EIRiS Experts in Responsible Investment Solutions

The State of Responsible Business in 2008: Implications for PRI signatories

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The state of responsible business 2008: Implications for PRI Signatories

An EIRIS report

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With thanks to Josh Brewer, Jennifer MacCarthy, Stephen Hine and Nadia Laine `

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The EIRIS Foundation is a charity that supports and encourages responsible investment. It promotes research into the social and ethical aspects of companies and provides other charities with information and advice to enable them to choose investments which do not conflict with their objectives. The Foundation funds specific projects to achieve these charitable aims.

EIRIS Ltd is a non-profit, independent research organisation which has been conducting environmental, social and governance (ESG) research on publicly listed companies for nearly 25 years. EIRIS Ltd provides research on corporate ESG and other ethical performance indicators to more than 100 institutional investors. It is a wholly-owned subsidiary of the EIRIS Foundation.

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Executive Summary

This report explores the key environmental, social and governance (ESG) risks and opportunities identified by the UN Global Compact of human rights, labour standards in the supply chain, environment and anti-corruption. The analysis indicates that the majority of companies are exposed to significant risks on these issues. Of those exposed to **high risk**[1], only a minority are acting to significantly mitigate those risks; 80% of companies in the FTSE All World Developed index face significant unmanaged ESG risks.

On all issues, some companies perform well, particularly on environmental issues. However, if companies are to keep pace with the climate change agenda increasingly being set by scientists and politicians, then the global corporate response on climate change needs to improve significantly. Only 10% of **very high** and **high impact** companies have adopted a **good** response to climate change[2]. Less than 10% of **high risk** companies have adopted **good** practices to manage human rights and labour standards in the supply chain, and only 10% of **high risk** companies manage their bribery risks to a **good** standard.

As well as highlighting areas of significant unmitigated ESG risk, the research shows that disclosure levels are generally not good enough for investors to be clear about the risks they face, or what companies are doing to manage their risks. In addition, examples of good practice are available on all issues; demonstrating that it is possible to mitigate risks on each of the issues covered by the UN Global Compact.

There is a growing body of evidence that effective management of ESG issues reduces the long term risk of investments. Furthermore, unmanaged ESG issues pose risks for investors as they have the potential to impact share value. As a result, EIRIS recommends that investors should integrate analysis of ESG risks into their existing investment strategy[3].

The United Nations Principles for Responsible Investment (PRI) promotes the incorporation of ESG factors into investment risk analysis. Complimenting the UN Global Compact, the PRI is a highly successful initiative for raising the profile of ESG issues amongst investors. Investors managing USD 15 trillion have now signed up to the PRI. It includes a commitment by investors to incorporate ESG factors into their investment analysis, and enables investors to share knowledge and develop effective engagement approaches. This report provides guidance to assist signatory investors to meet the challenges of the first three principles of the PRI, relating to integration of ESG into investment analysis, active ownership of investments and engagement to improve corporate ESG disclosure.

PRI signatories continue to face challenges in successfully meeting their commitments to the Principles. In order to facilitate effective implementation of the PRI, EIRIS has developed a toolkit consisting of three products designed to assist investors with integration, engagement and improving corporate ESG disclosure.

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[1] All companies are assigned a risk indicator based on the nature and location of their operations. Further details are available in Section 2.2.

[2] Companies are graded on a five point scale for all issues (**advanced**; **good**; **intermediate**; **limited**; **no evidence**). Further details are available in Section 2.2.

[3] EIRIS is a leading global provider of independent research into the environmental, social and governance (ESG) performance of companies, providing extra-financial information on approximately 3,000 companies worldwide.

Key findings

Human rights	
Unmitigated risks	Around a quarter of companies face high exposure to risk yet only 5% of those companies have adopted a **good** or **advanced** management response. The response is particularly poor amongst North American and Asian companies.
Disclosure levels	2% of **high risk** companies demonstrate **good** disclosure. Disclosure is strongest amongst resource companies, although even in this sector less than 10% demonstrate **good** disclosure.
Best Practice	Resource companies face the greatest risk on this issue, and demonstrate the strongest response. The only companies that have adopted **advanced** responses are in the resource sector.

Labour standards in the supply chain	
Unmitigated risks	A majority of companies have not mitigated the risk of labour rights abuses in their supply chains. Less than 20% of **high risk** companies have developed a **good** or **advanced** response to manage their labour rights risks. In addition, 17% of **high risk** companies face allegations of breaches of international conventions on labour rights in their supply chains and 75% of these companies have not fully addressed the allegations. Mobile telecommunications companies demonstrate particularly poor management of the issue.
Disclosure levels	Only 2.5% of **high risk** companies demonstrate **good** reporting levels. Although reporting is comparatively strong in Europe, the gap between response and reporting is notable amongst European companies - 26% of **high risk** companies have developed a **good** response yet only 7% demonstrate **good** reporting.
Best Practice	Only apparel companies have adopted an **advanced** response to their supply chain risks. This may be a result of pressure from external stakeholders.

Environment	
Unmitigated risks	The response to manage environmental issues is stronger than the response to other issues, partly because this has been an issue for companies over a longer period of time. Over 50% of **high impact** companies demonstrate a **good** management response. However, numerous companies face unmitigated environmental risks particularly in North America and Asia ex-Japan.
Disclosure levels	Less than 5% of **high impact** companies in Australia/New Zealand, North America and Asia ex-Japan demonstrate **good** disclosure. Disclosure in Asia ex-Japan is lowest; almost nine out of ten companies show no evidence of reporting.
Best Practice	Over 60% of **high impact** Japanese companies and 40% of **high impact** European companies have developed a **good** response. 30% of the companies adopting a **good** response also demonstrate **good** disclosure.

Climate change	
Unmitigated risks	**Very high impact** sectors account for over half of global greenhouse gas emissions either directly or through product emissions. Only 10% of **very high** and **high impact** companies have adopted a **good** or **advanced** response.
Disclosure levels	A quarter of **high** and **very high impact** companies demonstrate **good** disclosure. This high disclosure rate has been achieved partly through reporting initiatives such as the Carbon Disclosure Project (CDP).
Best Practice	As with other environmental issues, best practice examples can predominantly be found amongst Japanese and European companies.

Bribery and corruption	
Unmitigated risks	10% of **high risk** companies demonstrate a **good** response to managing their bribery risks. Companies across all sectors and countries are exposed to significant unmitigated risks.
Disclosure levels	Disclosure levels are very poor. Less than 1% of **high risk** companies demonstrate **good** disclosure.
Best Practice	Large companies are more likely to adopt a **good** response. The 10% of companies that have adopted a **good** response represent 21% of the market capitalisation of the companies in the index.

Based on the results of EIRIS' research, the following recommendations aim to assist investors considering ESG issues.

Recommendation 1 – Integrating ESG risk into your investment strategy

Investors need to identify clearly any areas they regard as unmanaged risks and decide how to incorporate that into their valuation models. This recommendation is relevant for all investors as links between ESG and shareholder value are increasingly widely recognised.

Investors should be looking to exploit opportunities as well as manage risks. It is easier to exploit opportunities on environment due to the relative wider availability of quality data and the proportion of companies that perform well. Less data is available on social issues, making integration more challenging.

EIRIS identifies companies that face multiple unmanaged risks and those facing unaddressed allegations on Global Compact issues as those most exposed to risk on these issues. A larger proportion of companies face unaddressed Convention Watch allegations on social issues[4].

Recommendation 2 – Engaging to improve company performance

A substantial proportion of companies have failed to mitigate their ESG risks, providing plenty of scope for engagement. Good practice examples exist which can be used on all issues to demonstrate to under-performing companies, particularly sector laggards, how to adopt a stronger management response.

Different strategies will be effective in different circumstances:

- Investors should adopt different strategies for companies that have left key risks unmanaged and those that some room for improvement.
- In the case of unaddressed Convention Watch allegations, where companies are already under the media spotlight, investors need to be clear about their expectations.
- In sectors where the carbon price alone is not sufficient to motivate action on climate change, concerned investors should encourage companies to adopt an improved response as a matter of corporate responsibility.

Primarily, engagement is undertaken with companies. Engagement with other key stakeholders such as governments or affected communities may enable investors to better identify the issues and achieve improvements in company performance.

Recommendation 3 – Seeking better corporate disclosure

Reporting lags behind performance on all UN Global Compact issues except climate change. Investors should be aware of where disclosure is weak in their portfolios. Where necessary they need to make clear that ESG data is increasingly important to them and that improved levels of disclosure helps them understand corporate risk exposure and performance on these issues.

A number of approaches may be taken:

- Engagement work can be linked with governance work or around annual meetings, or the issue may be tackled by sector or country.
- Investors may want to promote reporting initiatives such as the Global Reporting Initiative (GRI) and the Carbon Disclosure Project (CDP).
- EIRIS data can be used to identify companies with good management responses but poor disclosure of performance. Investors should advise such companies that they may be missing an opportunity to spread good news about their ESG performance.

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[4] The EIRIS Convention Watch service tracks allegations of breaches of UN conventions. Further details are available in Section 2.2

Recommendation 4 – Supporting the PRI

For those who have not signed, EIRIS recommends careful consideration of the benefits and obligations. The PRI offers asset managers a chance to be seen to be serious about these issues, and there is much practical support and exchange of expertise available from PRI itself. There are also other products and services, such as those offered by EIRIS, that are designed to lower the barrier to entry into this field.

For asset owners it is a chance to join with others in promoting this agenda and a place to meet asset managers who share a commitment to these issues.

For those who have signed, the challenge is to implement and make good use of the PRI. The EIRIS PRI toolkit has been developed for investors exploring opportunities to effectively meet their obligations under the PRI.

Collectively the challenge is to contribute to significantly improving the overall level of corporate performance in these areas in ways that increase long term shareholder value. EIRIS believes that this can be achieved if enough investors support the process.

1. Introduction

1.1. The Principles for Responsible Investment (PRI)

Launched in April 2006, the United Nations Principles for Responsible Investment (UN PRI) is an investor initiative undertaken in partnership with the United Nations Environment Programme Finance Initiative (UNEP FI) and the United Nations Global Compact. The Principles were designed to align the goals of institutional investors with the sustainable development objectives of the United Nations, in particular, addressing issues covered by the UN Global Compact of human rights, labour standards in the supply chain, environment and anti-corruption. The PRI has succeeded in drawing support from the investment community. Upon launch 20 mainstream institutional asset owners signed up, representing USD 2 trillion in assets under management[5]. As of September 2008, the value of assets managed by the signatories to the PRI exceeded USD 15 trillion[6].

The PRI, heralded as "*the global benchmark for responsible investing*" by UN Secretary-General Ban Ki-moon[7], comprise six principles (See Box 1), and reflects the values of a group of large institutional investors whose investment horizon is generally long term, and whose portfolios are often highly diversified. The principles are open to both asset owners and investment managers. The goal of the PRI is to help investors integrate consideration of environmental, social and governance (ESG) issues into decision making and ownership practices, and thereby both improve long term returns and encourage sustainable business practices.

Box 1: The Principles for Responsible Investment

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.

The PRI initiative has been effective in a number of ways. It has established a common framework for addressing ESG risks in investment and provided a global collaborative forum for investors to work together and share knowledge and resources to take action on ESG issues. Based on the UN Global Compact principles in the areas of human rights, labour standards in the supply chain, environment and anti-corruption, the Principles highlight the main issues facing responsible investors today.

1.2. Meeting PRI commitments

In signing up to the PRI, investors commit to incorporating ESG analysis into their investment decision making processes. Adopting a strategy that incorporates ESG issues can be complex. There is no single approach or model for incorporating ESG factors into investment decisions. The concept of integration itself remains difficult to define and implement as the term encapsulates different practices for different investment managers. In recognition of this

[5] www.unpri.org/media/PRI_media_release_29-04-07.php
[6] www.unpri.org
[7] www.unpri.org/files/pri.pdf

challenge the UN PRI Report on Progress 2008[8] states that *"Principle 1 of the PRI, which focuses on incorporating ESG issues into investment analysis and decision making, was ranked the most difficult to implement"*. Possible approaches to integration and incorporation are offered in the Recommendations section of this report.

This report analyses the extent to which companies are managing their ESG risks and explores opportunities for investors to incorporate those issues into their investment analysis. The data charts companies' progress in managing and reporting on ESG issues. It demonstrates to investors the ways in which companies are currently performing and highlights the range and scope of information that is available to them. The report also identifies the existence of leaders and laggards on a range of ESG issues to assist with the engagement process.

Box 2: Key questions for responsible investors and PRI signatories

1. As signatories to a voluntary and aspirational scheme, what can asset owners and investment managers do to promote the main goal of the PRI: to embed the idea of sustainability into investment management and encourage better corporate environmental, social and governance (ESG) practices?
2. How effectively are companies disclosing the ESG information that investors need?
3. Where are the opportunities to engage on company performance and disclosure on ESG issues? Which sectors and regions should investors target with their engagement efforts?

1.3. Financial implications of incorporating environmental, social and governance (ESG) issues

It is difficult to evaluate reliably the impact that ESG criteria have on investment returns, however a growing body of evidence suggests that ESG issues potentially have a material impact on stock price.

According to a 2007 Mercer report, 'Demystifying Responsible Investment Performance', *"a constant barrier to the widespread acceptance of responsible investment has been the misconception that it automatically translates to underperformance. The common school of thought is that a limited investment universe, as a result of a screening approach, entails a performance penalty"* [9]. The paper reviews 20 academic studies that examine the relationship between ESG factors and portfolio performance, finding a positive association in 50% of the studies, a neutral association in 35% and a negative association in 15%.

Increasing numbers of investors now argue that incorporating ESG factors in investment analysis has the potential to improve returns. There is certainly a strong argument that ignoring these factors, many of which have direct and indirect financial implications, can expose investors to greater risk and therefore be detrimental to the value of shareholdings. Companies failing to manage their ESG risks leave themselves open to reputational damage, as well as regulatory fines and legislation, and in the case of carbon emissions, possible higher operating costs. Conversely, companies taking advantage of ESG opportunities can deliver improved performance.

Incorporating ESG issues into investment analysis does not have to compromise financial performance. This means that investors can mitigate ESG risks without compromising their fiduciary duty. Freshfields, Bruckhaus, Deringer conclude in a UNEP FI report of 2005 that rather than preventing the integration of ESG considerations, the law permits and in certain

[8] www.unpri.org/report08
[9] www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf

circumstances requires that this be done[10]. The current instability within the financial sector demonstrates the potential impact of failing to adequately disclose and manage certain hidden or misunderstood risks. Given the potentially damaging implications, ignoring ESG risks is no longer compatible with a prudent approach to investment.

The current turmoil in the financial markets demonstrates the potential impacts of not managing risk effectively. Donald MacDonald, chairman of the UN PRI, is optimistic that the current credit crisis could prompt more sustainable market practices. He said recently:

> *"I think the increasing support for the PRI shows that investors in general have taken a long hard look at the credit crunch, and some of the practices that caused it, and decided they can benefit from more comprehensive analysis of investment risk, one which incorporates environmental, social and governance issues into decision making and ownership practices. The tough environment for investors has increased interest in responsible investment as a driver of long-term value."*

[10] www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

2. The State of Responsible Business

2.1. The ESG issues covered in this report

This report focuses on the issues identified by the Global Compact. UN Secretary-General Ban Ki-moon introduces the PRI by stating that:

> *"The Principles complement the UN Global Compact, which asks companies to embed in their strategies and operations a set of universal principles in the areas of human rights, labour standards, the environment and anti-corruption."*

The Global Compact's ten principles in the areas of human rights, labour, the environment and anti-corruption are derived from the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and the United Nations Convention Against Corruption (see Box 3)[11].

Box 3: The UN Global Compact Principles

The Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption:

Human rights

1 Businesses should support and respect the protection of internationally proclaimed human rights; and
2 Make sure that they are not complicit in human rights abuses.

Labour standards

3 Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
4 The elimination of all forms of forced and compulsory labour;
5 The effective abolition of child labour; and
6 The elimination of discrimination in respect of employment and occupation.

Environment

7 Businesses should support a precautionary approach to environmental challenges;
8 Undertake initiatives to promote greater environmental responsibility; and
9 Encourage the development and diffusion of environmentally friendly technologies.

Anti-corruption

10 Businesses should work against corruption in all its forms, including extortion and bribery.

These conventions and international agreements encapsulate some of the most significant ESG issues facing business today. For investors who have yet to examine ESG information as part of their analysis and decision making process, these criteria form a solid starting point. For those that already incorporate ESG information into their investment processes, these topics should be considered as the key issues.

This paper covers analysis of EIRIS research on these issues. The analysis also includes a specific section on climate change, despite the fact that it is not covered by the UN Global Compact.

[11] www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html

2.2. EIRIS research

EIRIS is a leading global provider of quality independent research into the environmental, social and governance (ESG) performance of companies. EIRIS provides research on corporate ESG and other performance indicators for approximately 3,000 companies worldwide. The research covers over 60 topics, including numerous environmental, employee and stakeholder issues. Information is updated from company reports and websites, third party sources and any additional information provided by companies. Company assessments are updated on an ongoing basis, with companies being contacted annually.

The data contained within this report relates to all companies covered by EIRIS in the FTSE All-World Developed index (2344 companies)[12]. All figures are based on information extracted from the EIRIS databases as of 15th September 2008.

All issues contained within this report are researched according to four criteria: risk exposure, policy, systems and reporting[13].

For each area EIRIS assigns a risk or impact indicator based on company exposure to the issues. This indicator reflects the type and location of companies' operations (details are provided under each section). Only **high risk** companies are analysed in this paper. As a result sample sizes vary from issue to issue (see Table 1).

Table 1: Risk exposure of companies covered in this paper

	high risk	**medium risk**	**low risk**
Human rights	525 22%	701 30%	1118 48%
Supply chain*	240 35%	149 22%	296 43%
Environment	827 35%	1042 45%	475 20%
Climate change	647** 27%	302 13%	1396 60%
Bribery and corruption	649 28%	1139 49%	556 24%

* % figures show percentage of companies in relevant sectors.
** Includes **high** and **very high impact**.

Policy criteria examine the extent and coverage of the policy adopted on each issue. The criteria include indicators such as senior responsibility, target setting, and integration with wider processes.

Systems criteria examine the systems in place to implement the policies, including indicators such as communication mechanisms, monitoring and auditing systems, training, and risk assessment procedures.

The reporting criteria examine the extent to which information has been made publicly available, including whether the company has published quantitative performance information for key issues, performance against targets, and violations, fines and legal cases.

For more information on the criteria please contact EIRIS.

12 The Index rules are available at www.ftse.com/Indices/FTSE_All_World_Index_Series/index.jsp
13 Climate change is researched according to risk exposure, response and reporting.

In this report, policy and systems criteria have been grouped together as 'response', so that all companies can be easily compared for their management response and reporting practices. Response grades are determined by assigning a combination of the policy and system grades.

Trends are reported by market capitalisation, region and industry sector. Market capitalisation data is provided by FTSE[14], regional allocation is determined by the country of incorporation and sector classification follows Industry Classification Benchmark (ICB) industry sector classifications[15].

Advanced corresponds to best practice and **good** to good practice. **Intermediate** indicates that the company is taking some meaningful steps to manage some of its risks on the issue. To meet **limited** levels, companies must demonstrate a commitment to at least one of the indicators in the criteria (typically, each EIRIS criterion consists of 20+ indicators). An **intermediate** or **limited** grade should not be interpreted to mean that a company is adequately managing its risks or demonstrating adequate levels of disclosure.

Convention Watch

The EIRIS Convention Watch service[16] tracks allegations of breaches of international conventions in relation to human rights, controversial weapons, environmental biodiversity, bribery, the ILO core labour standards and other key standards, including working hours and health and safety. All areas cover owned operations and some also examine the supply chain. Companies are notified that EIRIS holds such an allegation on its database and are invited to respond before publication of the allegations. Those companies that do not adequately respond are deemed to have left these risks as unaddressed and therefore face significant exposure to future allegations. Companies with unaddressed Convention Watch allegations are amongst those at highest risk and therefore present significant opportunities for engagement. Allegations are examined and details provided for each area, with the exception of climate change.

[14] Not publicly available
[15] www.icbenchmark.com/docs/English_Structure_Defs.pdf
[16] www.eiris.org/files/marketing%20leaflets/conventionwatchbriefingpaper.pdf

2.3. The EIRIS PRI toolkit

Recognising the challenges that committing to the UN Principles for Responsible Investment represents for investment managers and asset owners, EIRIS has developed a range of products that offer practical solutions for investors looking to implement the UN PRI, and in particular Principles 1, 2 and 3.

The toolkit is based on the issues covered by the UN Global Compact of human rights, labour standards, environment and anti-corruption. The toolkit incorporates Company's levels of risk exposure to each issue as well as company response and disclosure.

EIRisk

The EIRisk tool assigns companies an ESG risk management grade that can be integrated into investment analysis and decision making processes. It helps investors meet their commitments under Principle 1 of the PRI. The tool:

- identifies ESG risk levels with regard to the principles of the UN Global Compact
- scores companies based on risk exposure and management response, making it easy for investors to identify companies that have not mitigated their risks and therefore pose a greater investment risk.

Global Compact Engager

The Global Compact Engager provides investors with the resources they need to engage with companies and meet their commitments under Principle 2 of the PRI. The tool:

- helps investors set priorities for their engagement strategy
- highlights laggards as potential cases for engagement
- highlights leaders which can be used as good practice examples during engagement.
- allows users to generate detailed reports highlighting the strengths and weaknesses of the company which are useful in engagement meetings.

Report Monitor

The Report Monitor focuses exclusively on companies' reporting practices to assist signatories to encourage better corporate ESG disclosure, and meet their commitments under Principle 3 of the PRI. The tool:

- identifies leaders and laggards on ESG reporting
- grades companies on the quality of their reporting practices, incorporating the risk exposure to each ESG issue, taking into account its sector, activities and regional presence.

2.4. Human rights

While governments have the primary legal responsibility to promote and protect human rights, businesses are also recognised as having responsibility, particularly in relation to the conduct and influence of their own operations. Increasingly, investors are assessing global companies for evidence of compliance with standards of fundamental human rights as recognised in the Universal Declaration of Human Rights (UDHR) and related international conventions. Companies face potential damage to their reputation and brand if they are accused of being complicit in the violation of human rights standards. For both investor and company the risk is greatest if that company operates in a **high risk** country without mitigating those risks.

Some investors avoid investment in countries with poor human rights records. However, investors who own companies operating in emerging markets may choose to incorporate human rights risks into the investment analysis. EIRIS research covers both risk exposure and management response to human rights standards in owned operations. For some investors an engagement approach suits their strategy better than a country screening approach; EIRIS' products and services can be used to support both of these approaches.

Both the UN Global Compact Principles and EIRIS criteria correspond with the standards laid out in the core International Labour Organisation (ILO) labour standards. These state that businesses should uphold freedom of association and the effective recognition of the right to collective bargaining, and eliminate all forms of forced and compulsory labour, child labour and discrimination with respect to employment and occupation.

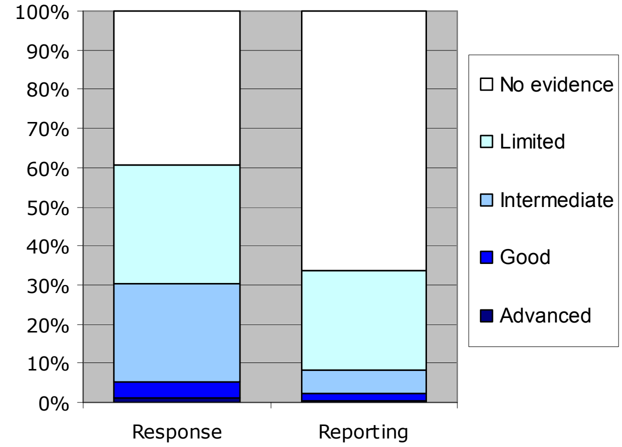
EIRIS human rights risk exposure definition
The EIRIS list of countries of concern for human rights abuses comprises 41 countries. Companies operating in these countries are identified as **high risk** for human rights if they are considered to have large operations in those countries, either by turnover or number of employees. Following the risk exposure analysis, companies are assessed against policy, systems and reporting criteria. Because of its particularly high exposure to risk, the oil, gas and mining sector is a focus of special analysis by EIRIS for human rights. This includes an evaluation of whether the company has policies in place with respect to armed guards and indigenous peoples' rights.

Key findings
Companies have been slow to adopt policies and systems to address their human rights risks. Although awareness and action on the issue has increased, a large proportion of companies continue to face exposure to significant levels of unmitigated risk.

At present only 5% of **high risk** companies in the FTSE All World Developed Index have adopted a **good** or **advanced** response. 30% have adopted a policy that covers all Core ILO labour conventions. Reporting on human rights issues is also poor; only 2% of companies demonstrate **good** disclosure mechanisms and over two thirds demonstrate little or no disclosure (see Figure 1).

6% of **high risk** companies in the FTSE All World Developed Index face allegations of breaches of international conventions on labour rights issues in their operations. 80% of these companies have not fully addressed the allegations.

Figure 1: Response and reporting on human rights issues for High risk companies



Differences by market capitalisation.

- Large companies are more likely to have stronger risk management policies in place. 5% of **high risk** companies have adopted a **good** response to human rights issues, representing 14% of the value of **high risk** companies in the index. 2% demonstrate **good** reporting mechanisms, representing 8% of the value of the index.
- Smaller companies have fewer resources to dedicate to managing ESG risks, and face less pressure from stakeholders to address the issues. However there are some examples of smaller companies that have developed a management response to address these risks.

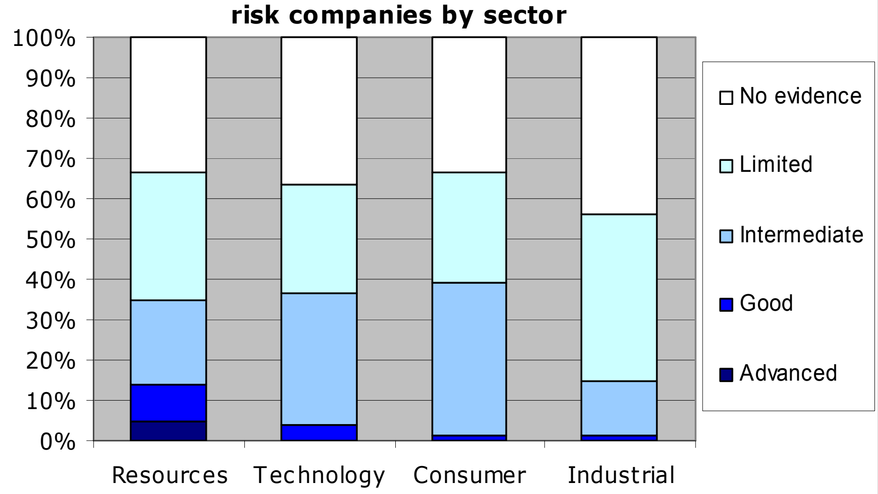
Regional differences

- Companies in Europe and Australia/New Zealand perform comparatively well, although even in these regions less than 30% of companies have adopted **good** practices.
- Only one company in North America and no companies in Asia (including Japan) have met this standard.
- Reporting is weak globally, although strongest in Australia/New Zealand, where there is a large proportion of resource companies.

Sector differences

- The companies facing highest risk on human rights are large resource companies. The response is also greatest amongst large resource companies; of the five companies that have adopted an **advanced** response, all are large resource companies.
- These five companies represent only 7% of all large resource companies covered in this report. The majority of resource companies must improve their human rights risk management practices is they are to effectively manage their human rights risks.
- 14% of resource companies have adopted a **good** or **advanced** response compared to 4% of technology companies and 1% of industrial and consumer companies (see Figure 2).

Figure 2: Response on human rights issues by High risk companies by sector



- Reporting is poor across all sectors. In all sectors over 85% of companies have not produced a report that meets **intermediate** levels.

Implications for investors

- Investors face significant exposure to human rights risks. Around a quarter of all companies in the FTSE All World Developed Index are classified as having high exposure to risk and only 5% of **high risk** companies have adopted a **good** or **advanced** response.
- Opportunities exist to engage with companies in all sectors, notably in the resource sector where, despite strong performance relative to other sectors, the majority of companies face unmanaged risks of human rights abuses in their operations. Best practice examples in Europe and Australia/New Zealand could be used to encourage laggards in other regions.
- The EIRisk tool highlights companies that have been accused of breaching international norms or conventions on human rights and other issues, and those that are most at risk of breaches because they have not addressed key ESG risks. The EIRisk tool helps investors identify leaders and laggards in terms of risk management practices, as well as highlighting significant areas of risk. For more information on the EIRIS PRI toolkit, see section 4.

2.5. Labour standards in the supply chain

Due to the increasingly globalised nature of production and trade, a growing number of products are assembled or processed by suppliers across the world. Working conditions within global supply chains now constitute a key issue for companies. Companies may be exposed to labour abuses in the supply chain, which may be detrimental to their reputation and therefore pose significant risks for both company and investor. An increasing proportion of companies now understand and address the issues and a number are taking steps to improve suppliers' labour practices.

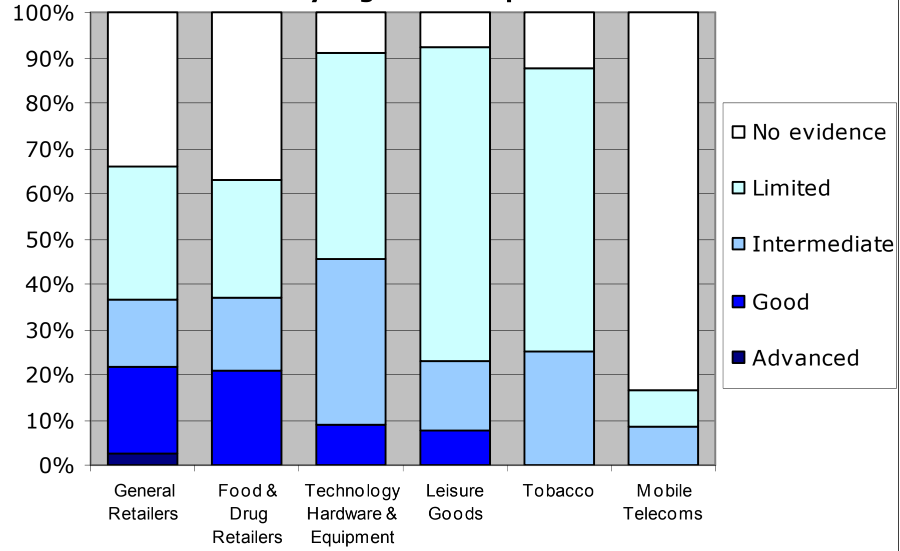
The EIRIS labour standards criteria correspond with both the UN Global Compact Principles and the core ILO labour standards. These state that businesses should uphold freedom of association and the effective recognition of the right to collective bargaining and eliminate all forms of forced and compulsory labour, child labour and discrimination with respect to employment and occupation.

EIRIS supply chain risk exposure definition
Companies sourcing high risk products from third party suppliers in high risk countries are considered to be **high risk**. High risk products identified by EIRIS include agricultural crops, consumer products (such as apparel) and consumer electronics. Over 70% of companies in the Mobile telecommunications, tobacco, food & drug retailers and general retailers sectors are classified as high risk on this issue. Once assessed as high risk companies are analysed using policy, systems and reporting criteria.

Key findings

The majority of companies are failing to manage their risks of supply chain labour standards abuses. Less than 20% of **high risk** companies have implemented a **good** or **advanced** response to manage their labour standards risks in their supply chain. Two thirds have either **no evidence** of managing their risks or a **limited** response.

Figure 3: Management response to supply chain issues by High risk companies



17% of **high risk** companies face allegations of breaches of international conventions on supply chain labour rights issues. Although 25% of these companies have addressed the allegations, this demonstrates that a large number of companies have yet to mitigate their risks of labour rights abuses in their supply chain.

Figure 3 shows the assessment of policies and systems adopted by companies in sectors exposed to particularly **high risk**. The stronger response amongst general retailers and food and drug retailers sectors may be a result of the pressure they have faced from NGOs and other stakeholders to improve supply chain policies and practices. The worst offenders are mobile telecommunications companies, where only one in ten companies has adopted a policy covering all core ILO labour standards and eight out of ten have not adopted any kind of response to manage these risks.

Reporting is at very low levels. Only 2.5% of companies demonstrate **good** reporting levels.

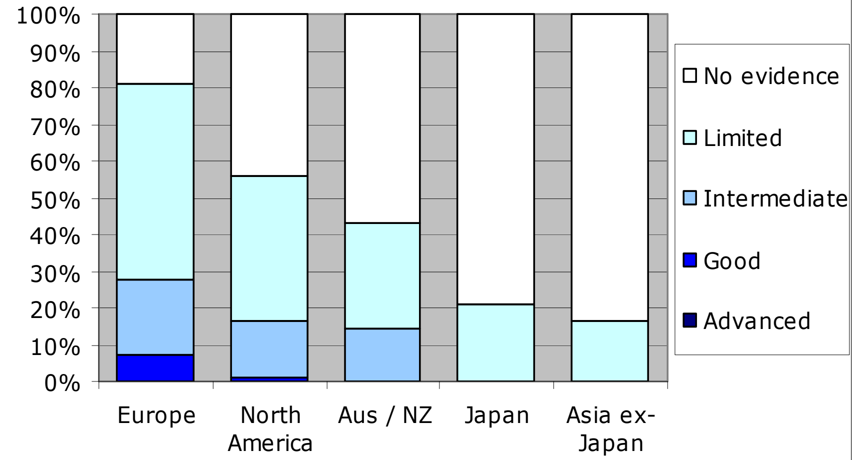
Differences by Market Capitalisation.

- As with human rights issues, large companies are more likely to have stronger risk management policies in place. 17% of companies have adopted a **good** or **advanced** response, representing 26% of the value of these companies by market capitalisation.
- Unmanaged risks are more prevalent amongst smaller companies. 66% of companies, representing 43% of the value of the index, have not developed a response beyond a **limited** standard.

Regional Differences

- European companies outperform companies in other regions. 60% have developed policies that meet all the core ILO labour standards, compared with 30% in North America.
- Awareness remains low in Asia (including Japan): less than 10% of **high risk** companies meet this level. Investments in Asia ex-Japan face increasing risk to reputation, particularly as NGO activity and demand for transparency increase globally.
- Disclosure is weak globally, but particularly so amongst Asian companies, where no companies have yet produced a report reaching an **intermediate** level (See Figure 4).

Figure 4: Regional reporting on supply chain issues by High risk companies



Sector Differences

- General retailers and food and drug retailers are most likely to demonstrate a **good** response (c.20%), however a large proportion do not demonstrate any response (c.40%), suggesting that there are clear leaders and laggards in these sectors.
- Mobile telecommunications companies demonstrate an exceptionally poor response to the issue. None demonstrate a **good** response and over 80% show little or no evidence of any response. These are high profile consumer products that are vulnerable to activities such as boycotts and therefore represent a significant risk to investors.

Implications for investors

- Investors face significant risk of exposure to allegations of labour rights abuses in the supply chain. 17% of **high risk** companies face allegations of breaches of international conventions on supply chain labour rights issues and 75% of these companies have failed to fully address the allegations.
- The range of performance in certain sectors, particularly general retailers and food and drug retailers, indicates opportunities to engage with laggards using various best practice examples. Significant opportunities exist to engage with the mobile telecommunications and tobacco sectors, where no companies have demonstrated a **good** commitment to address this issue.
- The EIRIS Global Compact Engager tool, designed specifically for PRI signatories, identifies companies that represent a significant risk to investors due to high profile allegations of breaches of labour rights in their supply chains. Investors can engage with companies to improve their management response on this issue.
- Both the EIRisk and the Global Compact Engager tool can help investors identify companies that have good risk management policies and systems in place. These examples of good practice can be useful when engaging with weaker performing companies.

2.6. Environmental issues

Climate change has been the most high profile environmental issue in recent years. However, public concern about other issues of environmental degradation, such as the use of hazardous chemicals, local pollution and water availability has also grown in recent years. Regulatory measures have increased both in frequency and scope, notably in Europe. These include WEEE (Waste Electronic and Electrical Equipment Directive) and REACH (Registration, Evaluation, Authorisation and Restriction of Chemical substances) which came into force in 2007 and RoHS (the Restriction of Hazardous Substances Directive), in 2006. There has also been a steady expansion in the number of companies seeking to actively manage their environmental impacts and disclose their performance.

Companies that operate in high environmental impact sectors (e.g. the extractive industries, air transport, agriculture, manufacturing, chemicals and pharmaceuticals) face a greater risk of damaging the environment, often stringent regulatory requirements, and significant pressure from stakeholder groups to both manage and report on their environmental impacts and strategy. As a result they present greater risks for investors in cases where they have not addressed their impacts.

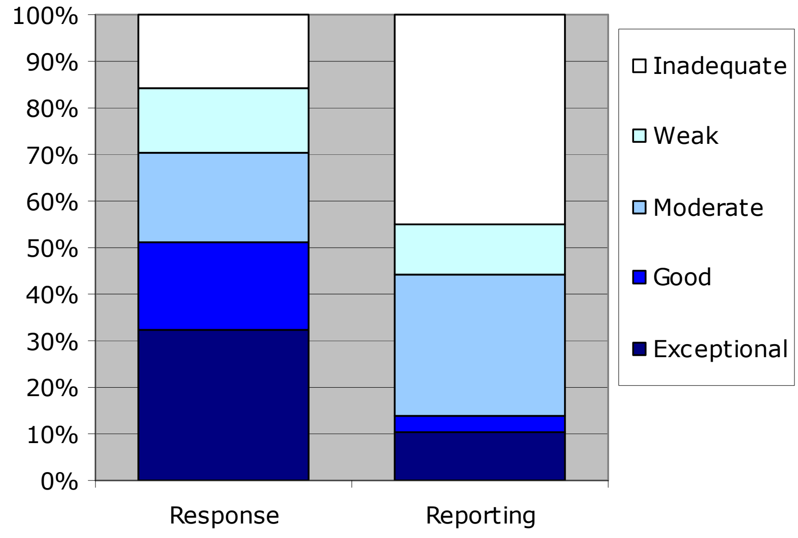
EIRIS environmental impact classification

Companies are assessed as **high**, **medium** or **low impact** based on the direct and indirect impacts of their business operations. Following the impact analysis, companies are assessed against policy, systems and reporting criteria. EIRIS also assesses companies on a range of other environmental issues, such as environmental performance, biodiversity, chemicals of concern and product stewardship.

Key findings

The management response to environmental issues is stronger than in other areas researched. There are a number of reasons for this: the issue of environmental stewardship is more tangible for executives to understand and value; companies can implement technical solutions; emissions and resource usage are quantifiable; and impacts are felt locally. In contrast labour rights violations often occur on the other side of the world and performance is harder to measure and report quantitatively. With stricter environmental regulation being introduced and carbon trading markets being established companies face a financial incentive, increasingly a requirement, to address their impacts on the environment.

Figure 5: Management response and reporting on environmental issues by High impact companies



Over half of **high impact** companies have developed a **good** or **advanced** response (see Figure 5). However, the majority of companies worldwide have yet to demonstrate comprehensive, good quality disclosure against all of their key environmental issues, including publishing quantitative performance data.

4% of **high impact** companies face allegations of a breach of the Convention on Biological Diversity, and 89% of these companies have not fully addressed those allegations.

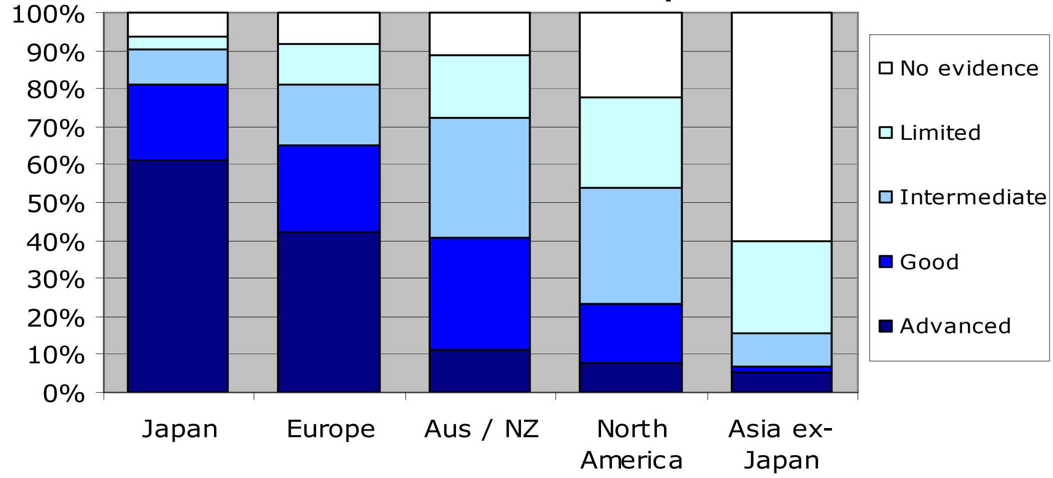
Differences by market capitalisation.

- Large companies by market capitalisation are likely to have managed their risks more comprehensively than smaller companies. Of the **high impact** companies in the FTSE All World Developed Index 52% have adopted a **good** or **advanced** response to manage their environmental risks, representing 63% of the value of **high impact** companies in the index.
- Large companies are also more likely to report on these issues. 14% of companies demonstrate **good** or **advanced** reporting mechanisms, representing 27% of the value of the corresponding companies in the index.

Regional differences

- Japanese and European companies are most likely to have adopted an environmental policy and management system. Over 80% and 60% of companies in these regions respectively have adopted a **good** or **advanced** response (see Figure 6).

Figure 6: Regional response by High impact companies to address environmental impacts



- The strong performance of Japanese and European companies may be linked to stronger regulatory frameworks in these two regions. Strong performance by European companies may also be driven by a number of additional factors including pressure from NGOs, civil society and investors.
- The performance of North American and Asian companies is particularly worrying. Regulation is weaker in these areas and commonly the approach taken is to meet legal standards rather than strive for best practice.

Industry sector differences

- There are few differences by industry in terms of overall performance. In all industry sectors between 45% and 55% of **high impact** companies have adopted **good** or **advanced** policies or systems.

Implications for investors

- A strong response across all sectors on the environment relative to other ESG issues enables PRI signatories to more easily incorporate environmental issues into investment analysis without severely restricting the investment universe.
- The gap between response and reporting highlights numerous opportunities to engage with companies to improve disclosure. Investors may be able to persuade companies that are addressing their environmental risks well that in order to improve investor perceptions of their environmental practices they need to improve their disclosure mechanisms.
- The EIRIS Report Monitor tool assesses companies' reporting practices across a broad range of ESG issues that mirror the ten principles of the UN Global Compact. The rating framework incorporates the materiality of each issue for the companies assessed, and the results generated highlight leaders and laggards.

2.7. Climate change

Environmental, Social and Governance (ESG) issues are usually associated with long term risk. However, carbon emissions will have significant financial implications for companies over the short term as the introduction and expansion of carbon cap and trade mechanisms has put a 'price on carbon'. Although the EU Emissions Trading Scheme only covers companies with a significant impact on the environment, the UK government plans to implement a cap and trade system for non-energy intensive industries in the form of the Carbon Reduction Commitment.

Climate change has the potential to impact shareholder value significantly. The Carbon Trust recently estimated that companies in the aluminium and automobile sectors could see their value decrease by up to 65% if they fail to prepare adequately for the transition to a low carbon economy. Conversely, companies in other sectors such as building could boost valuations by up to 80%[17].

This section examines those companies at risk of negative impacts as a result of climate change because of (a) high exposure to the issue and (b) a lack of well established management practices and reporting mechanisms. Following an impact assessment, companies are assessed against response and reporting criteria.

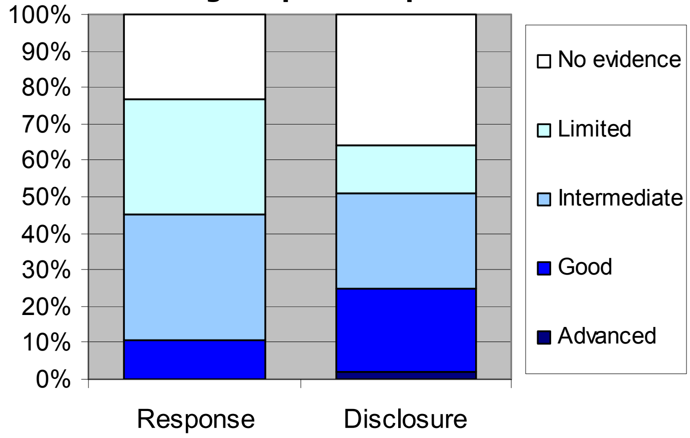
EIRIS climate change impact classification

All companies face exposure to risk as a result of climate change, whether through direct risks from the company's operations and products, or from risks associated with climate change impacts. EIRIS has classified 27% of companies in the FTSE All World Developed Index as **very high** or **high impact** for climate change as a result of their operations. These companies represent USD 7.9 trillion market capitalisation. EIRIS has calculated that **very high impact** companies account for over half of global greenhouse gas emissions, either directly or via product emissions.

Key findings

Globally, no companies have developed an **advanced** response to managing their climate change risks. Approximately one in ten **very high** and **high impact** companies have developed a **good** response. One in four have not developed a **limited** response (See figure 7). Despite the fact that these are **high impact** companies, over 50% have not adequately addressed these risks and 25% face significant unmitigated risks. A higher proportion of companies have developed **good** disclosure mechanisms (25%), although a larger proportion have failed to develop even a **limited** reporting mechanism (36%).

Figure 7: Response and reporting on climate change issues by Very High and High impact companies



Strong reporting amongst a subset of companies has been achieved partly through reporting initiatives such as the Carbon Disclosure Project (CDP). In 2008 CDP's annual Information Request was supported by over 385 international institutional investors, with USD 57 trillion in assets under management. Over 1,600 companies globally disclosed data via CDP 6 (2008)[18].

If companies are to keep pace with the agenda increasingly being set by scientists and politicians on climate change then the global response needs to improve significantly,

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[17] www.responsible-investor.com/home/article/carbon_trust
[18] www.cdproject.net/responding-companies.asp

particularly amongst **very high** and **high impact** companies. Disclosure is insufficient to allow investors and other stakeholders to accurately assess company performance. Much improvement is required in both the corporate response and levels of reporting on the issue of climate change.

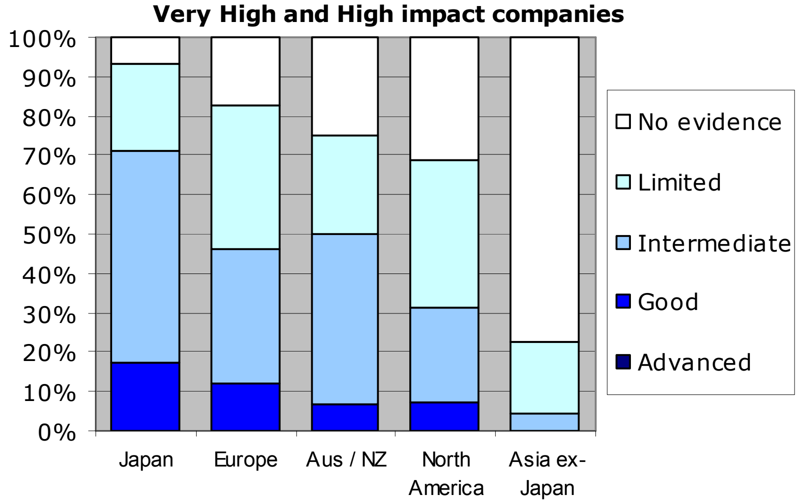
Differences by market capitalisation.

- Large companies are more likely to demonstrate a **good** response and disclosure than small and medium-sized companies. The 11% of **high** and **very high impact** companies which have developed a **good** management response represent 18% of the overall market capitalisation. The 25% of companies which demonstrate **good** reporting mechanisms represent 37% of the overall market capitalisation.

Regional differences

- The response is strongest in Japan and Europe, where 17% and 12% of companies respectively have developed a **good** response (see Figure 8).
- Companies in Asia ex-Japan score particularly poorly. Nearly 95% of companies have not developed a response to the issue beyond a **limited** standard.
- The response is very poor in North America given the scale of emissions in the region. Less than 10% of companies have adopted a **good** response and over two thirds have significant unmitigated risks.
- Reporting is strongest in Japan, where companies tend to produce high quality environmental reports. In Japan 33% of companies demonstrate **good** disclosure, compared with 28% in Europe, 18% in North America and 5% in Asia ex-Japan.

Figure 8: Regional response to Climate Change by Very High and High impact companies



Industry sector differences

- Industrials are most exposed to risk; over two thirds have either **limited** or **no evidence** of a response to climate change and only 6% have adopted a **good** response.
- Resource companies are most likely to produce a **good** level of reporting. Almost 33% demonstrate **good** disclosure compared with 20% of consumer companies and 16% of industrial companies. Resource companies may be more likely to report information because they are included in the EU Emission Trading Scheme (EU ETS) and face considerable pressure from various stakeholders to report on their environmental impacts.

Implications for investors

- There are significant numbers of companies (30% of market capitalisation) assessed as **high** or **very high impact** that show **no** or **limited** evidence of a management response. These companies are not dealing with key climate change risks, leaving shareholder value open to risk. It is important that investors understand these risks and integrate them into their investment approach.
- EIRIS has developed a suite of climate change products to help investment managers and asset owners measure the carbon performance of their funds, assess the carbon risk factor of companies in their portfolio or investment universe, and analyse companies' management response to the challenges and opportunities of climate change. For more information see EIRIS' recent report on climate change[19].

[19] www.eiris.org/files/research%20publications/climatechange08.pdf

2.8. Bribery and corruption

Tackling corruption was added to the UN Global Compact in June 2004. Corruption is an obstacle to sustainable development, impedes economic growth, distorts competition and poses serious legal and reputational risks to companies. It has been estimated that bribery and corruption add 10% to the costs of doing business in many parts of the world. The World Bank has estimated that "bribery has become a USD 1 trillion industry".[20]

Legal prosecutions relating to bribery and corruption are increasing globally. As a result companies are subject to ever greater pressure for transparency and ethical conduct, and face significant legal, financial and reputational risks related to bribery and corrupt practices. Increasing numbers of companies have internal controls and corporate governance standards that incorporate ethics standards.

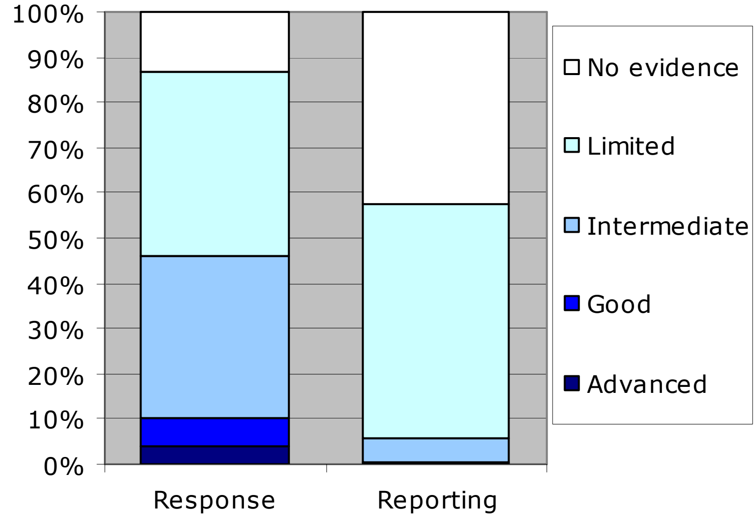
EIRIS bribery risk exposure definition

Companies operating in high risk sectors involving government contracts in high risk countries are classified by EIRIS as **high risk**. Sectors considered to be high risk include public works/construction, property development, defence, oil gas & mining, steel & chemicals, energy & utilities, and IT & telecommunications. High risk countries have been identified using Transparency International's Corruption Perception Index and the World Bank's Governance Indicators. Following the risk exposure analysis, companies are assessed against policy, systems and reporting criteria.

Key findings

Over 85% of companies in the FTSE All World Developed Index have adopted at least **limited** standards to address bribery. These require companies to demonstrate minimal steps to address bribery issues such as requiring employees to obey local laws and regulations. However the majority fall short of an adequate response; only 10% have adopted **good** practices (see Figure 9). Disclosure lags further behind; less than 1% of companies demonstrate **good** disclosure and only 5% meet **intermediate** levels. To meet **intermediate** reporting levels, companies must publish at least some information relating to performance against this issue. It may be the case that some companies are reluctant to publish performance data as admitting that the company is exposed to bribery issues may have serious legal and reputational implications.

Figure 9: Response and reporting on bribery practices by High risk companies



2% of companies face allegations of breaching the anti-bribery principles contained in the UN Convention against Corruption. Of those companies, over two thirds have not fully addressed the allegations.

Although company response and reporting on the issue is low at present, attempts to address the issue at a company level are relatively recent and improvements should be expected.

[20] www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/anti-corruption.html

Differences by market capitalisation.

- As with other criteria, large companies are more likely to have adopted a stronger response and more likely to have developed better reporting mechanisms. In this case 10% of **high risk** companies have developed a **good** or **advanced** response to managing bribery, representing 21% of the market capitalisation.

Regional differences

- In the USA the Sarbanes-Oxley Act requires all companies to make their code of business conduct publicly available. In all cases, the code incorporates information pertaining to bribery and corruption issues, albeit only to a **limited** level in nearly 50% of companies. Only 5% meet **good** or **advanced** standards, demonstrating that the majority of companies are meeting legal requirements but not yet meeting best practice (see Figure 10).
- Companies in Asia ex-Japan lag notably behind. Less than a third of companies have adopted **limited** practices and none score better than **intermediate**.
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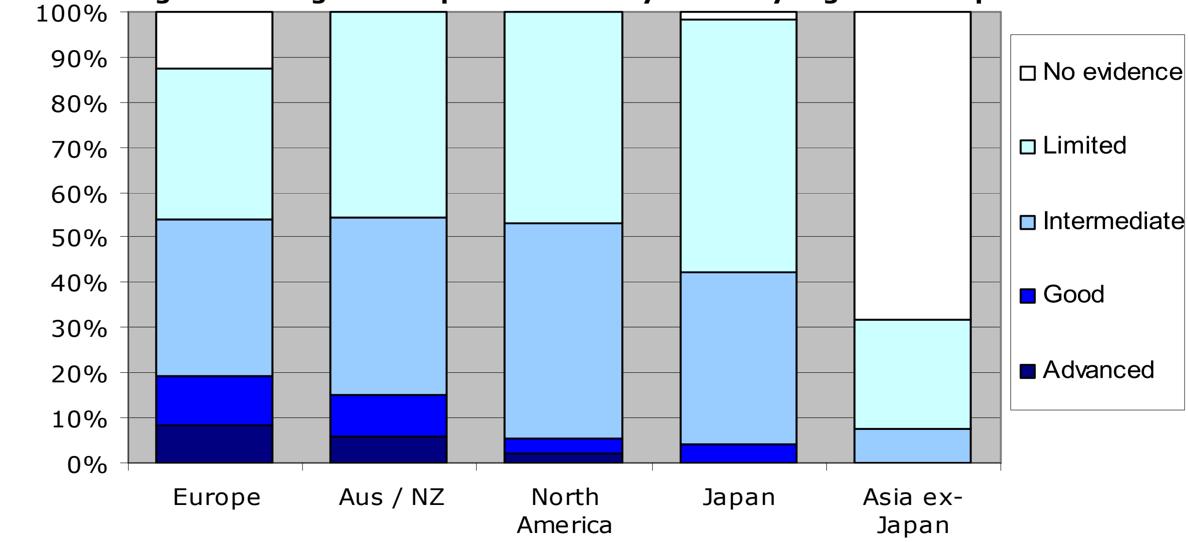
Figure 10: Regional response to bribery issues by High risk companies



Sector differences

- Companies in the health, technology and resource sectors are most likely to have managed bribery risks well. Over 10% of companies in these sectors have adopted **good** or **advanced** practices.
- Real Estate companies fall significantly behind other sectors. Only 2% have adopted **good** practices and 63% demonstrate **no evidence** of any response to the issue. Reporting is even worse; 75% of Real Estate companies demonstrate **no evidence** of disclosure on bribery issues.

Implications for investors

- Investors face significant exposure to bribery issues. Over a quarter of all companies in the FTSE All World Developed Index are classified as having high exposure to risk and only 10% of **high risk** companies have adopted a **good** or **advanced** response.
- Reporting is at a particularly low level for bribery issues; less than 1% of companies demonstrate **good** disclosure. Investors should engage with companies to improve reporting practices on this issue, whilst bearing in mind the sensitivities that companies may have about reporting on this issue.
- EIRIS UN Global Compact Engager is designed to assist investors wishing to pursue an engagement strategy, and meet their commitments under Principle 3 of the PRI. Investors wishing to engage specifically on bribery issues may also do so using EIRIS data.

3. Recommendations

According to research carried out by EIRIS 80% of companies in the FTSE All World Developed index face significant unmanaged Environmental, Social and Governance (ESG) risks[21]. For human rights, climate change and bribery, over 90% of companies that have a high exposure to risk are failing to adequately manage those risks. Reporting lags significantly behind management response on all issues covered here, with the exception of climate change. For human rights, labour standards in the supply chain and bribery, less than 5% of companies facing high exposure to risk demonstrate **good** reporting.

ESG issues pose significant risks for investors as, when not well managed, they have the potential to impact share value. The current turmoil on the global financial markets demonstrates the potential impact of underestimating risk. Taking climate change as an example, the 2006 Stern Report warns that ignoring the potential risks of climate change will be significantly more damaging to the economy than taking action now.

Incorporating ESG issues into investment analysis does not have to compromise financial performance and, therefore, fiduciary duty. In fact, increasing numbers of investors now argue that incorporating ESG factors in investment analysis has the potential to improve financial returns. Freshfields, Bruckhaus, Deringer conclude in a 2005 UNEP FI report that, rather than prohibiting the integration of ESG considerations, the law permits and in certain circumstances, requires that this be done[22].

Those investors that are signatories to the PRI have a duty under Principles 1-3 to incorporate ESG issues into their investment approach. A range of strategies is available to investors to do this. EIRIS products and services enable investors to meet their ESG analysis commitments.

Below are a set of recommendations that EIRIS believes should apply to all investors but particularly to those that have signed up to the PRI.

Recommendation 1

Integrating ESG risk into your investment strategy

Investors need to identify clearly any areas they regard as unmanaged risks and decide how to incorporate that into their valuation models. This recommendation is relevant for all investors as links between ESG and shareholder value are increasingly widely recognised.

Examples of investment approaches that incorporate ESG issues include positive screening, exclusions, norms-based screening based on breaches of international conventions, best-in-class, engagement and integration into traditional investment analysis. These practices are rarely performed in isolation; such strategies usually involve a combination of approaches.

Investors should be looking to exploit opportunities as well as manage risks. It is easier to exploit opportunities on environment due to the relative wider availability of quality data and the proportion of companies that perform well. Less data is available on social issues, making integration more challenging. Given the growing awareness that climate change will cost investors more later if not tackled now, EIRIS recommends that investors make the way companies are tackling this issue part of their perception of the value of the stock for the most exposed sectors.

EIRIS considers companies that face multiple unmanaged risks and those facing unaddressed allegations on Global Compact issues to be those most exposed to risk on these issues. The EIRisk product identifies such companies. A larger proportion of companies face unaddressed Convention Watch allegations on social issues.

[21] Figure calculated using the EIRisk tool
[22] www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

Recommendation 2

Engaging to improve company performance

A substantial proportion of companies have failed to mitigate their ESG risks, providing plenty of scope for engagement. Good practice examples exist which can be used on all issues to demonstrate to underperforming companies, particularly sector laggards, how to adopt a stronger management response.

Different strategies will be effective in different circumstances:

- Investors should adopt different strategies for companies that have left key risks unmanaged and those that have some room for improvement.
- In the case of unaddressed Convention Watch allegations, where companies are already under the media spotlight, investors need to be clear about their expectations.
- In sectors where the carbon price alone is not sufficient to motivate action on climate change, concerned investors should encourage companies to adopt an improved response as a matter of corporate responsibility.

Primarily, engagement is undertaken with companies. Engagement with other key stakeholders is important as it may enable investors to better identify the issues and encourage improvements in company performance. For example, engagement with affected communities can clarify the extent of potential risks facing a particular project. There is some evidence that better regulatory frameworks lead to stronger company ESG performance, so investors may wish to lobby governments to improve the regulatory environment.

EIRIS research shows that large companies are more likely to have stronger ESG risk management practices in place. Smaller companies have fewer resources to dedicate to managing ESG risks and face less pressure from stakeholders to address these issues. Despite this, there are some examples of good practice by small and medium-sized companies. It is important that these examples are recognised as they may be more appropriate to encourage the take up of good practice amongst similarly sized companies.

The EIRIS UNGC Engager tool enables investors to identify which companies it may be most productive to engage with.

Recommendation 3

Seeking better corporate disclosure

Reporting lags behind performance on all UN Global Compact issues except climate change. Investors should be aware of where disclosure is weak in their portfolios. Where necessary they need to make clear that ESG data is increasingly important to them and that improved levels of disclosure helps them understand corporate risk exposure and performance on these issues.

Information exists for investors to incorporate ESG issues into their investment decisions. However, if investors are to understand the risks that may be involved and the steps that companies are taking to mitigate those risks, then disclosure levels need to improve. There is significant scope for improvements in both the levels of disclosure and the quality and consistency of information provided.

A number of approaches may be taken:

- Engagement work can be linked with governance work or around annual meetings, or the issue may be tackled by sector or country.
- Investors may want to promote reporting initiatives such as the Global Reporting Initiative (GRI) and the Carbon Disclosure Project (CDP). These have been highly influential in achieving higher volumes and quality of data reported.

- EIRIS data can be used to identify companies with good management responses but poor disclosure of performance. Investors should advise such companies that they may be missing an opportunity to spread good news about their ESG performance.

The EIRIS Report Monitor product is designed to support investors seeking to engage with companies on ESG reporting issues. The Monitor identifies the leaders and laggards on reporting company performance against the UN Global Compact Principles.

<u>Recommendation 4</u>

Supporting the PRI

For those who have not signed, EIRIS recommends careful consideration of the benefits and obligations. The PRI offers asset managers a chance to be seen to be serious about these issues, and there is much practical support and exchange of expertise available from PRI itself. There are also other products and services, such as those offered by EIRIS, that are designed to lower the barrier to entry into this field.

Asset managers who have not signed up to the PRI might lose current or potential business as a growing number of asset owners are using it as a factor to evaluate and hire investment managers. For example, under proposals by the UK Conservative Party, UK pensions managers would be required to incorporate ESG issues into their investment policy statements[23]. Other examples include the French state pension fund and the UK Environment Agency's pension fund, both of whom have sought investment managers that are signatories to the PRI[24].

For asset owners it is a chance to join with others in promoting this agenda and a place to meet asset managers who share a commitment to these issues.

For those who have signed, the challenge is to implement and make good use of the PRI. For those exploring opportunities to effectively meet their obligations under the PRI, EIRIS recommends its PRI toolkit.

The PRI in Practice facilitates information sharing and the PRI Engagement Clearinghouse, an online forum for signatory collaboration, allows investors to post ideas for collaboration or conduct exploratory dialogue about issues of concern. For example, on October 27th 2008, a group of 52 PRI signatory investors collaborated to launch an initiative calling on almost 9,000 listed companies to sign international standards on human rights, the environment and anti-corruption[25]. In addition, in October 2008 the PRI merged with the Enhanced Analytics Initiative (EAI)[26], an association of investors and brokers that promotes the inclusion of extra-financial factors into company and sector research. The merger will enhance the PRI's capacity to prompt signatories to integrate ESG factors into the investment process.

Collectively the challenge is to contribute to significantly improving the overall level of corporate performance in these areas in ways that increase long term shareholder value. Although challenging, this can be achieved if enough investors support the process. EIRIS believes that the global reach of the Principles and their success in attracting high level support makes PRI one of the most exciting developments in our 25 year history.

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[23] www.responsible-investor.com/home/article/pada/
[24] www.responsible-investor.com/home/article/uk_environment_agency_awards_185m_in_ri_mandates/; www.responsible-investor.com/home/article/frr1/
[25] www.unpri.org/files/prfinalef2610.pdf
[26] www.unpri.org/files/2008-10-06%20press%20release_final.pdf

4. The EIRIS PRI Toolkit

The EIRIS PRI toolkit consists of three products specifically designed to assist PRI signatories with several aspects of the PRI including integration, engagement, and improving corporate ESG reporting practices. For further information on the PRI toolkit please contact EIRIS.

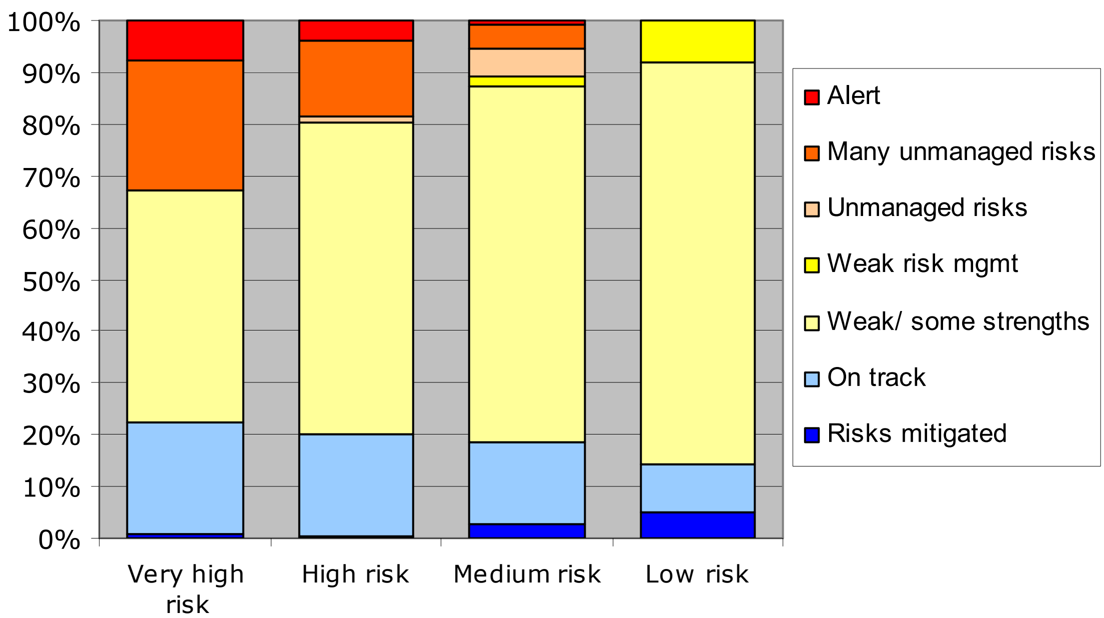
3.1. EIRisk

The EIRisk tool assigns companies an ESG risk management grade that can be integrated into investment analysis, helping investors meet their commitments under Principle 1 of the PRI. Based on the ESG issues encapsulated by the UN Global Compact, it categorises companies into different levels of risk, according to risk exposure and management response, making it easy for investors to identify leaders and laggards, as well as Alert cases (companies that have been subject to high profile allegations of breaches of international conventions). It can also be used to rank companies in specific sectors and identify best and worst in class companies.

The EIRisk rating includes a risk exposure assessment, identifying whether companies are **very high**, **high**, **medium** or **low risk** on UN Global Compact issues, taking into account their sector, business activities and regional presence. The rating also assesses companies' management response using a seven point scale, from 'Risks mitigated', to 'Alert'. Users can also access detailed reports outlining company performance on relevant issues.

Figure 11 shows the proportion of companies that are mitigating their risks and the proportion that face unmitigated risks. Overall, one fifth of companies are taking significant steps to mitigating their risks; three in five demonstrate weak risk management, although many of these also demonstrate some strengths; and one fifth face unmanaged risks. A higher proportion of **very high** and **high risk** companies are exposed to unmitigated risks, in part because they have to meet higher standards to achieve positive ratings. This reflects the greater potential risk these companies pose to investors.

Figure 11: EIRisk Results by overall risk exposure



3.2. Global Compact Engager

The Global Compact Engager provides investors with the resources they need to engage with companies and meet their commitments under Principle 2 of the PRI. The tool highlights laggards (companies that have demonstrated poor ESG risk mitigation practices) as potential cases for engagement. It also highlights leaders, which can be used as good practice examples during engagement.

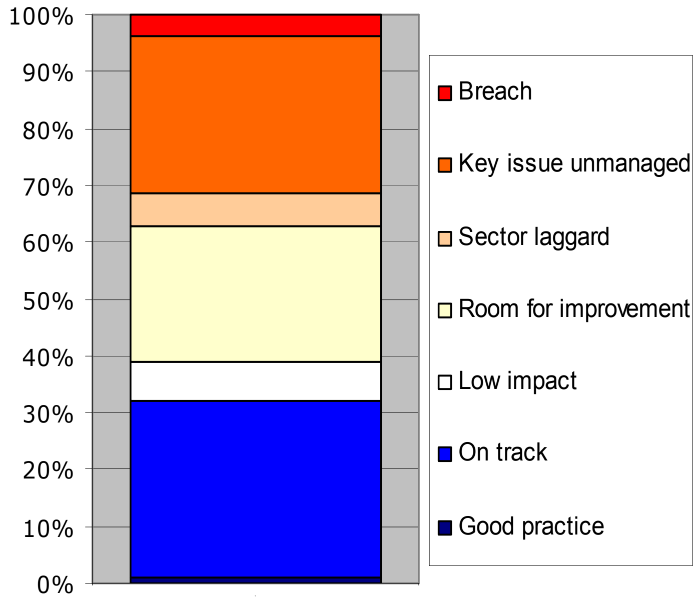
As well as providing an indication of the company's overall response (e.g. 'On track', 'Room for improvement' or 'Key issue unmanaged') the tool also allows users to generate detailed reports highlighting the strengths and weaknesses of the company.

Signatories might choose to identify and engage with companies that are accused of breaching conventions, or companies at risk of facing allegations in future (**high risk** companies that have not developed adequate policies and systems to manage their risks).

As shown in Figure 12, over 30% of companies have not yet implemented a sufficient management response to mitigate ESG risks in cases where they are exposed to a high level of risk on the issue. Around one in four companies have been identified as having 'Room for improvement' based on risk exposure and extent of the management response.

1% of companies demonstrate good practice. Companies demonstrating good practice can be used as examples in engagement discussions with under performing companies. Large Companies are more likely to demonstrate good practice although there are some examples of good practice by small and medium-sized companies.

Figure 12: UN Global Compact Engager Results



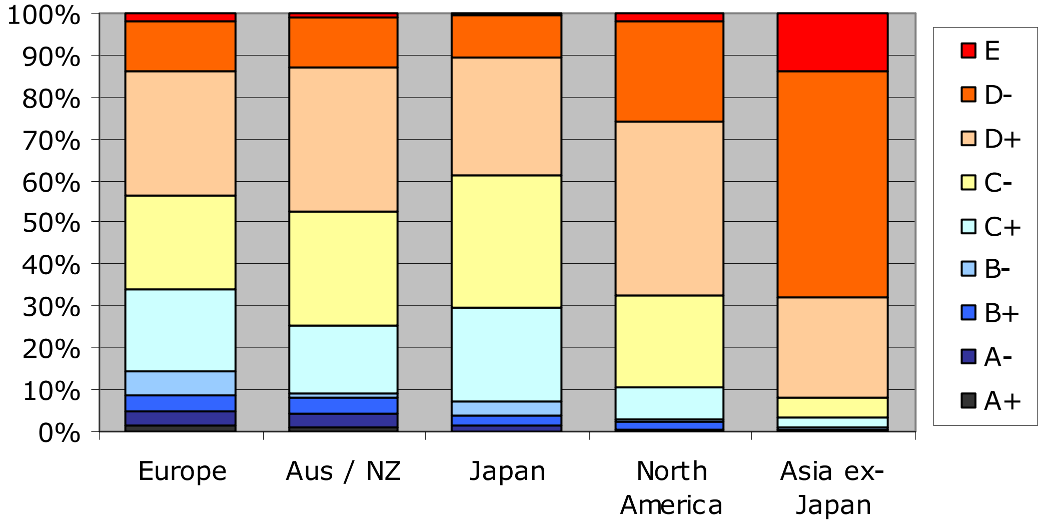
3.3. Report Monitor

The EIRIS Report Monitor tool focuses exclusively on companies' reporting practices to assist signatories to identify leaders and laggards on ESG disclosure, and meet their commitments under Principle 3 of the PRI. The tool grades companies on the quality of their reporting practices, incorporating the exposure level of the company to each ESG issue, taking into account its sector, activities and regional presence. It combines reporting practices on all of the UN Global Compact issues, providing an overall score and grade for each company, ranging from A to E.

Reporting is often the last stage of the process in managing ESG risk. A small proportion of companies demonstrate strong disclosure, although the majority have yet to publish comprehensive information on their key ESG issues. Very few companies report well on all **high risk** issues. Only 2.5% of companies score an A grade, representing 5.5% of the market capitalisation. Three quarters of companies score C- or below. These companies have weak reporting practices on all issues or fail to report beyond a weak standard for a **high risk** issue, a position that may be unacceptable to investors wishing to promote good reporting practices.

Figure 13 shows reporting standards worldwide. Companies in Asia ex-Japan are particularly poor reporters – 97% of companies fail to report beyond a C- grade. North American companies are also poor as 90% of companies also fail to report beyond a C- grade. Even in Japan, Europe and Australia/New Zealand, where reporting is stronger, over two thirds of companies fail to report beyond a C- grade.

Figure 13: EIRIS Report Monitor Results: Regional reporting standards



About EIRIS
EIRIS is a leading global provider of independent research into the environmental, social governance (ESG) and ethical performance of companies. With over 25 years experience of conducting research and promoting responsible investment strategies, EIRIS now provides services to more than 100 asset owners and asset managers globally.

In the last ten years new EIRIS research has focussed on the risks and exposure of companies in key ESG areas, and how companies are responding. EIRIS works with clients to create their own ESG ratings and rankings, to engage with companies and to create specific funds for their clients. EIRIS has a multinational team of over 50 staff in London, together with offices in Boston and Paris. The EIRIS network includes research organisations in Australia, France, Israel, Germany, Spain & South Korean, and now covers over 3,000 companies globally.

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