

MOVING TOWARDS STANDARDISATION

Developing environmental and social performance indicators is part of a move from anecdotal or qualitative evidence of impact to readily quantifiable information that allows for performance comparisons and increased accountability. Clear financial reporting guidelines exist for investors to assess and compare the financial performance of companies and funds. This creates a standard – a global language – and enables investors to compare financial performance across sectors and regions. Equivalent standards for the robust measuring of social and environmental performance are still in development. In response, a number of investors have developed their own systems – either in-house or based partly or wholly on emerging industry standards.

Developing systems in-house allows investors to select the indicators relevant to them. It also allows them to compare performance across investments. However, establishing bespoke systems can lead to duplication of reporting and additional costs in the investment chain. It can also be costly and time-consuming to obtain the desired information from companies or funds due to practical difficulties with data availability, collection and quantification. Some level of engagement with companies or funds is likely to be necessary, which can lead to companies and funds feeling burdened by reporting requirements. This is a particular problem if they are asked to report on different indicators to different investors. As a result, investors will have to consider what trade-offs to make between feasibility and credibility.

"Establishing bespoke systems can lead to duplication of reporting and additional costs in the investment chain."

Alternatively, investors may choose to accept the indicators proposed by the company or fund in question, as a cheaper and easier option. Just as investors have developed their own systems in the absence of global standards, many companies and funds have developed their own approach to measuring environmental and social outputs and outcomes. However, social and environmental performance covers a huge range of issues, across different industries and regions. So unless the indicators that different companies and funds use to measure the desired outputs or outcomes are exactly the same the indicators are neither comparable nor interchangeable. So how can investors compare the environmental or social performance of different investments? How can they aggregate this data for management and reporting purposes?

USING STANDARDISED INDICATORS

By providing a standardised approach to measuring environmental and social performance, some publicly available systems have begun to help investors answer these questions.

These can broadly be categorised as either methods or tools[2]. A method is a framework for evaluation that suggests methodological guidelines and process steps. A tool is a well-developed instrument that assesses performance based on fixed indicators.

Methods and tools for measuring environmental and social performance serve two purposes. They can provide a structured measurement and reporting system for individual investee companies or investors. They can also serve as a common language for comparing social and environmental performance.

The **TRASI database**[3] is a fully searchable database of nearly 200 public impact measurement systems developed by the Foundation Center. Users can search by approach (whether it is an assessment or management system, for example), sector and focus (output, outcomes or impact). Many of the systems listed in the database come from the world of grant-making. However, users can also search by the type of organisation to be assessed (for example, NGOs, social enterprises or social investors).

The World Business Council for Sustainable Development and the European Venture Philanthropy Association have both produced guidance documents that can be useful for investors in deciding which systems to use and how these can be applied. See references under 'Further reading'

IRIS[4] is an example of a system that seems to be gaining traction in the industry. It is a tool that companies and investors are using to standardise language around environmental and social impact. By bringing together well-established metrics from a range of sectors including microfinance, affordable housing and education IRIS helps investors in two ways. First, it makes it easier for investors to create informed performance measurement systems. Second, it enables investors to make performance comparisons and communicate results across the industry.

It is not intended that investors apply these systems wholesale. IRIS, for example, provides a large number of indicators with the intention that investors pick and choose among them. Also, many of the public systems are designed for data collection at company or project level, as opposed to fund level. Those investing indirectly through funds are likely to require different levels of information, which raises issues around aggregation and comparability. Few publicly available systems make reference to this.

2 Terminology developed by McKinsey & Co. More resources are available via its Learning for Social Impact programme: http://lsi.mckinsey.com/

3 http://trasi.foundationcenter.org/search.php

4 http://iris.thegiin.org/

CONCLUDING THOUGHTS

Most investors who measure environmental and social performance do so in order to understand and mitigate risk. Some use the information to identify E&S themed investment opportunities. A small number of these, including those investing indirectly via funds, are becoming interested in understanding the impact of these investments.

But there are barriers. Measuring impact, as we have seen, requires systems to collect and aggregate data across a number of funds. This can be both complicated and costly. However, with the development of standard indicators, there are methods and tools emerging that simplify this process for investors.

There remain fundamental questions that the PRI Initiative is exploring with indirect investors:

- How can investors work together to harmonise the indicators used, to reduce the reporting burden for companies and funds and make it easier to compare them?
- Are emerging systems suitable for indirect investors, or do they need different ways to compare the environmental or social impact of funds, or to measure and report against their own impact?

For more information, and to get involved, contact us at:
implementation.support@unpri.org
or follow the discussion on PRI's extranet.

FURTHER READING

- Balandina Jaquier, J. (2012) *Guide to Impact Investing for Family Offices and High Net Worth Individuals*
- Bouri, A (2011) *How standards emerge: The role of investor leadership in realizing the potential of IRIS. In: Innovations. Impact investing special edition*
- Bridges Ventures (2012) *Sustainable & Impact Investment - How we define the market*
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- Double Bottom Line Project (2004) *Assessing social impact in double bottom line ventures: Methods catalogue*
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- FSG & Shell Foundation (2006) *Investing for impact: Managing and measuring proactive social investments*
- Foundation Centre (2012) *Tools and Resources for Assessing Social Impact (TRASI)*. Available online from http://trasi.foundationcenter.org/
- GIIN & IRIS initiative (2011) *Data driven: A performance analysis for the impact investing industry*
- Global Reporting Initiative (2011) *Sustainability Reporting Guidelines version 3.1 including Technical Protocol*
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- The Rockefeller Foundation (2009) *Solutions for impact investors: from strategy to implementation*
- The SROI Network (2012) *A guide to Social Return on Investment*
- TIDES (2011) *Assessing social impacts of investments: Developing effective evaluation systems to measure social returns*
- UN Global Compact & The Rockefeller Foundation (2012) *A framework for action: Social enterprise and impact investing*
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- WBSCD (2013) *Measuring socio-economic impact – A WBCSD guide for business*

APPENDIX 1

INTRODUCTION

Investors may seek information about funds and companies' environmental, social and corporate governance (ESG) activities and performance to assess risks and opportunities. They may also seek such information to understand the wider impact of their investments on the local, regional or global society and environment.

While the reasons for measuring ESG performance may differ, there are similarities in the approach and the metrics used. Both are likely to track the outputs of a company or project. Elements of methods and tools that have been developed to assess ESG risks and opportunities may, therefore, also be of use when it comes to tracking impact performance. Tables A1 and A2 below indicate areas of overlap in the indicators proposed by three commonly-used systems – two that are designed to evaluate ESG risks and opportunities (the Global Reporting Initiative[i] and the KPIs for ESG from the EFFAS Commission on ESG[ii]), and a third that has been designed for impact measurement (the Impact Reporting and Investment Standards). The tables are taken from two sectors – environment and employment and labour practices – where there appears to be a high degree of overlap in the indicators proposed.

There are also fundamental differences between these reporting systems. Responsible investment reporting systems such as the GRI and EFFAS Commission on ESG aim to provide a universal investment reporting framework, and therefore include metrics for all possible sectors. However investors interested in generating positive social or environmental impact tend towards certain sub-sectors or themes, such as affordable housing, renewable energy and health. The latter would seek indicators of outcomes as well as outputs.

i **Global Reporting Initiative (GRI) Guidelines** http://www.globalreporting.org/
Since its creation in 1997, GRI has provided companies and organisations with a comprehensive sustainability reporting framework that is widely used around the world. Currently the third series of reporting guidelines are most commonly in use although the fourth generation of the reporting guidelines was published in May 2013. The guidelines and indicators are intended for general communications and transparency purposes and also include a supplement for reporting specifically by financial institutions.
The third generation reporting framework focuses on four dimensions of sustainability: environment, social, economic, and corporate governance. It includes a core set of metrics that need to be contextualised by a narrative on the management approach. Sector-specific supplements provide a higher level of detail or include information only relevant to particular industries, mainly by including additional indicators.

ii **Key Performance Indicators (KPIs) for ESG, European Federation of Financial Analysts Society (EFFAS) Commission on ESG (CESG)** http://www.effas-esg.com/
A standard indicator framework for environmental, social and governance aspects built to meet the needs of investment professionals. It is not so much a system as a guide that includes a wide variety of indicators, the result of a three-year process which included collaboration with a network of investment professionals and experts. EFFAS provides a reporting standard for companies from all sectors.
The framework includes around 600 indicators divided over a total of 29 topical sustainability areas. Ten of these areas apply to all companies reporting using the guide and include energy, climate change and employee-related issues such as staff turnover, training, and absenteeism, as well as corruption. The other areas are sector-specific and include more environmental indicators. The indicators are grouped based on the Dow Jones Industry Classification Benchmark and are banded in three grades of difficulty, referring to the level of detail and difficulty of data collection. The indicators are focused on outputs, and consist of both key performance narratives, qualitative statements on certain dimensions of sustainability and KPIs which are based on quantitative information.

TABLE A1 - METRICS FOR A SELECTION OF ENVIRONMENTAL CATEGORIES

	EFFAS KPIS FOR ESG		GLOBAL REPORTING INITIATIVE (GRI)		IMPACT REPORTING AND INVESTMENT STANDARDS (IRIS)	
ENERGY	E01-01	total energy consumption	EN3	direct energy consumption by primary energy source	OI8825	amount of purchased energy consumed
			EN4	indirect energy consumption by primary energy source	*OI3224* *OI1496*	*amount from renewable resources* *amount from non-renewable resources*
			EN6	initiatives to provide energy-efficient or renewable energy based products and services, and reductions in energy requirements as a result of these initiatives	OI9624 *OI2496* *OI1495*	amount of on-site energy produced and consumed *amount from renewable resources* *amount from non-renewable resources*
			EN5	energy saved due to conservation and efficiency improvements	**OI6697**	**energy conservation achieved through reducing the amount of energy needed to carry out the same processes or tasks**
			EN7	**initiatives to reduce indirect energy consumption and reductions achieved**		
CLIMATE CHANGE	E02-01	greenhouse gas emissions, total (scope 1 and 2)	EN16	total direct and indirect greenhouse gas emissions by weight	OI1479	greenhouse gases emitted through organisation's operations in tonnes of CO_2 equivalent
	E11-01	total number of EUA on hand at the end of the reporting period	EN17	other indirect greenhouse gas emissions by weight	*OI4112* *OI9604*	*amount from direct emissions sources* *amount from indirect emissions sources*
	E11-02	total income (expenditure) on emission right traded (emission rights bought) as a percentage of revenue	EN18	initiatives to reduce greenhouse gas emissions and reductions achieved		

	EFFAS KPIS FOR ESG		GLOBAL REPORTING INITIATIVE (GRI)		IMPACT REPORTING AND INVESTMENT STANDARDS (IRIS)	
SOLID WASTE	E04-01	waste scope I: total waste in tonnes	EN22	total weight of waste by type and disposal method	**OI6709**	**amount of waste created by the organisation's operations**
	E05-01	waste scope II: percentage of total waste which is recycled	**EN23**	**weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention, and percentage of transported waste shipped internationally**	*OI1346*	*amount of hazardous waste*
	E06-01	waste scope III: hazardous waste total in tonnes			*OI7442*	*amount of non-hazardous waste*
	E07-01	waste scope IV: top 2 components of waste incl. Emissions to soil by environmental importance (according to TRI; PRTR; and EPER) rank 1			OI6192	amount of waste disposed by the organisation
					OI9847	*through composting*
					OI2535	*through recycling/ reusing*
					OI8357	*through incineration*
					OI4483	*through landfill*
					OI8843	*through other means*
	E07-02	waste scope IV: top 2 components of waste incl. Emissions to soil by environmental importance (according to TRI; PRTR; and EPER) rank 2			OI7920	waste reductions achieved during through programs for substitution, recycling or recovery

TABLE A2 METRICS FOR EMPLOYMENT AND LABOUR PRACTICES

EFFAS KPIS FOR ESG		GLOBAL REPORTING INITIATIVE (GRI)		IMPACT REPORTING AND INVESTMENT STANDARDS (IRIS)	
S03-01	maturity of workforce: age structure/ distribution (number of FTEs per age group, 10-year intervals)	LA 1	total workforce by employment type, employment contract, and region	OI8869	total number of permanent employees (incl female, minority, previously excluded, disabled)
S10-01	percentage of female employees in relation to total employees			OI8266	number of employees, including full-time and part-time, but not temporary, that reside in low income areas
S10-02	percentage of female FTEs in senior positions in relation to total FTEs in senior positions				
S10-03	percentage of total FTEs from ethnic minority groups				
S17-01	*local staff: average percentage of FTE in non-domestic production and exploration sites hired from respective non-domestic labour markets as of total FTE* (oil & gas sector only)				
S01-01	staff turnover: percentage of FTEs leaving/ total FTEs	LA 2	total number and rate of employee turnover by age group, gender, and region	OI4499	total number of full-time and part-time employees departing the organisation
		LA 3	benefits provided to full-time employees that are not provided to temporary or part-time employees	OI4061	number of full-time employees who received healthcare benefits
S04-02	total number of injuries divided by total number of hours worked by FTEs	LA 7	rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region	OI3757	number of occupational injuries which affected any full-time, part-time or temporary employee
S04-04	total number of injuries in relation to FTEs				
S02-02	training and qualification: average expenses on training per FTE	LA 10	average hours of training per year per employee by employee category	OI4229	number of employees that were trained through programs provided by the organisation, both internally and externally
		LA 11	percentage of employees receiving regular performance and career development reviews	OI7390	costs incurred by the organisation as a result of training provided to employees
S08-01	total amount of bonuses, stock options and incentives paid out			OI9677	value of wages (including bonuses) paid to all full-time and part-time employees
S08-02	total number of employees that receive 90% of total amount of bonuses etc				

EFFAS KPIS FOR ESG		GLOBAL REPORTING INITIATIVE (GRI)		IMPACT REPORTING AND INVESTMENT STANDARDS (IRIS)	
S09-02	total spending in monetary terms on maintenance and safety of productions sites, plants etc	LA 8	education, training, counseling, prevention, and risk-control programs in place		
		LA 14	ratio of basic salary of men to women by employee category	OI1582	wage equity: wages of highest paid employee/ wages of lowest paid employee

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
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UN Global Compact

Launched in 2000, the United Nations Global Compact is a both a policy platform and a 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 10 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