UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNITED NATIONS ENVIRONMENT PROGRAMME FINANCE INITIATIVE

A Sustainability Integration Framework for Institutional Investors

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Executive Summary

Institutional investors,[1] such as sovereign wealth funds (SWFs), public pension funds (PPFs) and asset managers, increasingly recognize that sustainability-related risks pose a threat to the future value of their assets and even business models. They also understand that integrating sustainability performance into their operations is in their financial best interest and in line with their fiduciary duty.[2] While this acknowledgment is important, it is only the first step. To capture the potential benefits and protect against downside risks, institutional investors need to create and implement the necessary policies and frameworks to integrate sustainability into their operations. The longer that this implementation takes, the longer the pressures continue to grow – posing significant risks for investors and shareholders and increasing the likelihood of potential social and environmental catastrophes.

The Sustainability Integration Framework for Institutional Investors (hereafter "the framework") draws on best practices from asset owners and managers to assist institutional investors interested in crafting their own approach to sustainability integration. While it is mainly directed at SWFs and PPFs, many of the strategies and methodologies are applicable to a wider audience of asset owners and managers. The framework intends to offer a structured approach for thinking about sustainability and is supplemented by case studies and examples that illustrate best practices. Recognizing that institutional investors have different risk exposures and tolerances often stipulated by fiduciary rules, that they have different financial and human resource capabilities, and are bound by diverse regulatory environments, the framework offers valuable inputs for institutional investors across the maturity spectrum.

Additionally, although the strategies and recommendations included in this framework have been successful for certain investors, the national regulatory environment and development context, and the specific mission of the investor will drive individual strategy formation and implementation.

Broadly, the sustainability integration framework recommends that institutional investors should follow these steps:

1. Incorporate sustainability into the investor's mission;
2. Establish the governance structure for sustainability integration;
3. Put sustainability policies in place;
4. Integrate sustainability risk management in the investment process;
5. Incorporate sustainability into investment strategies;
6. Mainstream sustainability along the investment value chain;
7. Measure and report on progress.

In all instances, institutional investors such as SWFs and PPFs should ensure their approach is prepared to accommodate emerging practices and trends, in particular in international standards setting. Effective sustainability integration is a circular process, where practices are continually refined based on past performance and emerging best practices.

The framework therefore represents a "living document", open to feedback from multiple stakeholders in the global investment-development community, including through the UN World Investment Forum. It will be updated periodically with new practices and lessons learnt.

[1] There is no universally accepted definition of "institutional investor", but common definitions generally focus on the fact that institutional investors pool and invest large sums of money in securities and other financial assets for the benefit of third parties.
[2] UNCTAD, 2020, *How Public Pension and Sovereign Wealth Funds Mainstream Sustainability*, https://sdginvestors.net/document/how-public-pension-and-sovereign-wealth-funds-mainstream-sustainability/.

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Introduction: A framework for sustainability integration

Institutional investors, such as sovereign wealth funds (SWFs) and public pension funds (PPFs), are long-term investors mandated to preserve and grow wealth across generations for their beneficiaries. These missions necessitate portfolios that are resilient and well-structured for long-term returns. While many institutional investors are accustomed to assessing risks, it is crucial to adapt strategies and operations to incorporate sustainability risks and opportunities.

Sustainability risks, such as those associated with climate change and biodiversity loss, are among the most important risk management issues for institutional investors.[3] The emergence of a fast-growing sustainable finance market has also highlighted the need to integrate environmental, social, and governance (ESG) risks in investment strategies and, at the same time, offered tremendous opportunities to investors to capture new markets and shift consumer preferences.[4] The integration of sustainability performance not only reduces sustainability risks for individual investment portfolios, but can also increase the flows of capital towards investments and sectors aligned with the United Nations Sustainable Development Goals (SDGs).

The success of the 2030 Agenda for Sustainable Development is dependent on public and private sector mobilization. Institutional investors, such as SWFs and PPFs, are in a unique position to drive this progress, due to their substantial assets, influence, portfolio allocation decisions, and long-term perspective. Addressing sustainability risks can therefore strengthen portfolios as well as deliver tangible societal benefits.

The systematic integration of sustainability across business operations is imperative to capture the potential benefits and avoid physical and transition risks related to climate change and other sustainability challenges. Moreover, a greater emphasis on sustainability will make it easier to navigate evolving regulations.

Unctad's Sustainable Institutional Investment Programme and the UNEP Finance Initiative have been monitoring the sustainability integration practices of institutional investors and financial institutions and supporting their efforts through a range of initiatives. These include: the UN Global Sustainable Finance Observatory, UNCTAD's SDG Investors Partnership and UNEP FI's various programmes on sustainable banking, insurance and investment.

Research from UNCTAD finds that SWFs and PPFs are increasingly aware of sustainability issues and are making progress integrating sustainability into their investment portfolios.[5] However, about half of the world's top 100 pension and sovereign wealth funds do not disclose information on sustainability integration and performance and so there is still huge room for improvement.

One challenge has been a lack of widely accepted comprehensive frameworks and guidelines on sustainability integration for institutional investors, and related to this, a lack of consistent regulatory requirements at the national level. A number of international principles, standards, and frameworks, such as the Principles for Responsible Investment (PRI), the Santiago Principles, the Task Force on Climate-related Financial Disclosures (TCFD, which is now integrated into the ISSB standards) and UNEP FI's Principles for Sustainable Banking and Sustainable Insurance, have played an important role in mainstreaming sustainability in investments, but most of them are high-level principles that need to be complemented by actionable guidelines or tend to focus on certain aspects of sustainability integration, such as risk management and disclosure. As the deficiencies in the current system and the risks posed by sustainability become more widely acknowledged, regulators are increasingly adopting, to a greater or lesser degree, stricter requirements at the national level.

In order to address this challenge and better support institutional investors to address sustainability risks in a systematic and structured manner, UNCTAD and UNEP FI propose a framework for sustainability integration, based on international best practices and aligned with leading

[3] KPMG, 2022, Global Pension and Sovereign Funds Risk Management Survey, https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2022/03/global-pension-and-sovereign-funds-risk-management-survey.pdf.
[4] UNCTAD, 2021, The Rise of the Sustainable Fund Market and its role in financing sustainable development, https://sdginvestors.net/document/the-rise-of-the-sustainable-fund-market-and-its-role-in-financing-sustainable-development/.
[5] UNCTAD, 2020, *How Public Pension and Sovereign Wealth Funds Mainstream Sustainability*, https://sdginvestors.net/document/how-public-pension-and-sovereign-wealth-funds-mainstream-sustainability/..

international initiatives. Such a framework should ensure that institutional investors have the appropriate governance, risk management and investment policies in place to mitigate the risks and capture the opportunities posed by sustainability factors. Additionally, institutional investors, such as SWFs and PPFs, should leverage their status as “universal owners” to encourage investees, external asset managers, regulators and service providers to improve their approaches to sustainability. As institutional investors that represent the future interests of a pool of beneficiaries, PPFs and SWFs are in a unique position to shape the direction of public policy on issues such as climate change that will have an impact on the lives of its beneficiaries (financial and otherwise). Finally, investors should report on progress, drawing on key metrics and targets.

The framework uses a top-down approach, covering seven action areas and includes a number of concrete action items in each area. For each action area, best practice examples can be found in the relevant sections of this document. While many of the examples are taken from developed country contexts and from SWFs and PPFs, many of the strategies and methodologies are applicable to a wider audience of institutional investors and asset managers, including those in developing economies, to act on sustainability in line with their operational model and strategic priorities.

The framework intends to offer a structured approach to thinking about sustainability; however, the host country context and the specific mission of the institution should drive individual strategy and implementation. In all instances, institutional investors should ensure their approach is flexible enough to accommodate emerging practices and trends. The path toward effective sustainability integration is not going to be linear; it is a continuous process that is refined based on past performance and emerging best practices.

Summary of the Sustainability Integration Framework

1. Incorporate sustainability into the investor’s mission	• Affirm commitment and obligation to integrate sustainability in all investment decisions, considering both risks and opportunities. • Adopt long-termism. • Announce public support from the board of directors and management to create an accountability mechanism and provide better insight into the direction of the asset owner.
2. Establish the governance structure for sustainability integration	• The board of directors sets the broad sustainability strategy and provides oversight and accountability, ensuring that the strategy evolves according to past performance and new understandings. • Executive leadership oversees the day-to-day efforts of the sustainability strategy, either by an existing member of the c-suite assuming the responsibility of sustainability oversight, or by creating a dedicated position (for example, chief sustainability officer). • Create sustainability integration teams (for example, dedicated team, optimization model or integrated model).
3. Put sustainability policies in place	• Craft sustainable investment frameworks and policies, which can include topics such as investment strategy, stewardship, active ownership, corporate governance or other thematic issues (for example, human rights). These policies should be communicated to investees, internal and external asset managers and proxy voting services.
4. Integrate sustainability risk management in the investment process	• Understand the scopes and types of risk exposure and opportunities related to sustainability. • Put risk management strategies, policies and process in place. • Manage sustainability risk across asset classes, including private equity, debt and private sector investment.

5. Incorporate sustainability into investment strategies	• Develop broad screening methodologies for prospective investments, which can be designed and implemented across asset classes. • Explore the strategies of negative and positive screening, thematic investment and SDG-compliant investment. • Formulate investment strategies using sectoral and taxonomy methods.
6. Mainstream sustainability along the investment value chain	• Leverage privileges and rights as investors to encourage investees (and asset managers) to adopt more sustainable business processes. • Engage other actors in the investment ecosystem, such as regulators, rating agencies, index providers and other sovereign and institutional investors to help ensure the system continues to become more conducive to sustainable investment.
7. Measure and report on progress	• Give importance to sustainability disclosure in the overall sustainability integration strategy. • Overcome challenges in sustainability disclosure by standardization, transparency practices and international collaboration. • Report on governance, investment strategies and risk management frameworks, comparing actual performance with benchmarks and targets. • Define the scope of disclosure and reporting. • Seek external validation of public reporting around sustainability.

Source: UNCTAD.

1. Incorporate sustainability into the investor's mission

To start the "sustainability integration journey", institutional investors need to make sustainability a core element of their long-term mission. Incorporating specific aspirations around sustainability into their mission ensures that strategy and business planning encompass sustainability considerations (box 1.1).

Based on best practices in the industry, institutional investors should embed the three core principles in their commitment to sustainability:

(a) Affirm a commitment and obligation to integrate sustainability in all investment decisions;

(b) Adopt long-termism as a guiding principle of investments to safeguard and create sustainable value;

(c) Mainstream sustainability not only to manage risks (including financial, regulatory and reputation risks) but also to pursue opportunities linked to the transition to a more sustainable economy.

Institutional investors can also demonstrate their commitment to sustainability by committing to and implementing the Principles for Responsible Investment, in particular those principles related to ESG and sustainability integration.[6]

Box 1.1. Selected examples of mission and sustainability integration

Alecta (Sweden): "Because our mission is to create security for the future, we have a long-term approach. We want and we need to contribute to the society of the future being a good one to live in and one that creates sustainable growth and new jobs. That is also how we create a healthy return … Our ambition is to help generate long-term value in businesses and society at large."

Ontario Teachers' Pension Plan (OTPP): "An ESG lens brings focus to a much wider range of considerations that help us identify and evaluate emerging opportunities and be prepared for when they come. The care we take to ensure the companies we invest in are also managing ESG risks and opportunities makes us an attractive employer, partner and shareholder, and enhances our ability to earn the required returns to pay pensions for generations to come. Our long-term strategy to achieve stable returns to meet our pension promise include taking a systematic approach to identifying, assessing and managing environment, social and governance (ESG) risks and opportunities."

PFZW (Netherlands): "As a pension investor, we aim to achieve an optimal return for our clients while maintaining a responsible risk profile. Within this core task, we pay particular attention to responsible investment based on the conviction that this can reduce risks and offers opportunities to make a good return with investments that contribute to social and environmental solutions."

Source: Latest annual and/or sustainability reports by funds.

The board of directors and/or chief executive officer should make a firm, public commitment to the three core principles mentioned above. Public support from management serves three other purposes: (a) it creates an accountability mechanism and helps ensure that the commitment is embedded into the organization from the top-down; (b) it provides stakeholders (for example, prospective co-investors, pensioners and citizens) better insight into the direction of the investor; (c) it signals to stakeholders that sustainability is being managed at the most senior levels within the organization and, as such, is a priority. Doing so will provide institutional investors with a wider range of investment opportunities. A clear strategic vision consistent with global trends reduces

[6] https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment.

elements of uncertainty, attracts international investors and lowers the cost of financing. Incorporating sustainability in the institutional investor's mission, as recommended by the present guide, could prove particularly beneficial given the rise of co-investments between investors.

The board and management should also highlight that incorporating sustainability into the investor's mission does not threaten financial returns, especially from a long-term perspective; rather, a key element of sustainability is that it will bolster risk management frameworks and encourage investments into companies that are likely to grow over the long-term. These are two key attributes that will drive a strong and resilient portfolio and fulfil fiduciary duty (box 1.2). Explaining the connection between sustainability integration and financial performance is particularly important for SWFs and PPFs, which have long term liabilities and may also be aligned with public policy objectives in areas such as climate change.

Box 1.2. Pension fund-driven sustainability initiatives

United States of America–United Kingdom of Great Britain and Northern Ireland–Japan Partnership: March 2020 public letter "Our Partnership for Sustainable Capital Markets" from CIO, California State Teachers' Retirement System (CalSTRS); CIO, Government Pension Investment Fund (GPIF) (Japan); and CEO, Universities Superannuation Scheme (USS) Investment Management Ltd (United Kingdom): "As asset owners, our ultimate responsibility is to provide for the post-retirement financial security of millions of families across multiple generations. Since our commitment to providing financial stability spans decades, we do not have the luxury of limiting our efforts to maximizing investment returns merely over the next few years … Sceptics that continue to question the growing role of sustainability with the global investment community should realize that they are quickly becoming the minority. With a large majority of research in a meta-analysis of over 2,200 studies showing a positive relationship between sustainability investment and returns – and around 90 per cent showing at least a non-negative effect – they should also be aware that the evidence is not on their side."[7]

Maple 8 (Canada): 2020 public letter from CEOs of Canada's eight largest pension plan investment managers: "We are committed to creating more sustainable and inclusive growth by integrating environmental, social, and governance (ESG) factors into our strategies and investment decisions. It is not only the right thing to do, but also an integral part of our duty to contributors and beneficiaries. Doing this will unlock opportunities and mitigate risks, supporting our mandates to deliver long-term risk-adjusted returns."[8]

[7] https://www.gpif.go.jp/en/investment/Our_Partnership_for_Sustainable_Capital_Markets_Signatories.pdf.

[8] https://cdn3.cppinvestments.com/wp-content/uploads/2020/11/CEO-Statement-CEO-Signatures-EN-Nov25-2020.pdf.

2. Establish the governance structure for sustainability integration

"Governance" in this framework refers to oversight structures, processes and systems regarding an organization's sustainable investment decision-making, oversight and implementation. A good governance structure is the result of having appropriate structures and processes in place and conducting continuous reviews to ensure that such structures and processes are aligned with the objectives and needs of the investor. As sustainability performance is a rapidly evolving area, it is important that governance structures are flexible and responsive. This chapter will explore the best practice governance structures of leading institutional investors.

2.1. Commitment from the top

As mentioned in the previous chapter, accountability for sustainability integration rests with the highest leadership levels of the institutional investor. Senior leadership is responsible for fostering ethical and effective leadership, providing strategic direction and oversight of performance, and ensuring that sustainability is embedded holistically across the entire organisation. Depending on the corporate governance model of the investor, especially of pension funds, the role of beneficiaries may also be important. If they have voting power to elect the board and influence priorities, integrating sustainability into beneficiary duties can be another step towards fully integrating sustainability into the organisation and providing "commitment from the bottom".

The board of directors of leading institutional investors generally exercise their responsibilities by:

- **Putting internal policies and processes in place:** The board is the highest authority of most institutional investors and needs to authorize any change to its mission, investment strategy, and other core governance structures. This should include policies to define the commitment to sustainability and processes to implement and track progress (for example, via key performance indicators (KPIs) or other metrics) on sustainability considerations.
- **Encouraging the development of a plan to implement sustainability strategy:** This would involve developing a plan for delivering on the board's vision for integrating sustainability, managing related risks and opportunities to the portfolio, and setting forward-looking actions for implementing a sustainability strategy.
- **Regularly reviewing and discussing sustainability matters at board meetings:** To effectively provide oversight, the board should periodically discuss sustainability-related issues. These discussions may focus on internal operations (for example, diversity of staff, energy efficient offices), or the opportunities and risks to its investment portfolio (for example, those posed by climate change). For accountability and transparency purposes, leading asset owners and managers publish the frequency and topics of board-level discussions around sustainability.
- **Ensuring availability of sustainability investment knowledge and skills**. While the board provides oversight and accountability, it needs to ensure the institution has the appropriate expertise and competencies at the staff level. The specifics of the efforts will depend on the institution's context (for example, mission, staffing level, resources), but the board needs to ensure there is an adequate alignment of the sustainability strategy and resources.

2.2. Executive leadership

Another important step for sustainability integration is to establish a governing body that will oversee the day-to-day efforts of the sustainability strategy. Based on existing best practices, this framework recommends two common approaches.

The first is for an existing member of the "C-suite" to assume responsibility for all sustainability efforts. For example, the Ireland Strategic Investment Fund (ISIF) named the CFO and CIO as co-leaders of the fund's sustainability programme.

The second is to create a dedicated position. For example, the Canada Pension Plan (CPP) created the position of chief sustainability officer, who is responsible for the fund's approach to ESG matters, particularly climate change.

Whichever approach investors adopt, it is imperative that there is collaboration across key departments and business functions. These include risk management and compliance, investment management, finance, communication and human resources. Sustainability should be a firm-wide effort and incorporate all operations, extending beyond the scope of risk management and compliance departments.

2.3. Sustainable investment team

Leading institutional investors have employed a variety of models when putting in place dedicated teams to manage day-to-day sustainability integration. Several methods can be successful. Whichever structure an investor decides to adopt with respect to sustainability integration, it is necessary to involve different players at all levels and across functions, and have their roles and responsibilities clearly defined. Based on international best practices, institutional investors can consider the following models when structuring their sustainable investment teams:

(a) The optimization model

This model adds sustainability elements to the existing functions and responsibilities of staff with the aim to fully leverage existing structures in sustainability integration without the need for restructuring. Examples include GPIF and OTPP. In GPIF, its Investment Strategy Department is tasked with developing their sustainability investment strategy; its Public Market Investment Department takes care of external asset manager evaluation and stewardship related to sustainability issues in public markets; and its Private Market Department is responsible for sustainability integration in alternative assets and the evaluation of external asset managers for private market assets.[9]

The advantages of this model include its relative ease and lower cost (for example, the reduced need to recruit new staff specialized in sustainability integration). However, adding additional responsibilities to existing functions will likely require additional sustainability skills training for staff and may create capacity constraints on existing resources. The investor may also miss out on external expertise.

(b) The dedicated team model

This model refers to the establishment of a new dedicated sustainability team with the required knowledge and expertise to lead and drive the implementation and execution of a sustainable investment strategy and activities. Since sustainability-aligned investment and sustainability integration need a new set of skills and knowledge, the dedicated team model provides the necessary expertise on sustainability issues.

A dedicated team can provide support to the management and the investment teams through analytical and advisory work or take up certain functions such as stewardship, investee engagement and proxy voting. In other cases, a new team can be established to look into emerging sustainability investment opportunities. Examples include the Green Team of CalSTRS and the Responsible Investment Team of USS.

When building this team, institutional investors should take stock of existing staff competencies. For example, some investors second staff from other business areas, while others hire external experts. These considerations will also be subject to the financial resources of the firm. If the investor does elect to use in-house staff, it should ensure that the members have access to resources and training. For example, Compañía Española de Financiación del Desarrollo (COFIDES) provides special training focused on social and environmental issues, so that staff have the appropriate analytical skills to address sustainability-related challenges. Algemene Pensioen Groep (APG) (Netherlands) reports sustainable employability pilot trials. CPP provides sustainability-related training to all colleagues within equity, diversity and inclusion. The Caisse de

[9] https://www.gpif.go.jp/en/

dépôt et placement du Québec focuses on professional development to expand their teams' knowledge and expertise within sustainable investments.

Lastly, institutional investors will need to ensure that the creation of a dedicated team does not result in the creation of silos, with all sustainability matters relegated to the specialist team. This will require careful management to ensure that sustainability is integrated holistically throughout the organization, with all functions understanding that they have a role to play.

(c) The integration model

The integration model combines the dedicated team and the optimization approaches, usually by establishing a dedicated team to coordinate and support company-wide efforts that involve multiple functions to embed sustainability in the institution's investment decisions and processes. The integration model can ensure the availability of required knowledge and expertise for sustainability integration, while engaging all functions across the organization in the exercise. With the increasing maturity and sophistication of sustainability integration, investors, such as pension funds, are embracing this approach. Ultimately, the rationale behind sustainability integration requires that its values and logic are embedded across activities and not siloed in a niche team with responsibility for sustainability. Examples of funds that have successfully used an integration model approach include CPP[10] and AustralianSuper.[11]

[10] https://www.canada.ca/en/employment-social-development/programs/pension-plan.html

[11] https://www.australiansuper.com/

3. Put sustainability policies in place

While a reoriented mission statement, senior leadership support and a holistic governance structure are important steps for sustainability integration, it is critical for institutional investors to develop policies that will guide their efforts. Common inputs to sustainability-related policies include the United Nations Universal Declaration of Human Rights, Convention against Corruption, Guiding Principles on Business and Human Rights, the SDGs, International Labour Organization conventions, the Organisation for Economic Co-operation and Development's Responsible Business Conduct for Institutional Investors and the Paris Climate Agreement.

All institutional investors should strive to develop and publish a comprehensive strategy towards sustainability integration (that is, a sustainable investment framework), but those that are at an earlier stage of their sustainability journey may start with stewardship and active ownership policies that guide internal and external asset managers.

3.1. Sustainable investment frameworks and policies

Institutional investors should strive to draft and publish their overarching approach to sustainable investment that should set out how sustainable investment is integral to long-term value creation and fiduciary duties to beneficiaries. These strategies and documents generally include: a connection between mission and sustainability; the relevant governance structure; a commitment to considering sustainability factors in investment decisions; stewardship and active ownership policies; as well as a commitment to disclosure and reporting on sustainability-related performance and metrics. Such frameworks demonstrate an integrated approach to sustainability and are evident in many leading funds such as GIC (Singapore), Future Fund (Australia) and Alecta (box 3.1).

Box 3.1. Examples of sustainable investment frameworks and policies

APG – Responsible Investment and Stewardship Policy: The document outlines the Dutch pension fund's approach to responsible investment and stewardship. The policy includes APG's commitment to integrating ESG considerations into its investment process, engaging with companies on ESG issues, and exercising its shareholder rights to promote sustainable business practices. The policy also provides metrics for measuring the fund's sustainability performance and reporting on its progress.

California Public Employees's Retirement System (CalPERS) – Governance and Sustainability Principles: The document outlines the principles and practices that guide the investment decisions of CalPERS. The principles emphasize the importance of ESG factors in investment decisions, active ownership practices, and promoting sustainable corporate practices. The document also highlights CalPERS' commitment to transparency, accountability and engagement with its stakeholders in pursuit of its sustainable investment objectives.

Future Fund – Statement of Investment Policies: The document outlines the Australian SWF's approach to sustainable investing. The policy states that sustainability considerations are integrated into the investment process, and that the fund seeks to be a responsible owner and promote sustainable practices in its portfolio companies. The policy also identifies the key ESG risks that the fund considers when making investment decisions and outlines its commitment to measuring and reporting on the sustainability performance of its portfolio.

The Government Employees Pension Fund (GEPF) (South Africa) – Responsible Investment Policy: The policy recognizes ESG factors as key drivers of long-term investment performance. It outlines the GEPF's approach to responsible investing, including the integration of ESG factors into investment decision-making, active ownership and engagement with investee companies, and collaboration with other stakeholders to promote responsible investing practices. It also sets out the GEPF's commitment to sustainable development and the SDGs, and its expectations of asset managers to uphold responsible investing principles. The policy aims to ensure that the GEPF's investments contribute to sustainable development and are aligned with the interests of its members and beneficiaries.

GIC – Framework for Sustainability: The framework outlines the Singapore SWF's approach to sustainable investing. The framework includes integrating sustainability considerations into its investment process, engaging with portfolio companies on ESG issues and reporting on its sustainability performance. GIC also established the Sustainable Investment Group to provide oversight of its sustainability initiatives and promote knowledge-sharing across the organization. The framework emphasizes the importance of balancing sustainable investing objectives with generating good returns for the fund's stakeholders.

Source: Fund websites and latest annual or sustainability reports.

In some cases, these strategies and frameworks will be closely tied to the country's public policy goals. For example, the South African Public Investment Corporation aims not only to generate sufficient returns for its clients but seeks to generate social returns by investing in projects that ensure inclusive growth, which is aligned with the government's black economic empowerment policy.

3.2. Stewardship and active ownership policies

Institutional investors looking to integrate sustainability into their operations should create a new-generation stewardship policy[12] that makes clear that sustainability, as an important long-term investment value driver, is an integral component of its fiduciary duty. Such policies will normally also outline engagement strategies (that is, how the investor will influence investees and issuers[13] to improve its approach to sustainability); guidelines to asset managers; and voting policies (including proxy voting). Beyond stewardship and voting, investors can develop clear guidelines around engagement with investees and mechanisms for escalation if there is no appropriate response from investees, ultimately leading to divestment of assets. Often, these policies are the basis for a sustainable investment framework and can be a helpful step for investors looking to better integrate sustainability into their operations (box 3.2).

3.3. Policies on corporate governance and other thematic issues

Institutional investors can also issue policies on specific sustainability issues, which both internal and external asset managers are expected to follow. Corporate governance of investee companies is the most common area and covers issues such as the election of the board, shareholder rights, remuneration and conflict of interest. In addition, some institutional investors have also put in place policies on a wide range of other issues such as human rights, divestment, tax and climate change. For example, PFZW (Netherlands) has developed policies on anti-bribery and corruption issues and published recommendations on green and social bonds (see box 3.3 for more examples).

[12] Principles for Responsible Investment (PRI) defines stewardship as "the use of influence by institutional investors to maximize overall long-term value including the value of common economic, social, and environmental assets, on which returns and clients' and beneficiaries' interests depend".
[13] The stewardship code may also detail engagement strategies towards policymakers or standard-setting bodies.

Box 3.2. Examples of stewardship and voting policies

APG – Responsible Investment Stewardship Policy: The document sets out the policy of APG Asset Management on stewardship and active ownership. The policy is guided by principles such as long-term value creation and ESG integration. It outlines the company's engagement strategies and voting policies, which are aimed at promoting sustainable investment practices and driving positive change at the companies in which it invests. The policy emphasizes the importance of ongoing evaluation and reporting to ensure that the stewardship policy is effective in achieving its goals.

CalPERS – Global Principles of Corporate Governance: The document outlines a set of principles for good corporate governance, covering topics such as the rights and responsibilities of shareholders, the role of the board of directors and the need for transparency and accountability in corporate decision-making. The document also includes specific recommendations for companies on issues such as executive compensation, board diversity and risk management. The principles are intended to guide companies in which it invests in developing governance practices that promote long-term value creation and protect the interests of all stakeholders.

The Church of England Pensions Board (United Kingdom) – Stewardship Implementation Framework: The document provides guidance on how to implement its stewardship policy. The framework is divided into three stages: (a) establishing governance arrangements and processes; (b) developing an engagement and voting strategy; (c) implementing and monitoring the strategy. It outlines key actions that the board can take at each stage, such as identifying priority issues for engagement and setting targets for progress. The framework emphasizes the importance of ongoing evaluation and reporting to ensure that the stewardship policy is effective in promoting sustainable investment practices.

State Street Global Advisors (SSGA) – Proxy Voting and Engagement Guidelines: The guidelines provide guidance on the firm's approach to proxy voting and engagement with companies in which it invests. The guidelines cover a range of topics, including board composition, executive compensation, environmental and social issues, and shareholder rights. The document outlines SSGA's engagement process, which involves identifying key issues, engaging with companies to discuss these issues, and escalating the engagement as necessary. The guidelines also provide information on SSGA's voting policies and explain how the firm uses its voting power to support good governance practices and sustainable business models. The guidelines reflect SSGA's commitment to promoting long-term value creation and responsible corporate behaviour through its engagement and proxy voting activities.

Temasek (Singapore) – Stewardship and Voting Principles: The principles provide guidance on engaging with its portfolio companies on ESG issues and encouraging sustainable practices through active ownership and engagement. Temasek's stewardship activities include collaborations with portfolio companies on sustainability initiatives and engaging with boards on ESG issues. The company is committed to transparency and reporting on its stewardship practices. Temasek aims to use its influence as an investor to promote sustainable and responsible business practices among its portfolio companies.

Source: Fund websites and latest annual or sustainability reports.

Box 3.3. Examples of policies on thematic sustainability issues

The CPP Investment Board has a responsible investing policy that covers issues such as climate change, human rights and labour standards.

Grupo SURA (Colombia) has a sustainability policy that includes a commitment to promote sustainable development and social and environmental responsibility. The company also has a responsible investment policy that covers issues such as ESG risks, human rights and corporate governance.

The Korea Investment Corporation has a responsible investment policy that incorporates ESG factors into the investment decision-making process and includes guidelines for engagement with investee companies on sustainability issues.

The National Pension Scheme Authority of Zambia has a responsible investment policy that covers issues such as climate change, human rights and labour standards, and includes guidelines for engagement with investee companies.

The New Zealand Superannuation Fund (New Zealand Super Fund) has a responsible investment policy that covers issues such as climate change, human rights and labour standards. The fund also has a climate change investment strategy that aims to reduce the portfolio's carbon footprint and increase investments in low-carbon assets.

The Norges Bank Investment Management (NBIM) has policies on a wide range of issues, including climate change, human rights and water management.

The Swedish National Pension Funds has policies on a range of issues, including human rights, labour standards and environmental sustainability. The council engages with companies on these issues and may recommend exclusion of companies that do not meet its standards.

The United Nations Joint Staff Pension Fund has a policy on divestment from companies involved in the production of anti-personnel mines and cluster munitions.

Source: Fund websites and latest annual or sustainability reports.

4. Integrate sustainability risk management into the investment process

4.1. Sustainability-related risk exposure

Sustainability issues, particularly environmental issues, and climate change pose a range of risks that can have significant impacts on businesses, economies and societies, and thus on the value or performance of investments committed by institutional investors. Recent climate-related disasters, such as the 2022 floods in Pakistan, demonstrate that neglecting environmental risks can leave society and the economy exposed to the loss of life and financial losses. Additionally, disasters such as viral pandemics, which often have a sustainability dimension at their root, can suddenly hurt the value of the assets, destabilize actuarial positions, and jeopardize long-term obligations to beneficiaries.

Institutional investors face several categories of sustainability risk, including:

- **Physical risks:** These risks arise from the impact of weather events and long-term environmental changes such as extreme weather conditions, natural disasters, and other physical impacts of climate change that can damage infrastructure, disrupt supply chains and cause property damage.
- **Transitional risks:** These risks arise from the process of adjustment to a low-carbon economy, including changes in regulations and public policies, shifts in consumption and investment preferences, and technological disruptions that can lead to stranded assets and reduced profitability for high-carbon industries.
- **Reputational risks:** These include risks related to the negative public perception of an investee company's sustainability performance, which can harm its brand value and market position.
- **Financial risks:** These include risks related to the impact of sustainability risks on the value of investments, such as the potential for stranded assets and reduced profitability in high-carbon industries or a negative financial impact such as an increase in insurance claims after a natural disaster or environmental damage.[14]

Managing these risks effectively can help investors comply with evolving regulatory requirements regarding sustainability-related policies such as green taxonomies and mandatory ESG disclosure. Building resilience against the impact of environmental risk as part of business and risk management strategies will also enable investors to meet the expectations of clients and other stakeholders who are increasingly focused on sustainable investing practices, contribute to sustainable development and positive change, while minimizing the potential for financial losses and reputational damage associated with sustainability issues.

4.2. Risk management strategies, policies and processes

Institutional investors, should put risk management strategies, policies and processes in place to effectively identify, assess and manage sustainability risks in the investment process. Key actions include:

- **Establishing governance structures and policies for managing sustainability risks:** As discussed in chapter 2, the establishment of a robust governance structure is extremely important for integrating risk management into operations and investment strategies. A good governance structure will ensure compliance with the mission and vision of the investor with regards to implementation and investment decision making. A good governance structure will include clear roles and responsibilities for managing sustainability risks, designation of

[14] https://www.mas.gov.sg/publications/consultations/2020/consultation-paper-on-proposed-guidelines-on-environmental-risk-management-for-asset-managers.

a senior executive or a team responsible for overseeing risk management, and integration of sustainability risk management into the overall risk management framework and processes (see chapter 2 for more detail).

- **Identifying and assessing sustainability risks in the investment process:** investors should incorporate the relevant environmental and other sustainability-related risks into their portfolio construction to gauge the potential impact of sustainability risks on investment returns and on society. For this purpose, investors need to conduct risk assessments to identify and evaluate environmental and other sustainability risks, such as physical, transitional and reputational risks with respect to their portfolio in the short, medium and long term. The investor should also analyse the impact of sustainability risks on investment performance, including the potential for financial losses, reputational damage, and legal liabilities. In addition, investors should consider the materiality of sustainability risks to investment decisions, based on factors such as the size of the investment, the level of exposure, and the nature of the risk.

- **Integrating sustainability risk factors into investments:** investors should incorporate sustainability risks into due diligence processes, regularly monitoring and reviewing sustainability risks over the entire investment lifecycle, and engaging asset managers and/or investee companies in risk management (box 4.1).

Box 4.1. Best practice examples of sustainability risk management

CPP's due diligence framework on climate risks: CPP has developed the Abatement Capacity Assessment Framework. The framework proposes three steps: (a) companies calculate their actual emissions (scope 1, 2 and 3); (b) assess the long-term (probable) projected abatement capacity (assuming no change to today's technology costs and regulations but using standardized carbon prices that are higher than current levels); (c) determine the uneconomic projected abatement capacity. The proposal would encourage companies to take a more realistic look at their plans, foster greater competition to reduce greenhouse gas (GHG) emissions, and standardize a reporting format that would be understood by investors and analysts. While not all companies committed to a more sustainable future will operate such models, institutional investors such as PPFs and SWFs should be very attentive in their due diligence and expect companies to do more than make simple declarations.

ISIF constructs investment portfolio based on carbon emission performance: In line with its net-zero pledge, ISIF, the Irish SWF, has prioritized collecting and analysing data around the carbon emissions of its portfolio. The fund, in conjunction with third-party data providers, calculates a variety of climate-focused metrics, including the emissions exposure and intensity of its various portfolios. ISIF then uses this data to guide its asset allocation and portfolio holdings.

Sources: Relevant public reports of CPP and ISIF.

- **Developing strategies to manage sustainability risks:** investors should develop measurable goals and concrete strategies to manage risk exposure, including setting risk limits (for example, defining the maximum exposure to environmental risks at the portfolio level) and identifying risk mitigation measures, such as raising benchmarks for required sustainability performance in investee companies. Investors should also engage with companies to improve their sustainability risk management practices. This will require close engagement with companies that have high environmental risks on a transition to more sustainable business practices. Escalation mechanisms should also be put in place to manage companies that are not responding appropriately to engagement (with divestment as the ultimate step).

- **Evaluating and measuring sustainability risk and performance:** Institutional investors can measure the sustainability performance of their investment portfolios using both qualitative and quantitative indicators. Qualitative indicators, for example, could include whether an investee or asset manager has adequate sustainability policies and processes in place, or whether an investment is in a high-risk industry or location. Quantitative indicators can be used to measure the sustainability risks and performance based on the portfolio company's investment objectives. Environmental or climate-related indicators, such as carbon emissions, water usage and waste production, and social indicators, such as job creation or gender equality-related indicators, can also be used. UNCTAD's Core SDG Indicators for Entity Reporting[15] could serve as a good reference for indicator selection.

  In addition, institutional investors can also consider using scenario modelling to assess climate-related risks and opportunities (box 4.2). The Guidance on Scenario Analysis for Non-financial Companies of the Task Force on Climate-related Financial Disclosures (TCFD)16 provides practical guidance for organizations to conduct climate scenario analysis, which can help identify potential risks and opportunities associated with climate change. The guidance also provides examples of how organizations can integrate scenario analysis into their decision-making processes and disclose their findings in alignment with the TCFD recommendations.

Box 4.2. Leveraging climate scenario analysis in sustainable investment decisions

Similar to its traditional financial counterpart, the climate value-at-risk (CVaR) model estimates the maximum loss over a given period (given a particular confidence interval), based on various climate scenarios. GPIF first implemented its CVaR model in 2017, and it continues to refine it; recently, it adopted climate scenarios proposed by the NGFS. The GPIF model measures the impact of possible central bank policy changes related to climate change on equities, corporate bonds and government bonds. Such analysis also helps funds identify industries and companies that should be subject to further scrutiny during investment due diligence.

GIC employs carbon earnings-at-risk scenario analysis (CESA) to understand the impact of future carbon prices on its portfolio. By estimating the impact of higher carbon prices on a company's earnings, investors gain a better understanding of the financial implications. The first step in the CESA is to calculate a company's carbon intensity based on emission targets and past performance. The second step is to choose the most appropriate carbon pricing, mindful that the prices will likely vary by region and industry. GIC integrates a range of future prices from models developed by organizations such as the NGFS and the International Energy Agency. Step three calculates a company's carbon cost liabilities, which are the product of step one (carbon intensity) and step two (carbon prices). The fourth step requires GIC to assess the viability of the company passing on these costs to customers while maintaining demand for its goods or services. Step five models the impact of the previous steps on the company's profitability. For companies not covered by GIC analysts, the fund uses a five-year average profit margin, while internal analysis drives long-term profit margins for covered companies.

Sources: Website and sustainability reports of GPIF and GIC.

[15] UNCTAD, 2020, *Core SDG Indicators for Entity Reporting Training Manual* (United Nations publication, Geneva), https://isar.unctad.org/wp-content/uploads/2020/04/UNCTAD_DIAE_2020_2.pdf.
[16] 2020-TCFD_Guidance-Scenario-Analysis-Guidance.pdf (bbhub.io).

The Network for Greening the Financial System (NGFS) also published the Guide to Climate Scenario Analysis for Central Banks and Supervisors17 to help financial institutions conduct scenario analysis to assess the risks and opportunities associated with climate change. The NGFS guide provides a step-by-step approach to conducting scenario analysis and includes a range of climate scenarios and associated climate indicators. Although these guides were not prepared for asset owners specifically, they could serve as good references for SWFs and PPFs on climate scenario analysis.

- **Monitoring and reporting on sustainability risks and performance:** This may include disclosing material environmental and other risks, overall sustainability impacts, progress against sustainability performance indicators, and the measures taken to manage and mitigate environmental risks (see chapter 7 for detailed guidance). As well as identifying and disclosing risks, it is also important to develop indicators and metrics to measure progress on sustainability risk management over time.

4.3. Managing sustainability risks across asset classes

Given the variance in sustainability risk profiles across asset classes, institutional investors should consider developing and implementing specific techniques when assessing and managing sustainability risk in such classes (box 4.3). This section will explore some risk management practices – focusing on due diligence – across public equities, fixed income, private equity, real estate and infrastructure. Institutional investors that outsource investment management should ensure external asset managers employ similar processes.

Box 4.3. Environmental, social, and governance asset valuation methodology

To fully integrate sustainability into investment due diligence, the Government Pension Fund (GPF) (Thailand), in collaboration with the World Bank, developed the ESG Weight and Score Asset Valuation Methodology[18] to connect ESG scores to equity valuations. GPF relies on MSCI ESG data as a baseline but then alters the weighting system to reflect the fund's belief that governance is the most important element of ESG. While the weighting is data-driven, the score incorporates the investment team's professional judgment. The final weightings produce a comprehensive ESG rating, which is then factored into the valuation model's weighted average cost of capital (WACC). For companies with a strong ESG rating, the fund applies a lower WACC (minus 25 "basis points" (bps)), whereas a fund with a poor ESG rating will receive a higher discount rate (plus 25 bps). The fund also considers ESG-related risks and opportunities when calculating a company's growth potential. While this approach is driven by structured analysis, it demonstrates the importance of tailoring models to reflect the fund's beliefs and strategies. Ultimately, the analysis helps inform analysts' thinking, but it is not a substitute for professional judgment.

Source: UNCTAD based on the World Bank.

(a) Equities

Given the disclosure requirements for public companies, funds and other investors have greater access to company documents – including those that detail the company's strategy around sustainability – and these resources should be important inputs during the due diligence phase. The specifics of the approach will vary according to the investor, but templates prepared by organizations are available as a foundation (for example, PRI's due diligence questionnaires (DDQ) for listed equity investors). Institutional investors can also utilize ESG rating agencies and

[17] ngfs_guide_scenario_analysis_final.pdf.
[18] https://elibrary.worldbank.org/doi/abs/10.1596/34534

other service providers, which generally have better coverage of public companies in the largest capital markets.[19]

The large number of public equity holdings in many investment portfolios necessitates that institutional investors prioritize their efforts. Institutional investors can concentrate their analysis on their largest investments, as well as those that face the highest risks (for example, those operating in industries that are most susceptible to transition or physical climate risks).

Institutional investors should also be aware of the challenges posed by index tracking. While this investment strategy has become increasingly popular, traditional indices (for example, MSCI ACWI) do not screen companies' sustainability standards. To overcome this challenge, institutional investors can increase their due diligence of companies about to enter indices or choose to dedicate more capital to indices that already incorporate sustainability factors. Institutional investors should ensure adequate discussions between the board and senior management about the risks and opportunities posed by either strategy (box 4.4).

(b) Fixed income

While there are similarities with public equities, fixed income analysis is primarily concerned with protecting against downside risks and spans public corporations, private companies and sovereigns – each requiring slightly different analysis. Investors increasingly acknowledge that sustainability factors affect bond issuers' cashflows and impact their probability of default (box 4.5);[20] as such, institutional investors should factor sustainability-related metrics into credit ratings and/or allocate funds into sustainable solutions (for example, green bonds and fixed-income sustainability indices). Smaller institutional investors may find the latter strategy more feasible.

Box 4.4. Addressing the challenges of index investing

NBIM focuses on the sustainability practices of index newcomers: NBIM evaluates companies before they enter the FTSE Global All Cap Index, the basis for the fund's benchmark index. However, such screening can be challenging because many of the newer firms are smaller or recently listed, and therefore there is less publicly available information. In these instances, NBIM relies more heavily on sectoral or industry data. In certain cases, the fund will not invest, even if the company is included in the index; however, this is an additional risk for the fund because it could negatively affect the fund's performance compared to its benchmark, at least in the short term.

New Zealand Super Fund searches for new sustainability-friendly indices: In 2017, the New Zealand SWF began shifting a portion of its passive equity tracking portfolio to low-carbon indices. By September 2022, the fund announced that it had moved $15 billion, or 40 per cent of its portfolio, into these climate-friendly strategies. While the change in strategy is intended to help the fund meet its carbon emissions commitment, the move also creates a smaller, more concentrated portfolio, which the fund expects to produce cost and efficiency improvements. Between 2019 and early 2022, the fund found that its new reference portfolio (with the low-carbon approach) outperformed the original reference portfolio; however, as of June 2022, there was no material difference in performance.[21]

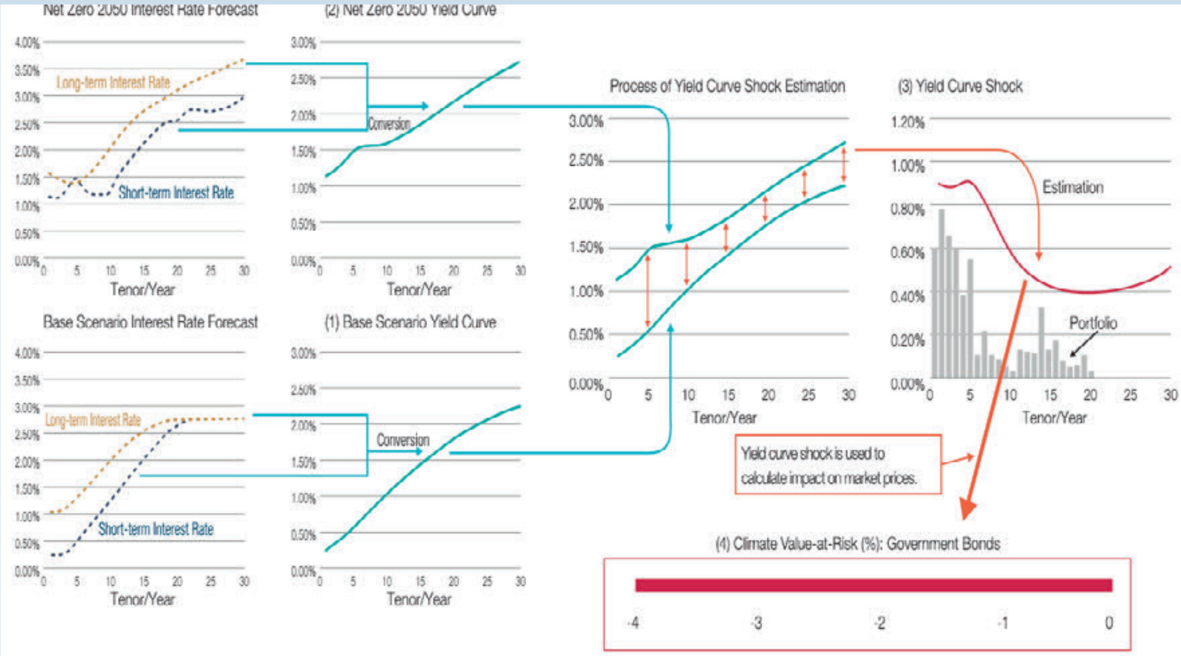
Source: Fund websites and latest annual or sustainability reports.

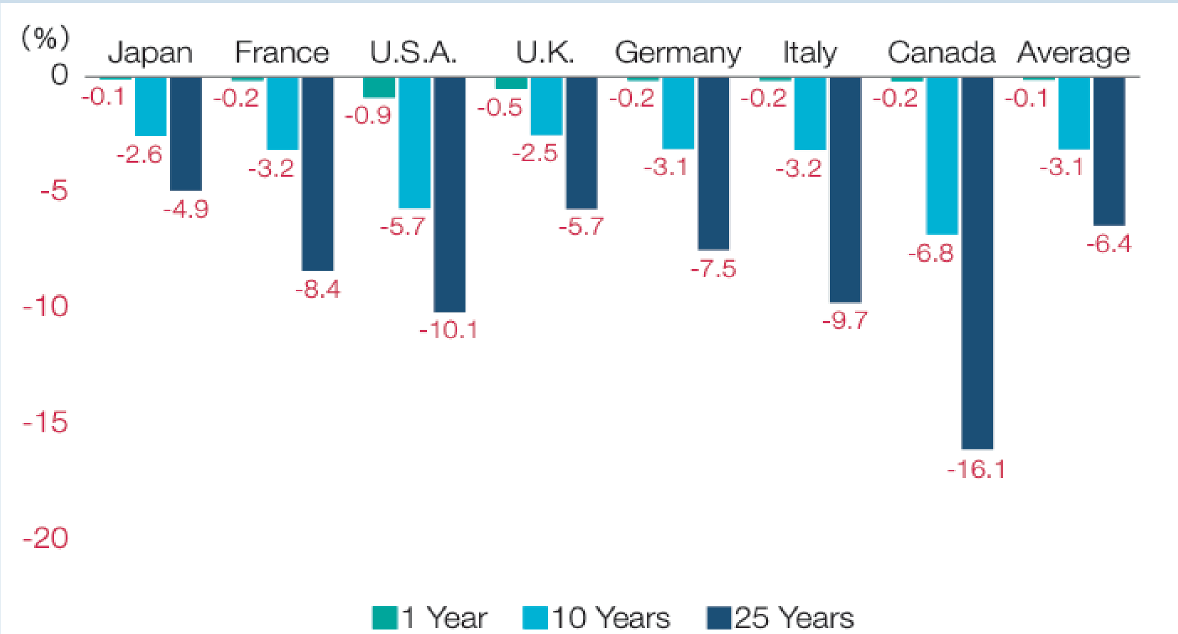
[19] While ratings may vary across different agencies, the availability of such scores can help guide investors in their assessments, and the consistency and coverage of the agencies will likely continue to improve. For more information on the topic, see GPIF's 2021 ESG report.
[20] See PRI, 2022, Statement on ESG in credit risk and ratings.
[21] Guardians of New Zealand Superannuation Annual Report, 2022, p. 45.

Box 4.5. Government Pension Investment Fund (Japan) CVaR model[22]

Institutional investors that have greater in-house capacity may choose to model the impact of various climate scenarios on interest rate moves and subsequent sovereign debt repricing.

For example, GPIF has developed a sovereign CVaR model that seeks to predict interest rate movements for countries that comprise a significant portion of its sovereign debt portfolio. As a base assumption, GPIF selected the 30-year interest rate forecasts produced by NGFS to calculate a 30-year yield curve, assuming no impact of climate change. Next, it calculated new 30-year yield curves, based on five of NGFS's climate scenarios. The difference between the two curves represented the possible yield curve shock.[23] With those data, the fund then repriced the governments' bonds. The fund also distinguished between various maturities, assuming a zero-coupon bond.





Source: Taken from GPIF, 2021, ESG Report, pp. 77 and 78.

[22] GPIF, 2021, ESG Report, pp. 77 & 78.
[23] This model excludes acute impacts (for example, disasters caused by extreme weather events).

(c) Sovereign, public and private debt

Sovereign debt

Governance has long been a critical factor in sovereign debt analysis; however, investors should also consider environmental risks (both physical and transition) and social risks (for example, demographic trends, income inequality, and the like). While these three themes are wide-ranging, such data can come from international organizations such as the World Bank free of charge, or from third-party data providers.[24] Research from IMF and the World Bank found that credit ratings and ESG scores are highly correlated (although the relationship breaks down for countries lower on the income spectrum),[25] so institutional investors with fewer resources may use credit ratings as rough proxies for ESG performance. During the due diligence phase, it is also important to recognize that engagement with a sovereign issuer is different from that of a company – bilateral relationships may provide greater access to documentation and information, but it is unlikely that creditors will be able to influence a country's approach to sustainability.

Public debt

Institutional investors should incorporate sustainability-related concerns alongside other financial metrics into the credit ratings of public companies. The greater disclosure requirements for public companies alongside service provider coverage should help investors generate qualitative or quantitative sustainability metrics. These sustainability factors should be considered when calculating the creditworthiness of the issuer. Investors can apply a standard formula (for example, GPF allocates an 8.75 per cent sustainability weighting to the credit score) or adopt a more flexible approach (for example, sustainability weightings change based on the nature of the asset). Investors that find the due diligence requirements too onerous for their current frameworks and staff competencies can consider allocating additional capital to fixed-income sustainability indices, effectively outsourcing the due diligence.

Private debt[26]

While the transparency of private companies is generally more limited, the PRI and private creditor investors have developed the private credit–private equity ESG factor map to improve the transparency of target companies during the due diligence phase.[27] Institutional investors can structure their analysis around these criteria, which draw on existing standards such as the Sustainable Accounting Standards Board (SASB), TCFD and the ESG Data Convergence Project. Investors that invest in private debt can also take advantage of the more flexible financing terms to negotiate sustainability-related conditions within operational covenants.

(d) Private investment

Private investment funds

For investments into private equity, real estate and infrastructure funds, institutional investors should focus the due diligence on the general partner, as this is the entity that will source the specific investments and drive sustainability engagement with future investees. Depending on the relationship between the general partner and investor as the limited partner, the data-gathering process can range from conversations with the general partner to more formal due diligence questionnaires. Generally, investors should gather information on fundraising (for example, whether or not the general partner has made formal sustainability commitments), pre-investment, during the asset holding phase and post-investment, and also reporting and disclosure policies related to sustainable investment. It can also be helpful to review past investments made by the general partner to better understand their sustainability integration efforts (box 4.6).[28] As a general

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[24] For more information, see PRI, 2019, A Practical Guide to ESG Integration in Sovereign Debt.
[25] See S Cevik and J Tovar Jalles, 2020, This changes everything: Climate shocks and sovereign bonds, working paper (IMF, Washington, D.C.); and EM Gratcheva, B Gurhy, A Skarnulis, FE Stewart and D Wang, 2021, Credit Worthy: ESG Factors and Sovereign Credit Ratings (EFI Insight-Finance, World Bank, Washington, D.C.).
[26] Private debt includes a variety of strategies, but this section will touch on broad recommendations for due diligence.
[27] For SWFs and PPFs that outsource the management of private debt mandates to external asset managers, the PRI's responsible investment DDQ for debt investors provides guidance on evaluating the GP.
[28] SWFs and PPFs that outsource their private market investments should ensure their asset managers have similar policies and frameworks in place.

principle, institutional investors with less developed sustainability-related policies and frameworks will likely find the due diligence requirements for private funds to be less resource intensive than direct deals.

Direct investments in private equity assets

For direct deals or co-investments, sustainability-related due diligence should concentrate on the specific asset, and as these investments tend to be larger, institutional investors should exercise increased caution. For example, CPP developed a comprehensive sustainability evaluation that investigates 45 areas of review, including environment, health and safety, labour and human rights, community rights, cybersecurity and data privacy, business integrity and corporate governance. The assessment is tailored to each investment opportunity and considers the deal structure, company, industry and geography. Institutional investors also consult with the public affairs and communications team to evaluate potential reputational risks.[29]

While direct investments into private companies entail increased risk, investors can ask for a board seat(s), which can be a powerful tool in future engagement efforts. Depending on the deal, an institutional investor could tolerate a weaker initial sustainability profile if it believed engagement could lead to improvements.

Box 4.6. Impact oriented private equity funds

The Partners Group verifies impact: The Partners Group, a Swiss-based private equity firm, launched an impact-at-scale investment strategy in 2018 that aims to contribute to the SDGs. To determine its impact aims, the firm uses the five dimensions (what, who, how much, contribution, risk) proposed by the Impact Management Project. Partners Group also engaged BlueMark, an impact verification provider, to provide independent verification of its impact management system and ensure it is aligned with the Operating Principles for Impact Management.[30]

Bpifrance commits to the Eiffel Essentiel Fund: In 2021, the French sovereign wealth development fund, Bpifrance, made an undisclosed commitment to the Eiffel Essentiel Fund, the Eiffel Investment Group's growth fund targeting the energy and ecological transition. The Essentiel Fund will target French and European companies working to develop innovative solutions around renewable energy, sustainable mobility, energy efficiency and sustainable agriculture and food. Bpifrance decided to invest in the fund because of Eiffel's sector expertise, having already deployed over $1 billion to companies and projects in energy and ecological transition, and the firm's commitment to sustainability.

Source: Fund websites.

Direct investments in private real estate assets

In direct real estate deals, investors should implement increased due diligence, broadly focusing on evaluating the specific property, as well as any environmental risks related to the location of the property that might include, for example, natural disasters and climate change-related factors. These observations should then be incorporated into valuation models.

Given the wide variety of sustainability-related risks facing individual real estate investment properties, investors should consult checklists such as those published by the PRI and SASB to structure their due diligence. Key considerations during the due diligence phase include the potential for improvements, identifying legacy issues and analysing the impact of sustainability factors (for example, land contamination or controversial tenants).[31]

The inputs to the analysis may come from raw data (for example, conversations with tenants or utility bills), third-party data reports (for example, surveyors' reports) and independent analysis and

[29] It is also helpful to have staff across different asset classes discuss transferable lessons around ESG integration.
[30] https://www.partnersgroup.com/en/sustainability/responsible-investment/impact-investment/.
[31] PRI, 2022, An Introduction to Responsible Investment: Real Estate.

vendors (for example, geospatial databases or flood records).[32] When available, investors may find GRESB data and assessments, which provide a standardized reporting framework, helpful for evaluating the sustainability profile of prospective investments (box 4.7).[33,34]

Box 4.7. Ireland Strategic Investment Fund sustainable real estate investment

In November 2022, the ISIF invested $26 million to fund the development of around 1,900 new homes in counties Dublin, Kildare and Wicklow over several years. The fund will provide the capital to D/RES, an Irish homebuilder that was established in 2017. D/RES is one of the leading sustainable homebuilders in Ireland, and the first Irish homebuilder to achieve GRESB accreditation. D/RES will use the capital invested by ISIF to acquire and develop up to five individual sites across the three counties. Social and affordable homes will account for approximately 17 per cent of the new homes. This project is aligned with the fund's strategy to provide new homes in a sustainable manner.[35]

Source: Fund website.

Direct investments in private infrastructure assets

In direct infrastructure deals, it is critical that investors devise a sustainability due diligence strategy that is tailored to the potential asset and operating context.[36] Whether an SWF or PPF, for example, conducts the primary due diligence itself or relies on the project's sponsor, the type of data evaluated should be similar.

Investors should evaluate how the ownership structure of the project will affect future engagement. In brownfield investments, the institutional investor can evaluate the project's past sustainability profile and those findings can help guide predictions about future performance. While historical data can be insightful, investors should also consider how sustainability-related risks could evolve and if the project's sponsors can mitigate them.

Greenfield investments may present more immediate and unexpected risks. While new investors typically investigate environmental and governance concerns before investing in infrastructure projects, institutional investors should ensure the social element is also analysed (box 4.8). New construction can disrupt communities, generating significant resentment, which, if serious enough, could threaten the project and create negative sustainability impacts. Governance challenges are common in large infrastructure projects, so investors should also consider the sponsors' policies on anti-bribery and corruption.

Box 4.8. Compañía Española de Financiación del Desarrollo makes an impact abroad

In 2020, the Spanish fund for foreign investment deployed $26 million to acquire capital in three Chilean wind farms (Malleco, Lomas de Duqueco and Negrete) from WPD Wind Investment, a Spanish company. According to the COFIDES press release, the farms' construction was designed to minimize environmental impact and was done in close collaboration and engagement with government authorities and the local communities. These wind projects are expected to help Chile meet its objectives defined in the National Road Map 2050, as well as support the SDGs, namely 7 (affordable and clean energy), 8 (decent work and economic growth) and 13 (climate action).[37]

Source: Fund website.

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[32] Ibid.
[33] GRESB used to stand for Global Real Estate Sustainability Benchmark, however, the organization recently began to evaluate infrastructure assets and has adopted what was originally an acronym as its formal name.
[34] GRESB also provides data that funds can use to calculate carbon emissions of prospective investments..
[35] https://isif.ie/news/isif-invests-25m-to-fund-delivery-of-1-900-new-homes.
[36] Investors can use the open source ESG due diligence tool for infrastructure assets developed by the GRESB and B Capital, a Swiss investment firm, to structure their approach.
[37] https://cofides.es/en/que-hacemos/casos-cofides/wpd-wind-investment.

5. Incorporate sustainability into investment strategies

In addition to monitoring and managing sustainability risks, institutional investors can implement sustainable investment strategies to guide future performance; capture emerging opportunities related to sustainable development and climate transition; and ensure investments make positive contributions to sustainability-related objectives.

5.1. Negative screening

As a starting point, institutional investors can filter out certain investments with significant exposure to sustainability risks or potential violation of international norms (for example, on human rights issues). These exclusions could be prohibited by law, or institutional investors can choose to exclude industries on their own accord. For example, many investors exclude assets such as arms, tobacco and fossil fuel companies (see box 5.1 for more examples).

PPFs can also choose to offer greater portfolio customization to their beneficiaries. For example, AustralianSuper offers "socially aware" or customizable investment portfolios for pensioners. The former applies additional exclusions based on values, whereas the latter allows pensioners to build a unique portfolio of publicly listed companies, ETFs, and money market funds based on personalized criteria. Other examples include the screening of assets on the basis of aggressive tax avoidance by the investee (ATP, Denmark), labour rights violations of core International Labour Organization conventions (APG) and contraventions of international law (PFZW).

5.2.Positive screening

Institutional investors can also employ a "best-in-class" screening process, where companies are compared to competitors across a range of financial and non-financial metrics, and the leading firms are scored more highly. Investors should then target investments in those leaders. While current performance is important, it is also important to consider companies' trajectories. In instances where a company may fall below industry averages, the investor should evaluate the possibility of improvement. The path forward will depend on the firm's leadership, but the investor should also weigh its ability to influence positive change (that is, to make sustainability a higher priority) through future engagement.

5.3.Thematic Investing and the SDGs

Institutional investors can also develop investment strategies that intentionally target sustainability-oriented sectors (for example, renewables or green housing) or capital market instruments (for example, ESG funds). In terms of thematic area, investors have been keen to invest in what can broadly be termed as climate- or environment-related positive impact assets, such as carbon-efficient assets, renewables and green real estate and infrastructure. Some investors choose to invest in indices (for example, S&P/JPX's Carbon Efficient Index), while others target investments in private market assets (for example, real estate projects that meet LEED criteria) (box 5.2).[38]

Some pension and sovereign wealth funds have also been active investors in debt instruments that have a sustainability dimension, such as green, social or sustainability bonds (ATP, Denmark; Alecta; bpfBOUW, Netherlands). Meanwhile, some pension funds, particularly in North America, have also been issuers of bond products. CPP (Canada) was the first pension fund to issue green bonds, completing its inaugural issuance in June 2018. Investors bought $1.5 billion of the 10-year bond, which Bloomberg reported was a record at the time for a single green bond transaction in Canada. This was followed in 2019 by CalSTRS which issued $281 million in municipal green bonds.[39]

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[38] Leadership in Energy and Environmental Design (LEED) is a green building certification programme used worldwide and developed by the non-profit U.S. Green Building Council.
[39] Bloomberg, 2018, Canada pension sells $1.2 billion green bond in global first, 13 June.

Box 5.1. Negative and positive screening in action

NBIM's exclusion framework: Norway's Ministry of Finance has issued ethically motivated guidelines for the observation and exclusion of companies from the fund. The fund must not be invested in companies that produce certain types of weapons, base their operations on coal, or produce tobacco. Nor may the fund be invested in companies whose conduct contributes to violations of fundamental ethical norms. The Ministry of Finance has set up an independent Council on Ethics to make ethical assessments of companies. The Council on Ethics sends its recommendations to Norges Bank and the bank's executive board makes the final decision on exclusion, observation or active ownership.

APG's leaders and laggards framework: For APG, "inclusion means that we evaluate all the companies that we can invest in through equities or bonds (the investment universe) in terms of return, risk, cost and the degree to which they operate responsibly. If a company meets our fund clients' parameters and scores above average compared to its industry peers, we call it a "leader". We like to invest in such companies for our pension fund clients. In addition, there are companies that score well on return, risk and cost but lag on sustainability and good corporate governance. We may invest in such "laggards", but only if we think we can encourage them to improve their performance on sustainability. Engagement is a condition for investing in these companies, which we refer to as "potential improvers". The criteria we have developed to evaluate companies in the areas of human rights, labour rights, the environment and business ethics are based on the principles of the United Nations Global Compact. We check whether companies have a sound policy in these areas, whether they generally honour agreements and whether any incidents have been flagged. We use separate criteria for every industry that considers the specific sector-related risks. We also look at the countries and regions where companies operate. We expect companies that operate in areas with an increased risk of human rights violations to be able to detect and limit those risks. This means they should always have an appropriate human rights policy in place".

Source: Sustainability reports of relevant funds.

Box 5.2. Sustainability-themed investment by CalSTRS

In March 2021, the CalSTRS Investment Committee approved a new sustainable investment and stewardship strategies private portfolio to create a systematic platform to expand sustainability-focused investment opportunities in private markets, including low-carbon solutions, that meet the fund's risk and return objectives.

The fund claims that: "We intend to deploy about $1 billion to $2 billion per year over the next two years, with a focus on low-carbon solutions and affordable housing. The new private portfolio changes and enhances the dynamics of internal staff governance for certain investments by enabling a collaborative approach to investment due diligence and recommendations. The portfolio also expands our understanding of how specific investments demonstrate positive contributions to a more sustainable global economy, including mitigating and adapting to climate change. Since this is an evolving and fast-moving element of the global investment industry, this new portfolio will expand our expertise in the intersection between risk-adjusted returns and sustainability drivers and outcomes."

Source: Sustainability report of CalSTRS.

To help target impactful sectors, institutional investors can craft investment strategies around the SDGs. As part of the move towards sustainability-dedicated investment, the consideration of the SDGs in investment decision-making processes and asset allocation has emerged as one of the latest iterations of ESG integration and sustainable investing. There are two common approaches: sectoral- and taxonomy-based.

The sectoral approach focuses on allocating capital to the industries that are most important to fulfilling the 2030 Agenda. UNCTAD has identified eight SDG sectors that offer significant opportunities for investors and that are critical for achieving the SDGs: transport infrastructure; telecommunication infrastructure; water and sanitation; food and agriculture; climate change mitigation (renewable energy and cleantech); health; education; and ecosystem diversity; and has been monitoring investment flows to these SDG sectors by sustainable equity funds.[40] Based on their mandate and the national SDG objectives of their country, SWFs and PPFs, for example, can prioritize and allocate capital to selected SDG sectors (box 5.3).[41]

Box 5.3. Social investment by the Senegalese SWF, FONSIS

The Senegalese SWF, FONSIS, was formed in 2012, and its investment strategy was based on helping the country achieve SDG targets. Recently, FONSIS partnered with the International Finance Corporation to develop over 20,000 new homes for low-income earners, a key target of SDG 11.3. Such projects are often shunned by private developers because of concerns over repayment. Given the support of the International Finance Corporation and FONSIS, the project is expected to mobilize and attract other institutional investors. This case exemplifies the power of sovereign investors – their long-term investment horizons and implicit government support allow them to take on riskier projects, which in turn lowers the project's risk profile and encourages other private sector participation.

Source: Fund website.

The taxonomy approach requires institutional investors to assess each investee or project against certain taxonomies in terms of their contribution to the SDGs and commit investment to taxonomy-aligned assets. In addition to taxonomies published by government entities (such as the European Commission), there are also several taxonomies developed by the industry. For example, PFZW, AustralianSuper and British Columbia Investment, through the SDI Asset Owner Platform (SDI AOP) developed a taxonomy to determine whether and to what extent companies contribute to the SDGs with their products and services. The SDI definition and taxonomy are publicly available and apply to unlisted investments, such as real estate and infrastructure. BlackRock's recent decision to use the platform is another sign of demand from the private sector.

[40] See UNCTAD's Global Sustainable Finance Observatory, https://gsfo.org/sustainable-funds-database.

[41] In some instances, federal governments are linking the SDGs to country-specific goals. For example, Statistics Denmark has created indicators that translate the SDGs to the Danish context. PensionDanmark reports progress on the indicators in its annual reports. See PensionDanmark corporate responsibility reports for more information.

6. Mainstream sustainability along the investment value chain

While integrating sustainability into investment decisions is a critical step for institutional investors, the work should not end after the initial investment. Rather, institutional investors should use their leverage – and privileges as shareholders and bondholders – to push their investees (and asset managers) to adopt more sustainable business processes. Additionally, investors should continue to engage other actors in the investment ecosystem, such as regulators, rating agencies, index providers, and other sovereign and institutional investors to ensure the system continues to become more conducive to sustainable investment. This chapter will propose recommendations based on best practices in engagement techniques, such as dialogue, exercising voting rights, and divestments. It will also explore how SWFs and PPFs can engage with asset managers and other stakeholders in the investment chain.

6.1. Engagement with stakeholders

Investees

Active communication: Institutional investors should ensure there is an active dialogue with investees across all asset classes.[42] The topics and frequency will depend on the investor's policies but should be shaped by due diligence during the screening process. Leading institutional investors have developed custom engagement heatmaps, which are based on industry, region and prior sustainability efforts. While not all investors will have such elaborate models, they may prioritize companies that are at the highest risk or those that constitute their largest investments. Once an investor has established sustainability policies, voting guidelines and/or stewardship codes, it is important that they are shared with investees so companies gain a better understanding of expectations. As a first step, institutional investors can verify if their investees are signatories to any international standards (PRI, United Nations Global Compact, and the like). For example, British International Investments provides guidance to companies on recommended practices within its responsible investment policy.[43] Another way of communicating on sustainability topics is by supporting shareholder resolutions on sustainability risks and opportunities, which many investors do systematically.

Guidance and knowledge exchange: Although external managers will normally drive the discussions with investees, institutional investors should endeavour to make dialogue a two-way street. As universal investors, SWFs and PPFs have a unique vantage point and can offer lessons and suggestions to companies looking to integrate best practices in sustainability. In line with this thinking, institutional investors who have a controlling stake should give thought to their nominees for board seats. For example, CPP requires that its nominated non-executive directors (NEDs) complete training based on the fund's guidelines. It also offers an ongoing training series where NEDs can share best practices in asset management and receive training in a variety of areas, including equity, diversity, inclusion, and climate change. This program helps ensure that its NEDs have the necessary competencies to fulfil their duties, and it also facilitates knowledge exchange.

Constant evaluation: Regardless of the specific form of engagement and dialogue, it is important that institutional investors implement a consistent structure and one that allows for monitoring and evaluation, which in turn is contingent on the availability of relevant and usable sustainability data. These benchmarks and progress will feed into voting decisions, as well as investment and divestment decisions (box 6.1).

Asset managers

Similar to investee engagement, institutional investors that rely on external asset managers need to ensure that these firms are operating in a manner consistent with their policies and guidelines (box 6.2). While the initial due diligence should provide the basis for engagement, ongoing monitoring, discussions and review of progress is important. Some investors may choose to go further and conduct surveys of investees to measure stewardship efforts of internal or external

[42] Some funds (for example, New Zealand Super) rely on external engagement providers to manage investee engagements.
[43] British International Investment, 2022, *Policy on Responsible Investing*, annex D.

asset managers. Additionally, SWFs and PPFs can appoint external managers with an explicit mandate to enhance engagement efforts.

Box 6.1. Temasek joins partnership to explore sustainable aviation fuel

Temasek is a global investment company owned by the government of Singapore (making it an SWF). In November 2021, Temasek, the Civil Aviation Authority of Singapore and Singapore Airlines announced a partnership to pilot the use of sustainable aviation fuel in Singapore. Temasek, which committed to a net zero carbon emissions portfolio by 2050, recognizes the need for decarbonization strategies, especially in hard-to-abate sectors such as aviation and transport. This is particularly important for Temasek, as it holds a 56 per cent stake in Singapore Airlines. The partnership allows the three actors to draw on their respective strengths to work towards a more sustainable future and is an example of how investors and investees can work together.

Source: Fund website.

Box 6.2. Setting expectations for external asset managers

Alecta sets clear expectations on sustainability management and performance in its external asset manager selection process and communicates these expectations to external asset managers. External asset managers should act in accordance with rules, international conventions and legislation, as well as developing and maintaining a sound corporate culture and strong business ethics that characterize the business. All external asset manager relations are subject to regular monitoring to follow up on these principles. In cases of infringement, Alecta will expect swift action to rectify the situation.

Source: Alecta.

Rating agencies and index providers

Institutional investors can engage rating agencies and index providers given their important role, particularly in public equity and bond markets. Although rating agencies have further to go in providing comprehensive coverage of sustainable and sustainability-related risks across countries and industries,[44] greater engagement by investors is contributing to improvements. Similarly, if index providers strengthen their sustainability standards for inclusion, more firms may prioritize their sustainability profiles. While index providers and rating agencies are outside of the investment portfolio, their work has a tangible impact on the efficiency of capital markets and the bottom line of asset owners and managers.

Governments and international organizations

Institutional investors can also engage with national regulators and international standard-setting bodies by providing suggestions and constructive feedback on how to improve regulatory and standard-setting efforts. Although each country has its approach to legislation and rulemaking, as they are universal owners SWFs and PPFs can offer their perspectives to both national regulators and international bodies, especially in promoting greater comparability and evaluation. For instance, CalSTRS regularly interacts with the United States Securities and Exchange Commission to advocate for increased corporate disclosure requirements concerning carbon emissions.[45] Such initiatives can encourage greater transparency and support funds' transition to net-zero emissions.

[44] For example, see the GPIF *2021 ESG Report* for a study that explores the correlation between FTSE and MSCI ESG ratings.
[45] See, for example, https://www.calstrs.com/calstrs-calls-on-sec-to-require-stricter-climate-disclosures.

Collaboration with other investors

Institutional investors should continue to create and join collaborative platforms and initiatives that promote sustainability and a better understanding of the impact of sustainability on investments. There is a plethora of international initiatives (the Global Asset Owners Forum, Climate Action 100+, International Corporate Governance Network, among others) where asset owners and managers and other financial institutions work together to demand investees improve and adopt best practices in ESG.

To stay ahead of the curve, investors with the necessary resources should continue to pursue further studies of sustainability-related issues. From research studies exploring long-term strategic allocation (GIC) to papers on the future of sustainability investing (Mubadala and Bloomberg), investors are driving improvements, which will not only impact themselves, but also their investees and the international community (box 6.3). Funds can also invest in technology to better evaluate and address sustainability. For example, APG is committed to exploring how artificial intelligence and digital technologies can complement existing analytical techniques when it comes to fundamental valuations and risk management.

Box 6.3. Canadian Pension Plan develops institute to foster knowledge exchange

In March 2022, CPP launched the Investments Insights Institute, which aims to unlock value by drawing on its global investing expertise and partnerships. The institute explores ways for the global investment ecosystem to address climate change, technology disruption and evolving stakeholder expectations. The institute brings together fellow investors, CEOs, policymakers and others to engage on ways to overcome sustainability challenges. In 2022, CPP used the platform to discuss topics of mutual interest, including CPP's proposed Abatement Capacity Assessment Framework. Based on the feedback from investors, CEOs and consultants, CPP then took steps to refine and improve the model.

Source: Fund website.

6.2. Exercise voting rights

Shareholders wield most of their influence on public companies through voting on company directives and on the board of directors (box 6.4). The specific mechanism can vary (for example, by proxy or direct), but voting on the strategic direction of the company is an important way for investors to ensure their investees are serious about sustainability. Whether investors vote by proxy or rely on internal teams, they should have clear, public policies on voting. Other investors rely on internal teams to implement a consistent and transparent voting policy. While KPIs and voting principles should be important inputs to decision-making, investors can also provide leeway to companies, assuming there is a compelling case for why a company has taken a certain action.

Box 6.4. Public pension funds take stronger stances

As asset owners and managers become more aware of sustainability-related issues, voting against the board of directors when insufficient attention is placed on sustainability is becoming more common. For example, CalSTRS supported Engine No. 1's efforts to replace several seats on the board of ExxonMobil with individuals who were committed to actively addressing the effects of climate change and Exxon's GHG emissions. In May 2021, the activist hedge fund was successful after shareholders elected three of its nominated board members, representing a significant change in the composition of the 12-person board. It was the first time that shareholders voted for directors who were not supported by Exxon's management. As another example, in 2021, APG voted against approving financial statements for companies that did not link remuneration to climate targets.

Source: Fund websites.

6.3. Divestments and asset manager mandates

Institutional investors should develop a framework that guides their divestment decisions if engagement and voting have failed to lead a company to become more sustainable. While it should generally be employed as a last resort because of the loss of control over the company, divesting remains a source of leverage for investors and is a powerful demonstration of its commitment to sustainability.[46] Other investees will certainly take note and may be more likely to take investor demands more seriously.

As asset owners, sovereign and public investors should exercise control over external asset managers through the renewal or termination of investment mandates. It is important for investors to evaluate the asset manager's progress towards the established KPIs when deciding on whether to renew.

[46] There are also arguments that divestment from ESG-deficient companies and investment in ESG-conscious companies will raise the cost of capital for the former group, while lowering the cost for the latter.

7. Measure and report on progress

In the interests of transparency, and to enable beneficiaries and other stakeholders to identify how the institutional investor is managing sustainability, it is critical for institutional investors to evaluate and measure their impact and communicate those results. Since there is no commonly agreed template for sustainability reporting for institutional investors, there is a huge discrepancy in their sustainability reporting in terms of scope, structure, the issues covered and the level of detail provided. This lack of consistency among funds makes comparisons of their sustainability integration performance difficult. To address this challenge, this chapter, based on international best practices and recognized international frameworks, tries to propose a generic framework for sustainability disclosure for institutional investors.

7.1. Disclosure and sustainability integration

Institutional investors, as responsible asset owners, should put sustainability disclosure at the heart of sustainability integration efforts for a number of reasons:

- **Transparency:** By disclosing their sustainability performance, asset owners can provide transparency to stakeholders such as investors, customers, beneficiaries employees and communities. This can increase trust in the organization and demonstrate a commitment to sustainability.
- **Risk management:** Sustainability risks, such as climate change, resource scarcity and human rights violations can have significant financial and reputational impacts on organizations. By disclosing their sustainability performance, asset owners can better manage these risks and make informed decisions to reduce them.
- **Improved performance:** Disclosing sustainability performance can help asset owners identify areas for improvement and set targets to achieve sustainability goals. This can lead to improved performance, cost savings and operational efficiency.
- **Competitive advantage:** In today's business environment, sustainability is becoming an increasingly important factor for customers, investors and other stakeholders. By disclosing their sustainability performance, asset owners can differentiate themselves from competitors and gain a competitive advantage.
- **Regulatory compliance**: Disclosure of sustainability performance is becoming mandatory in some jurisdictions, and it is likely that more regulations will be introduced in the future. By disclosing sustainability performance, asset owners can ensure compliance with current and future regulations.

Despite all these benefits, research by UNCTAD has found that more than half of the world's largest SWFs and PPFs, for example, do not report on sustainability in a systematic manner.[47] In all jurisdictions, regardless of mandatory disclosure requirements, SWFs and PPFs should produce timely and high-quality disclosures about sustainability integration practices, policies and impact to their key stakeholders and the wider public.

7.2. Address the key challenges

While there are many benefits to disclosing sustainability performance, SWFs and PPFs and other institutional investors have several challenges to overcome. The biggest challenges include the lack of standardization in reporting frameworks, difficulties in gathering and verifying sustainability data, resource constraints, the complexity of sustainability issues, and the legal and reputational risks associated with disclosure. To address these challenges, SWFs and PPFs, and other investors, can take several actions, including:

[47] UNCTAD, 2020, *How Public Pension and Sovereign Wealth Funds Mainstream Sustainability* (United Nations publication, Geneva), https://sdginvestors.net/document/how-public-pension-and-sovereign-wealth-funds-mainstream-sustainability/.

- **Identify relevant sustainability issues:** As the starting point, the funds can follow the steps as suggested in chapter 4 to assess and identify the key sustainability issues and risks that are most relevant to their operations and stakeholders and should be covered by their sustainability disclosure.

- **Use recognized reporting frameworks:** To increase the comparability and credibility of sustainability reporting, institutional investors such as SWFs and PPFs have been using recognized reporting frameworks, such as the TCFD recommendations (see box 7.1),[48] the Global Reporting Initiative (GRI) Standards[49] or SASB[50] in sustainability disclosure. As an important development in international standard setting, the International Sustainability Standards Board (ISSB) of the International Financial Reporting Standards (IFRS) Foundation is consolidating existing investor-focused sustainability disclosure frameworks and standards, including the TCFD, SASB, GRI and Climate Disclosure Standards Board into a coherent global sustainability disclosure framework. The ISSB standards could emerge as the baseline for sustainability disclosure for institutional investors globally and thus lead to more consistency, transparency and comparability in sustainability reporting.

- **Improve data collection and management:** Institutional investors should invest in improving data collection and management processes, such as implementing data management systems, conducting audits and engaging with suppliers and partners to improve data quality. They can also use professional sustainability data providers as sources of data that may be needed for the reporting.

- **Allocate resources:** Institutional investors should allocate the necessary resources, including time, staff and financial investments, to ensure that sustainability reporting is a priority and can be conducted effectively. This may involve creating dedicated sustainability teams or outsourcing reporting to external consultants.

- **Ensure legal and reputational compliance:** Institutional investors should ensure that sustainability reporting is compliant with applicable legal requirements and that reporting is accurate, complete and transparent. For this purpose, external auditing is recommended. Just as financial statements are audited, many funds, such as APG, Alecta, bpfBOUW, PensionDanmark, PFZW and New Zealand Super Fund have employed auditors for sustainability reports, which is essential for quality assurance and maintaining public trust.

[48] For example, SWFs and PPFs such as Mubadala, CalSTRS, ISIF, GIC and CPP are following the TCFD disclosure framework.
[49] Some SWFs and PPFs, such as APG, OTTP, QIC, Samruk-Kazyna JSC (Kazakhstan) and USS use the GRI standards in their sustainability reporting.
[50] SWFs and PFFs such as Australia Super have used the SASB to guide annual reports. Many more, including NBIM, QIC (Australia) and New Zealand Super Fund encourage investees to report according to the SASB Standards. The ISSB is proposing two standards around climate and general sustainability-related disclosures. Thus far, the proposed standards have garnered strong support from leading PPFs (for example, CPP), SWFs (for example, NBIM) and high-level politicians.

Box 7.1. Task Force on Climate-related Financial Disclosures as a sustainability disclosure framework

The TCFD was formed by the Financial Stability Board in December 2015 in response to a request from the G20 countries to better understand the financial risks posed by climate change. The main objective of the TCFD is to develop consistent climate-related financial disclosures to help investors, lenders and insurance underwriters improve their understanding and analysis of climate-related risks and opportunities.

The voluntary recommendations set out by the TCFD have been designed to assist companies, including asset owners, in identifying and disclosing the potential financial impacts of climate-related risks and opportunities. The TCFD structured its recommendations, which transcend sectors and jurisdictions, around four key areas: governance, strategy, risk management, and metrics and targets. An overview of the framework and specific recommendations on sustainability disclosure are detailed below.

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Source: Diagram taken from https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing_Guidance.pdf.

7.3.Define the scope of sustainability disclosure

Based on international best practices and internationally recognized frameworks such as the TCFD and GRI, institutional investors, such as SWFs and PPFs ,should consider covering the following areas in their sustainability reporting:

- **Governance:** Institutional investors should disclose their governance structures and processes for managing sustainability risks and opportunities, as well as the roles and responsibilities of senior management and the board of directors.

- **Strategy:** Institutional investors should describe their sustainability strategy, including how it is integrated into their overall business strategy, how sustainability risks and opportunities are identified and managed, and how the organization plans to achieve its sustainability goals.
- **Risk management:** Institutional investors should disclose how they identify, assess and manage sustainability risks, including physical, transition and liability risks, and how they plan to adapt to changing climate and sustainability conditions.
- **Performance:** Institutional investors should report on their sustainability performance, including ESG indicators such as GHG emissions, energy use, employee diversity, health and safety, and community engagement.
- **Targets and metrics:** Institutional investors can set targets to improve their sustainability performance and disclose progress towards meeting those targets. For example, these targets could include achieving net-zero emissions, sourcing 100 per cent renewable energy, reducing water consumption, achieving zero waste to landfill, increasing the representation of women and underrepresented groups in leadership positions, and supporting community development initiatives.
- **Stakeholder engagement:** Institutional investors should disclose how they engage with stakeholders, including investors, customers, beneficiaries, employees, investee companies, regulators, policymakers and communities, on sustainability issues and how they respond to stakeholder concerns.

Previous chapters of this framework recommended a set of actions that can be taken in each of these areas. The outputs of these actions can serve as inputs to sustainability disclosure for SWFs and PPFs.

It is recommended that sustainability should be disclosed at both entity and product or project level whenever possible. For example, if SWFs and PPFs also invest in private equity, infrastructure projects or green bonds, they should report on sustainability at project or product level.

* * *

While this framework proposes concrete steps and strategies that institutional investors, such as SWFs and PPFs can use, addressing sustainability will require an iterative approach as investors gain a better understanding of the issues. With this in mind, institutional investors should stay open-minded and up to date on the latest practices and trends, including the latest developments in international standards setting. Additionally, the diverse mission of these investors and the context of the host country in which they are located will impact their respective strategy and practice.

UNCTAD and UNEP FI will continue to monitor the best practices in sustainability integration and provide necessary support to institutional investors in implementing the framework's recommendations through capacity building and other activities. Meanwhile, UNCTAD and UNEP FI are open to feedback from the multiple stakeholders of the global investment-development community and will update the framework periodically to reflect new practices and lessons learnt.

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