Conference Report

New Frontiers in Emerging Markets Investment

Who Cares Wins Annual Event 2007

IFC International Finance Corporation World Bank Group

Schweizerische Eidgenossenschaft
Confédération suisse
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THE GLOBAL COMPACT United Nations Global Compact

Conference Report

New Frontiers in Emerging Markets Investment

Who Cares Wins

Annual Event 2007

Thursday, 5 July 2007

Credit Suisse Forum Genève, Geneva, Switzerland

Hosted by:

- International Finance Corporation (IFC)
- Swiss Department of Foreign Affairs
- UN Global Compact

Report prepared by:

- Gordon Hagart and Ivo Knoepfel, onValues Ltd.

August 2007

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Foreword by hosting institutions

New Frontiers in Emerging Markets Investment

Who Cares Wins Annual Event 2007

The Who Cares Wins initiative was launched in early 2004, with the aim of supporting the financial industry's efforts to integrate environmental, social and governance (ESG) issues into mainstream investment decision-making and ownership practices.

The intervening years have seen the ESG landscape evolve exponentially, through initiatives such as the Principles for Responsible Investment, industry collaborations such as the Enhanced Analytics Initiative and the Marathon Club, and the innumerable efforts of institutions and individuals at all stages in the investment chain.

Who Cares Wins' part in this evolution has been a series of annual closed-door events for professionals from the asset management and investment research communities, hosted by the International Finance Corporation (IFC), the Swiss Department of Foreign Affairs and the United Nations Global Compact.

The third and most recent event took place in Geneva, Switzerland, on 5 July 2007, and focussed on the crucial role that ESG issues play in emerging markets investments. This report presents the conclusions of that event, with examples of how leading professionals on the buy and sell sides are integrating ESG issues into their emerging markets work. We believe that the resulting recommendations are a further step in the ESG evolution. A better consideration of ESG issues in emerging markets investments will help to foster stronger and more resilient financial markets, and contribute to the sustainable development of societies in emerging countries.

However, this evolution is yet to become a revolution. We must not be under the illusion that the individuals who control the vast majority of capital markets flows routinely and systematically integrate ESG issues into their investment decisions. A large intellectual divide remains between the vanguard on 'ESG Street' and the majority of professionals on Wall Street.

The hosting institutions believe that the catalytic role that Who Cares Wins was meant to play is nearing completion. We plan a series of strategic discussions with industry executives in 2008, before summarising lessons learned in a final report.

The following phase — bridging the divide — will require creativity from and collaboration between all concerned parties, and above all renewed impetus from the industry itself. The IFC, the Swiss Department of Foreign Affairs and the United Nations Global Compact look forward to continuing their support of the financial community as it embarks on this journey.

Rachel Kyte
Director, Environment and Social Development Department
International Finance Corporation

Ambassador Thomas Greminger
Head of Political Affairs Division IV, Human Security
Swiss Department of Foreign Affairs

Gavin Power
Head, Financial Markets
UN Global Compact

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Abbreviations

EM	Emerging market(s)
ESG	Environmental, social and governance [issues]

"The risks to emerging markets in the medium and long term are mainly political and social. The inequalities are pretty stark, and the education levels need to go up. Social indicators need to improve for growth to continue."

— Christian Deseglise
Global Head of Emerging Markets, HSBC Investments

"An entrepreneurial approach to frontier markets can have positive systemic impacts in terms of standards of disclosure, governance and ESG practice, and handsome financial rewards. The key is to establish standards that are in the interests of long-term investors before less scrupulous investors set the bar at lower levels."

— Hendrik du Toit
CEO, Investec Asset Management

1. About Who Cares Wins

In June 2004 a group of 20 financial institutions with combined assets of over US$6 trillion published and publicly endorsed a report entitled 'Who Cares Wins: Connecting Financial Markets to a Changing World'[1]. Facilitated by the UN Global Compact, the focus of the report was a series of recommendations, targeting different financial sector actors, which taken together seek to address the central issue of integrating environmental, social and governance (ESG) issues into mainstream investment decision-making and ownership practices.

The key characteristics of Who Cares Wins are as follows:

- The core constituency is the middle of the investment chain: asset managers and the investment research community
- However, Who Cares Wins also provides a platform for asset managers and investment researchers to engage not only with their peers, but also with companies, institutional asset owners and other private and public actors in the investment chain
- The principal setting for this engagement is an annual closed-door, invitation-only event for investment professionals (previous Events took place in Zurich, Switzerland in 2004, 2005 and 2006)
- The public bodies that host Who Cares Wins aim to create a neutral and protected space for frank dialogue between financial professionals on the challenges of integrating ESG issues into investment processes

[1] Who Cares Wins endorsing institutions: ABN AMRO, Aviva, AXA Group, Banco do Brasil, Bank Sarasin, BNP Paribas, Calvert Group, China Minsheng Bank, CNP Assurances, Credit Suisse, Deutsche Bank, F&C, Goldman Sachs, Henderson, HSBC, Innovest, IFC, KLP, Mitsui Sumitomo Insurance, Morgan Stanley, RCM, UBS and Westpac

2. Objectives of the 2007 Event

Event focus and goals

On the basis of feedback from the previous year's participants, the Who Cares Wins 2007 Event focussed on the consideration of ESG issues in emerging markets (EM) investments.

The **goals** of the 2007 Event were to:

- Assess the importance of ESG issues in EM investments
- Showcase and reinforce best-practice in the consideration of ESG issues in asset management and investment research relating to EM investments
- Identify opportunities for future developments and collaboration in this area

To achieve these goals, Event participants were asked to consider the following **framing questions**:

1. How important are ESG considerations for EM investors:
   - Overall, compared to developed economies?
   - For country allocation purposes?
   - For selecting individual securities?
2. Are there ESG issues whose importance is overstated; others whose importance is understated?
3. What have been the challenges so far in terms of integrating ESG in asset management and investment research?
4. Are asset owners rewarding these efforts?
5. Does an active ownership work in emerging markets?
6. How important is local expertise in EM and how can access to ESG information be improved?

Background research structured according to a series of hypotheses was sent to the participants before the Event (see page 20). The **hypotheses** were as follows:

1. The risks posed to emerging markets investments by environmental and public health issues are generally underestimated
2. Investors should attribute greater importance to the impacts of corruption and poor governance on the long-term economic prospects of emerging markets

3. ESG disclosure in emerging markets is poor. Investors should be more active in ensuring that minimal standards for ESG disclosure are applied (e.g. by engaging with exchanges)
4. Investors are willing to pay a premium for well-managed companies in markets where corporate governance standards depart substantially from best practice. However, corporate governance is seldom systematically factored into decision-making in emerging markets investments
5. The inclusion of ESG issues in country-level investability analysis may be cost-effective and may encourage regulatory reform. However, by using ESG data only at the country level, the investor risks excluding best-practice companies in non-permissible markets, and including worst-practice companies in permissible markets

Area of interest and participants

In addition to both mainstream and specialised asset managers and researchers, representatives from the following communities were present at the Event:

- Institutional asset owners
- Investment consultants
- Private and investment banking representatives
- Data providers
- Exchanges
- Multilateral agency and government representatives

A full list of participants can be found in the appendices on page 17.

Initial assumptions

The following 'ground rules' were established for the discussions that took place at the Event:

- The Event is focussed on mainstream institutional investment. Although there are clear overlaps with the interests of ethical / SRI investors, the target community is investors (and their agents) who are exclusively concerned with the long-term financial performance of their investments
- The core constituency of the Event is professionals from the asset management and investment research communities. A limited number of actors from other parts of the investment chain are also invited

- Participants are assumed to have basic knowledge of the ESG business and investment case (and the fact that it may vary across different companies, sectors and regions)
- In keeping with the aim of encouraging frank dialogue, the entirety of the Event is held under the Chatham House Rule[2]
- Although other asset classes, issuers and countries may be discussed, given the limited time available the Event will concentrate on the publicly-traded equity of companies domiciled in countries that are generally accepted as emerging markets[3]

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[2] The Chatham House Rule: participants are free to use the information received, but neither the identity nor the affiliation of the speakers, nor that of any other participant, may be revealed

[3] A market is generally classified as 'emerging' if it meets at least one of two general criteria: (1) it is located in a low- or middle- income economy as defined by the World Bank and (2) its investable market capitalisation is low relative to its most recent GNP figures. The lower cut-off of an emerging markets classification is generally driven by investability considerations such as absolute market size and liquidity.

The Morgan Stanley Capital International (MSCI) Emerging Markets Index contains companies from the following countries (largest capitalisation markets in **bold**): Argentina, **Brazil**, Chile, **China**, Colombia, Czech Republic, Egypt, Hungary, **India**, Indonesia, Israel, Jordan, **Korea**, Malaysia, **Mexico**, Morocco, Pakistan, Peru, Philippines, Poland, **Russia**, **South Africa**, **Taiwan**, Thailand and Turkey

3. Key insights from the Event

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On the importance of ESG issues in emerging markets (EM) investments

- Many participants confirmed — from their experiences as asset managers and investment researchers — that the investment case for considering ESG issues in EM investments is on average stronger than in the case of developed market investments. Inter alia, participants noted that:

  - Departures from ESG best-practice tend to be larger in the worst-case EM companies (compared with worst-case developed market companies)
  - Macro growth rates in EM are often impacted by ESG issues such as political stability, governance, corruption, education levels and public health
  - A relative lack of oversight by regulators and gatekeepers such as analysts and institutional investors results in weaker investor protection and ultimately higher agency costs

- As a consequence, asset owners are increasingly demanding a more explicit consideration of ESG issues in EM investments (as shown by preliminary results from an IFC-sponsored Economist Intelligence Unit survey presented at the Event)

- The importance of ESG issues in EM is not limited to the relatively small part of an investor's portfolio allocated to EM investments. In reality, these issues — through macroeconomic effects and the increasing operational exposure of non-EM-domiciled[4] multinational companies to EM — can affect a large part of an investor's portfolio

- Participants from institutions headquartered in EM emphasised the fact that social and governance issues are often more pressing and material than international investors realise[5]. The latter investors often seem to put a greater emphasis on environmental issues

- There is also a time element attached to different ESG issues: in the short-term, the importance of social and governance issues tends to

[4] An issuer's domicile is generally determined by a subjective decision based on a number of factors, including country of incorporation, location of headquarters, primary exchange, primary liquidity, geographic source of revenues and location of assets

[5] See Hypothesis 2 (page 20)

be underestimated; in the long-term the importance of environmental issues is expected to come to the fore

- Corporate governance issues are particularly important when companies are controlled by governments and families, which is often the case in EM. Issues such as minority shareholder protection and board quality are crucial in such cases

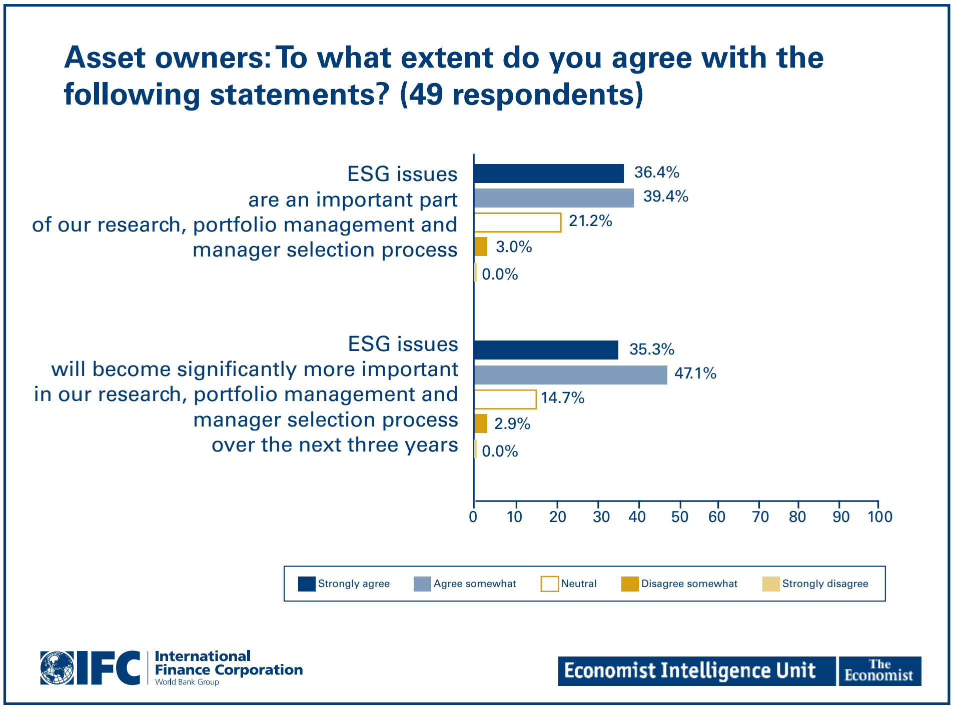
On the awareness of ESG issues among different types of investors

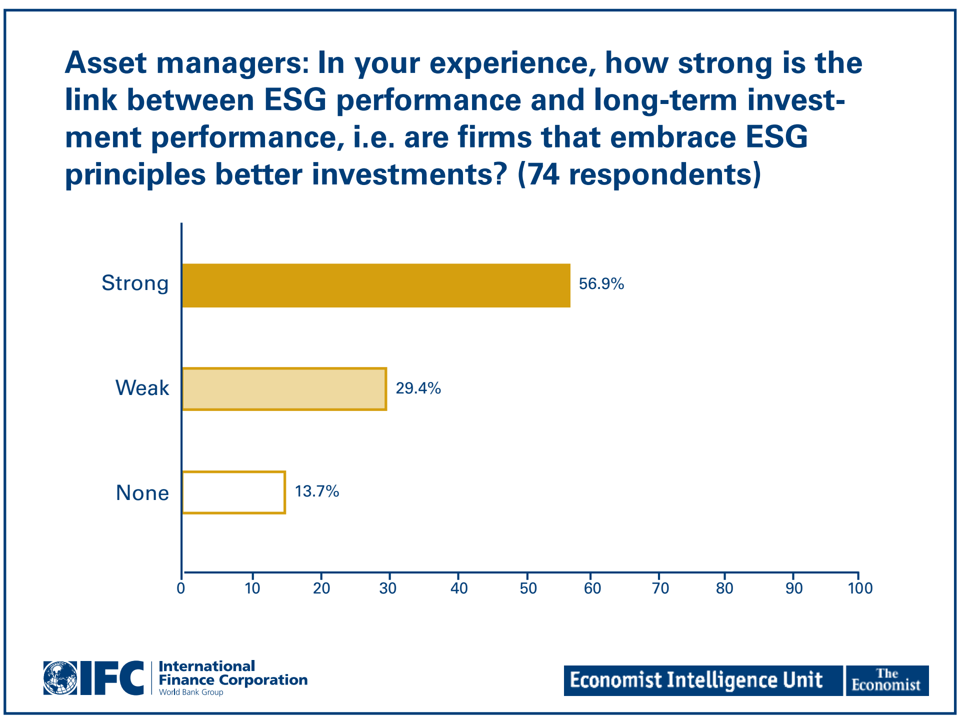
- On average, local investors in EM are more aware of the importance of ESG issues than international investors. A panellist, for example, mentioned that trustees of EM asset owners — beside traditional measures of financial performance — often consider how an asset manager considers community / social issues when assessing his performance

- Several participants described international investors as opportunistic ("you sell if the investment case deteriorates"), whereas domestic investors are locked into their economies and therefore more interested in understanding ESG impacts

- One panellist stressed the fact that investment consultants also need to prepare better — i.e. assess risks in different EM environments more realistically and offer more sophisticated advice to asset owners. Too often consultants paint a picture of emerging markets as being necessarily very high risk (high inflation, government default, etc.), which is not consistent with the realities of a global economy with increasing numbers of EM-domiciled multinationals

Nigel Holloway, Economist Intelligence Unit:





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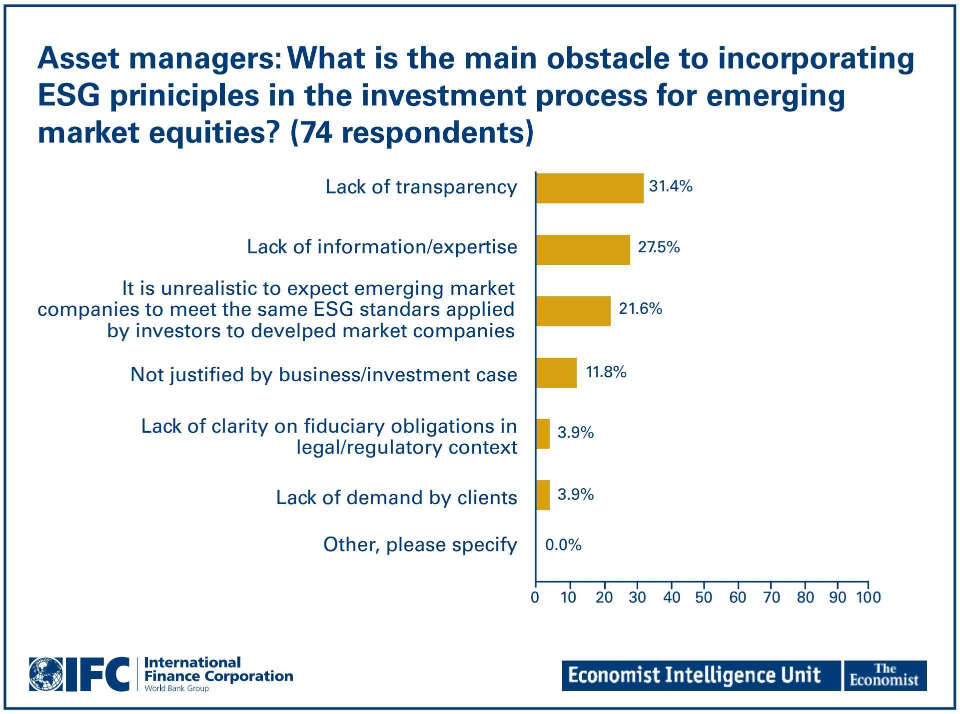

Asset management and engagement: best-practices and opportunities for further development

- Panellists from BankInvest, First State Investments, Investec Asset Management and State Street Global Advisors presented ESG-inclusive EM investment approaches at their institutions
- ESG-inclusive approaches provide the portfolio manager with an additional 'lens' with which to spot dissonances between companies' stated and actual risk management
- The current range of investment products that specifically focus on ESG issues available is still very limited. More innovation and a larger offer are needed
- The mainstreaming of ESG is more advanced for certain issues: e.g. governance issues are usually part of mainstream considerations (albeit often not considered in a very systematic way[6]) , as well as environmental issues in highly-exposed sectors
- Several participants supported the notion that simple ESG country screens are not a viable option, because they risk excluding best-practice companies in non-eligible EM[7]
- International investors should be more aware of their central role in establishing high standards of disclosure and ESG practice, and should consider investing capital not only in established EM but also in frontier markets[8]. Injecting international capital into frontier markets would help to establish basic investability conditions, such as custody, efficient settlement services, etc., which are critical for market development
- The overall message from participants was that international investors need to become more sophisticated in looking at ESG issues in EM. There are positive signs that investors are becoming more discerning in dealing with difficult cases such as Myanmar and Sudan (avoiding blanket divestment from those countries), and making a clearer distinction between acceptable and harmful business practices. Investors are also placing increasing emphasis on engagement on ESG issues

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[6] Several participants remarked that Hypothesis 4 (see page 21) was too critical of the current treatment of corporate governance issues

[7] See Hypothesis 5

[8] Countries whose markets are in the tier below emerging markets in terms of investability are generally classified as 'frontier markets'

- In their presentations, panellists from both the asset management and investment research sessions used the example of China to highlight the scale of environmental challenges (see following slides)

On engagement

- Participants from EM stressed that engagement with EM-domiciled companies is usually not a strictly formalised process, but a very direct, 'hands-on' type of dialogue of which ESG issues form a natural part. This does not make engagement less effective than that in developed markets, where ESG discussions tend to be more formalised, but often more limited in scope (often becoming stuck in the 'SRI niche')
- One large EM-based asset owner commented that they had a presence on the board of a great number of the publicly-traded companies in their home country. Engagement was therefore woven into the fabric of their ownership
- Several participants noted that companies' reactions to engagement activities by investors vary greatly by region, with Latin American and South African companies being the most receptive, and Asian companies often reacting defensively
- A manager of EM assets stressed the importance of knowing one's co-investors (especially where they include management insiders, families and government investors), and attempting to dialogue with investors who share a long-term vision for the company
- A participant, whose institution systematically engages with EM companies across all asset classes, stressed the importance of ESG issues for fixed income investments
- It was noted that discussing ESG issues with a company's management is often a very effective gauge of the management's vision and long-term strategy
- International investors should be much more vocal in requiring minimum ESG disclosure standards from local legislators and exchanges[9]. The engagement of ASrIA and investors represented on the Hong Kong Stock Exchange Listing Committee, for example, has resulted in such standards being introduced

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[9] See Hypothesis 3. One participant noted that the increasing move of exchanges away from mutual or quasi-public structures towards privately-held company structures meant that investors seeking regulatory solutions should look to the true regulator, rather than to exchanges

Simon Powell, CLSA:

But growth has come at a cost

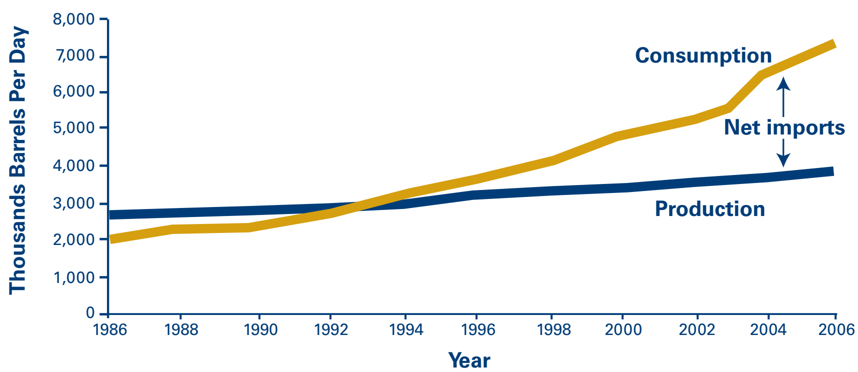
The brochure

The reality

Source: Historylink101.com

Bill Page, State Street Global Advisors:

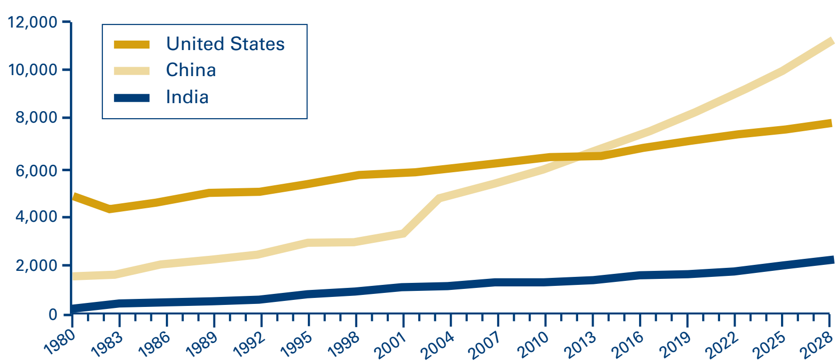
China's Oil Production and Consumption, 1986-2006*



Source: EIA *International Petroleum*

* 2006 is Jan-Aug only

C0₂ Emissions from the Consumption and Flaring of Fossil Fuels (Millions Metric Tons of Carbon Dioxide)



Source: IEA 2004; DOE/EAI-0484 (2007)

Investment research: best-practices and opportunities for further development

- Participants stressed that emerging markets can not be viewed monolithically — country specificity and the ability to contextualise ESG issues are very important
- Only a small number of research providers actively integrate ESG issues in their mainstream research — overall, sell-side and independent research must improve their coverage of ESG issues in EM considerably
- However, it was pointed out that in the current exuberant bull market in certain emerging markets (such as the BRICs, Korea and South Africa), valuations are highly sensitive to shorter-term drivers. Clients are not asking for visibility on longer-term, more strategic issues, given the departure of valuations from fundamental measures
- Clearer signals from clients are essential to improving the quantity and quality of ESG-inclusive research. For the same reason, it was stressed that investors should switch to an unbundled system for allocating research commissions, and encourage independent (non-broker) research (particularly for insight into management quality)
- Without some degree of local presence it will be increasingly difficult to deliver valuable EM investment research in the future
- Many participants also stressed the importance of incentive systems to reward the analysts that engage in ESG-inclusive research
- ESG-inclusive indices were found be a valuable investment tool for global investors. In countries like India and Brazil, the relatively high level of disclosure and transparency facilitates the construction and operation of ESG-inclusive indices
- The example of HIV/AIDS in South Africa was mentioned. When such an issue reaches a critical level of impact on a region, then both the sell and buy sides start focussing on it and producing relevant research. ESG issues that remain below the critical level seldom receive adequate research coverage

Valéry Lucas-Leclin, Société Générale:

India: Many challenges on the road ahead ESG issues will feature prominently			
Challenge	*Risk factor*	*Magnitude of risk (1-5)*	*Opportunity factor?*
Climate change	✓	3	✓
Demographics	✓	2	✓
Domestic unrest	✓	1	
Economy overheating	✓	3	
FDI restrictions	✓	2	
Governance	✓	2	
Human resources	✓	3	✓
Infrastructure	✓	5	✓
Poverty	✓	4	✓
Protectionism	✓	2	

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4. Recommendations for asset managers and investment researchers

The most important recommendations for asset managers and investment researchers based on the insights from the Event can be summarised as follows[10]:

1. Improve the understanding of portfolio impacts from ESG issues in EM — not just EM equity investments, but for other regions and asset classes, and at both the asset allocation and issuer selection levels

2. Identify the ESG issues that are already part of EM investment decisions at your institution (often relating to corporate governance) and support a more systematic approach. Consider improving the consideration of social and environmental issues, e.g. by accessing external research or collaborating with professional associations and think tanks. Note that the skills required for corporate governance analysis are not always synergistic with those required for analysis of environmental and social issues

3. Strengthen and incentivise the efforts of your portfolio managers and analysts

4. Approach asset owners to confirm their interest in a better integration of ESG issues in EM investments. If possible also contact asset owners based in EM to understand their specific views and needs

5. If the mandate allows, consider allocating a small part of your assets to low-correlation frontier markets (or building new strategies including these markets)

6. Include ESG issues in regular company meetings and engagement activities. Do not forget that ESG issues can be material for both equity and fixed income investments

7. Consider launching innovative investment products to make full use of the ESG business opportunity

8. Consider collaborating with other investors in requiring minimum ESG disclosure standards from local legislators and exchanges

[10] The recommendations have been edited by the authors of this report

5. Reflections on the progress made so far and next steps

The Event closed with comments by Rachel Kyte of the International Finance Corporation (IFC) on the day's proceedings, and the actions that IFC is taking in this space. She noted that:

- IFC firmly believes that environmental and social issues are inextricably linked in emerging markets, and that an economic expression of those issues (in terms of both risks and opportunities) is inevitable
- IFC is conducting its own research on this relationship. Preliminary findings suggest a causal relationship between corporate ESG performance and credit quality. However, it does not seem to be true to say that EM companies with strong financial performance are necessarily ESG outperformers
- Rachel commented on the sophistication with which investors were beginning to treat ESG issues in emerging markets, while at the same time recognising the scale of the challenge ahead. She urged investment professionals not to let the search for the perfect obscure many of the great investment stories in emerging markets
- As part of its commitment to this space, IFC is working with EM-domiciled companies on how to better communicate material ESG issues to financially-focussed investors

Next steps

Who Cares Wins was always meant to be an initiative limited in time, with the intention of catalysing action that can then be embedded in and carried forward by the industry itself. The hosting institutions believe that the role that Who Cares Wins was meant to play is nearing completion.

The hosts are planning a last series of strategic discussions with industry executives in 2008. The discussions will assess progress since the launch of the Who Cares Wins initiative, and make recommendations for next steps for the industry in terms of the full integration of ESG issues into mainstream investment decision-making and ownership practices.

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6. Appendices

Event agenda

Thursday, 5 July 2007
Credit Suisse Forum Genève, Geneva, Switzerland

12:15 Buffet lunch, registration

13:45 Framing the issues

- Welcome
- Hendrik du Toit, CEO, Investec Asset Management
- Nigel Holloway, Director, Economist Intelligence Unit (presentation of insights from an EIU survey of emerging markets investors)

14:15 Innovations in asset management

- Presenter:
  Bill Page, Portfolio Manager, State Street Global Advisors
- Challenger:
  Søren Bertelsen, Chief Portfolio Manager, BankInvest
- Panellists:
  - Hendrik du Toit, CEO, Investec Asset Management
  - Glen Finegan, Senior Analyst, Global Emerging Markets, First State Investments
  - José Reinaldo Magalhães, CIO, PREVI (Banco do Brasil Pension Fund)

15:30 Coffee break

16:00 Pushing the boundaries of investment research

- Presenter:
  Valéry Lucas-Leclin, Co-head of SRI Research, Société Générale
- Challenger:
  Simon Powell, Head of Power Research, CLSA
- Panellists:
  - Melissa Brown, Executive Director, ASrIA
  - Subir Gokarn, Executive Director, CRISIL / Standard & Poor's

17:20 Closing remarks

- Ivo Knoepfel, Managing Director, onValues Ltd.
- Rachel Kyte, Director, Environment & Social Development Department, International Finance Corporation (IFC)

17:30 Adjourn and aperitif reception

- Moderators:
  - Ivo Knoepfel, Managing Director, onValues Ltd.
  - Gordon Hagart, Senior Consultant, onValues Ltd.

Participants

Organisation	Name	Position
ABP Investments	Lake, Rob	Senior Portfolio Manager, ESG
AHV Ausgleichsfonds	Zimmermann, Christoph	Manager, External Investments
ASrIA	Brown, Melissa*	Executive Director
ASrIA	Tracy, Alexandra	Director, Asian Sustainable Pensions Project
ASSET4	Steffensen, Henrik	Vice President, Business Development
AXA Investment Managers	Duffy, Shade	Head of Corporate Governance
BankInvest	Bergstedt Jørgensen, Christine	Client Service Manager
BankInvest	Bertelsen, Søren*	Chief Portfolio Manager
BNP Paribas Asset Management	Borremans, Eric	Head of Sustainability Research
Bovespa (São Paulo Stock Exchange)	Sardenberg, Izalco	Advisor to the Chairman
CA Cheuvreux	Voisin, Stéphane	Head of SRI Research
Calvert Group	Hilton, Paul	Director, Investment Strategy
ClearBridge Advisors	McQuillen, Mary Jane	Director, Social Awareness Investment
CLSA	Powell, Simon*	Head of Power Research
ConSer Invest	de Wolff, Angela	Founder
CPP Investment Board	Barnett, Brigid	Manager, Responsible Investing
Credit Suisse	Kretschmer, Ralph	Director
CRISIL	Gokarn, Subir*	Executive Director & Chief Economist
DELSUS	Siddy, Dan	Director
Dexia Asset Management	Herinckx, Gaëtan	Head of Sustainable and Responsible Investment
Eco-Frontier	Chun, Woo Joung	Analyst
Economist Intelligence Unit	Holloway, Nigel*	Director, Executive Services, Americas
EIRIS	Maradei, Brunno	Assistant Director
Ethos	von Moltke, Daniel	Asset Manager
Eurizon Capital	Manca, Gianluca	Head of Global SRI Equities, Fund Manager

Organisation	Name	Position
First State Investments	Finegan, Glen*	Senior Analyst, Global Emerging Markets
Forma Futura Invest	Karius, Oliver	Head of Research
GES Investment Services	Nyström, Fredric	Marketing Director
Goldman Sachs	Fox, Marc	Research Analyst
GovernanceMetrics International	Sherman, Howard	President & CEO
Hermes Pensions Management	Joffe, Bess	Manager
HSBC Investments	Churet, Cécile	SRI Analyst & PRI Coordinator
HSBC Investments	Desmadryl, Xavier	Global Head of SRI Research
ING Financial Markets	Klijn, Robert	Specialist Sales
Innovest Strategic Value Advisors	Kiernan, Matthew	Chief Executive
International Finance Corporation (IFC)	Bjerborn, Cecilia	Program Officer, Sustainable Financial Markets Facility
International Finance Corporation (IFC)	Kyte, Rachel	Director, Environment & Social Development Department
Investec Asset Management	du Toit, Hendrik*	CEO
Investec Asset Management	Gray, Malcolm	Head of Client Service, Fund Manager
KLD Research & Analytics	Umlas, Elizabeth	Senior Research Analyst
Lombard Odier Darier Hentsch	de Brito, César	Head of Responsible Investments
London Bridge Capital	Campanale, Mark	Director
Mercer Investment Consulting	Ambachtsheer, Jane	Global Leader, Responsible Investment
Mercer Investment Consulting	Guyatt, Danyelle	Principal, Responsible Investment
Mitsubishi UFJ Trust and Banking Corporation	Kato, Masahiro	Senior Manager
New York City Employees' Retirement System (NYCERS)	Musuraca, Michael	Trustee
New Zealand Superannuation Fund	O'Connor, Anne-Maree	Head of Responsible Investment
Norges Bank Investment Management (NBIM)	Kettis, Magdalena	Senior Analyst, Corporate Governance

Organisation	Name	Position
Oddo Securities	Desmartin, Jean-Philippe	Analyst, SRI Research Manager
onValues	Hagart, Gordon*	Senior Consultant
onValues	Knoepfel, Ivo*	Managing Director
onValues	Specking, Heiko	Analyst
PGGM	van Stijn, Pieter	Advisor Responsible Investment
Pictet & Cie	Butz, Christoph	Sustainable Investment Specialist
PREVI	Magalhães, José Reinaldo*	CIO
SAM Sustainable Asset Management	Menzli, Pierin	Senior Equity Analyst
SNS Asset Management	Verwey, Berrie	Head of Research
Société Générale	Lucas-Leclin, Valéry*	Co-head of SRI Research
Standard & Poor's	Dallas, George	Managing Director
State Street Global Advisors	Page, Bill*	Portfolio Manager
Swiss Department of Foreign Affairs	Probst, Marc	Head of Desk, Human Security and Business
Trucost	Thomas, Simon	Chief Executive
UBS	Seidler, Alexander	Group Risk Control, Group Environmental Policy
UBS Global Asset Management	Würtenberger, Laura	Analyst
UN Global Compact	Power, Gavin	Head, Financial Markets
UN Secretariat for the Principles for Responsible Investment	Gifford, James	Executive Director
UNEP Finance Initiative	Clements-Hunt, Paul	Head of Secretariat
UNEP Finance Initiative	Sinclair, Graham	Project Lead, Emerging Markets
Watson Wyatt	Zaugg, Beat	Head, Investment Consulting (Switzerland)
World Resources Institute	Klop, Piet	Senior Fellow

* Indicates speaker / panellist

Hypotheses and selected reading on environmental, social and governance (ESG) issues in emerging markets investments

Prepared by Gordon Hagart and Ivo Knoepfel, onValues Ltd.

Hypothesis 1:

The risks posed to emerging markets investments by environmental and public health issues are generally underestimated.

Suggested reading: Goldman Sachs | Why the BRICs Dream won't be Green (October 2006)

Summary: The unstoppable trend of urbanisation brings increasing strains on land and water resources. These challenges will be especially acute in China and India, where the urban share is projected to rise sharply over the next 25 years, from 41% to 61% in China and from 29% to 41% in India. Air pollution is also a burgeoning problem and a predictable consequence of the BRICs' growth, given that they are passing through the most energy-intensive phase of development.

Hypothesis 2:

Investors should attribute greater importance to the impacts of corruption and poor governance on the long-term economic prospects of emerging markets.

Suggested reading: Y Lengwiler, University of Basel | The Rationale of Transparent Public Finances: Impacts on Economic Growth (March 2007)

Summary: The literature converges on the following linkages between corruption and economic growth:

- Corruption reduces private investments of all forms
- Corruption reduces economic growth (East Asia has been exceptional in some respects)
- Corruption increases as:
  - Per capita income decreases
  - Income distribution becomes less equal
  - Public finances (in the form of higher debt and lower per capita tax revenues) become weaker

Hypothesis 3:

ESG disclosure in emerging markets is poor. Investors should be more active in ensuring that minimal standards for ESG disclosure are applied (e.g. by engaging with exchanges).

Suggested reading: ASrIA | A Cat and Mouse Game for Investors: Assessing ESG Disclosure of Supply Chain Listings in Hong Kong (August 2006)

Summary: As the global trend of outsourcing from Europe and the United States to low cost markets such as Asia looks set to continue, there is an increasing trend of Asian supply chain companies listing on the Hong Kong Stock Exchange (HKEx). ASrIA undertook a review of IPO documents as a means of assessing critical disclosure and operational trends on ESG issues from a representative cross section of supply chain companies operating in China and listing on the HKEx. The findings indicate that whilst the environment in which these companies operate in is rapidly changing, disclosure is generally at a standstill, both in terms of coverage and content.

Hypothesis 4:

Investors are willing to pay a premium for well-managed companies in markets where corporate governance standards depart substantially from best practice. However, corporate governance is seldom systematically factored into decision-making in emerging markets investments.

Suggested reading: McKinsey & Company | Global Investor Opinion Survey 2002: Key findings (July 2002)

Summary: An overwhelming majority of investors are prepared to pay a premium for companies exhibiting high governance standards. Premiums averaged 12–14% in North America and Western Europe; 20–25% in Asia and Latin America; and over 30% in Eastern Europe and Africa. More than 60% of investors state that governance considerations might lead them to avoid individual companies with poor governance, with a third avoiding countries entirely. Investment behaviour is affected by a broad spectrum of factors, not just those at the corporate level. The quality of market regulation and infrastructure is highly significant, along with enforceable property rights and downward pressure on corruption.

(continues)

Hypothesis 4 (continued)

Suggested reading: L Frésard and C Salva | Does Cross-listing in the U.S. Really Improve Corporate Governance?: Evidence from the Value of Corporate Liquidity (February 2007)

Summary: Many emerging markets-domiciled companies choose to cross-list their securities in developed markets (notably on the New York and London exchanges). Motivations include access new sources of (potentially cheaper) capital and the possibility for the company's securities to trade on a more efficient and more liquid market. However, non-US companies that list in the US (other than under Rule 144a or in the OTC market) have to register with the SEC and become subject to US securities laws. These laws increase disclosure and financial reporting requirements. Cross-listing also increases oversight by regulators and gatekeepers such as analysts and institutional investors. These impositions are thought to reduce agency costs to shareholders and restrain controlling shareholders. Cross-listing can therefore be a proxy for enhanced corporate governance, particularly for companies domiciled in countries where investor protection is weak. The premium investors attribute to the cash of cross-listed companies provides evidence of the materiality of enhanced corporate governance.

Hypothesis 5:

The inclusion of ESG issues in country-level investability analysis may be cost-effective and may encourage regulatory reform. However, by using ESG data only at the country level, the investor risks excluding best-practice companies in non-permissible markets, and including worst-practice companies in permissible markets.

Suggested reading: Wilshire Associates | Permissible Equity Markets Investment Analysis (Prepared for CalPERS): Executive Summary (January 2007)

Summary: The purpose of Wilshire's annual report for CalPERS is to evaluate a market's ability to support institutional investment. The permissible markets analysis is based on a seven-factor model defined by the CalPERS Investment Committee. There are three country factors (political stability, transparency and productive labour practices) and four market factors (market liquidity and volatility, market regulation / legal system / investor protection, capital market openness and settlement proficiency / transaction costs). The 2007 analysis resulted in 20 of 27 emerging markets evaluated being deemed permissible. From April 2002 to December 2006 the policy had an overall negative impact on the actual performance of CalPERS' external emerging markets managers.

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