

# Description of the ESG4Real Standard

*Mandatory requirements to comply with to become licensed  
(asset owners) and certified (asset managers)*

Version 1.0 - 2018-12-03



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# 1 Introduction

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## 1.1 Overview of this document

The primary purpose of this document is to provide asset owners and asset managers with guidance and clarification on the requirements of ESG4Real. It describes the *mandatory* requirements that are needed to comply with in order to become a licensed asset owner or a certified asset manager. It is recommended that an asset owner or asset manager aiming to apply for licensing or certification read this document prior to application in order to get a detailed picture of what requirements that are to be met. The document may also be used by asset owners to get an understanding about what requirements that are met when assigning an ESG4Real certified asset manager and what level of RI practices that is reached. The document includes the following parts:

- **Introduction:** contains general information about this document, reference to other relevant documents and contact information to ESG4Real.
- **Purpose of ESG4Real:** describes what is meant to be achieved by ESG4Real.
- **Scope of ESG4Real:** indicates who is eligible for becoming a licensed asset owner and certified asset manager.
- **Requirements of ESG4Real - licensing of asset owners:** describes the requirements of the ESG4Real standard applicable to asset owners.
- **Requirements of ESG4Real - certification of asset managers:** describes the requirements of the ESG model and the use of Tools for implementation and compliance
- **Appendix:** defines terminology used in this document and gives references to further information about norms and conventions.

## 1.2 References to other relevant documents

Please refer to the following documents for additional clarification of some elements in this document:

- *Description of ESG4Real Standard recommended requirements v 1.0* – Includes the recommended requirements for asset owners and asset managers which may be used to build further upon the minimum level. (Not subject for licensing or certification.)
- *ESG4Real Licensing process v. 1.0* – Includes information about the licensing process for asset owners.
- *ESG4Real Certification process v. 1.0* – Includes information about the certification process for asset managers.
- *ESG4Real Control points v. 1.0* – Includes detailed information about items to be controlled in quality check/audit for licensing/certification.
- *ESG4Real ESG criteria v. 1.0* – Full description of mandatory and recommended ESG criteria.

## 1.3 Contact

Questions regarding ESG4Real and the content of this document may be put forward to RIA Intl. at [info@riainternational.org](mailto:info@riainternational.org) or by contacting the nearest RIA company, please visit [www.riainternational.org](http://www.riainternational.org) for further contact information.

## 2 Purpose of ESG4Real

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ESG4Real aims to gather asset owners behind a set of fundamental demands regarding RI, including norms, conventions, exclusion factors, ESG analysis and integration and engagement that will be put on asset managers. The demands are a minimum level for RI within the services that asset managers provide to asset owners.

By uniting asset owner demands, discussions between asset owners and asset managers are meant to be facilitated working towards an increased transparency regarding parameters used in ESG analyses as well as support asset managers and asset owners that are beginners within RI reach a balanced minimum level of RI. To ensure compliance with the minimum requirements, ESG4Real entails independent quality assurance (certification) of how asset managers comply with these requirements and licensing of asset owners that use ESG4Real certified asset managers.

## 3 Scope of ESG4Real

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The scope of ESG4Real refers to both which type of organisations that are included and what kind of asset classes and investment strategies that are in scope.

Regarding types of organisations included, ESG4Real applies to the following:

- **All types of institutional asset owners** e.g. pension funds, insurance companies, labour unions, foundations, endowment funds and NGOs.
- **All types of asset managers** e.g. banks and insurers.

Organisation types currently out of scope of ESG4Real:

- Intermediaries/service providers, e.g. investment consultants or financial advisors.
- Retail investors. (May benefit customers indirectly by quality assurance of asset managers)

Current scope for asset classes is equities and corporate bonds. Included investment strategies are active and enhanced indexing. Passive fund mandates are currently out of scope as many of the most frequently used underlying indices do not meet the ESG4Real criteria.

Different requirements are put on asset owners and asset managers, these are described in chapter 5 and 4. In case of activities being outsourced (e.g. purchase of external funds), the asset manager or asset owner should use ESG4Real certified asset managers to as large extent as possible.

Depending on whether the organisation is an asset owner or an asset manager the following applies:

- **Licensing** applies to asset owners that comply with the ESG4Real requirements applicable to asset owners, relating to investment policies and evaluation of asset managers on RI practices. Gives access to the ESG4Real standard, member forums and right to use the ESG4Real trademark.
- **Certification** against the requirements in the ESG4Real standard applicable to asset managers. It certifies that the asset manager's RI work is compliant with the ESG4Real standard and gives access to member forums and right to use the ESG4Real trademark.

Disclaimer:

ESG4Real requirements cover areas as described in this document only, see chapter 4 and 5 . It does **not** cover financial risks or returns or application of applicable national laws and regulations. It is the sole responsibility of the individual asset owner or asset manager to ensure compliance with laws and regulations and economic viability.

## 4 Requirements of ESG4Real - licensing of asset owners

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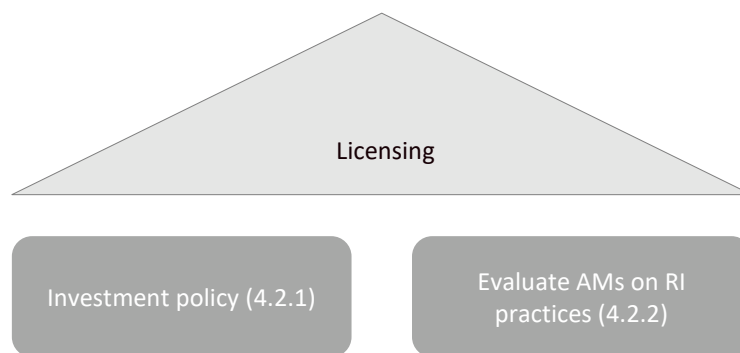
### 4.1 Overview

This chapter describes in detail the *mandatory* requirements an asset owner needs to comply with in order to become licensed according to the ESG4Real standard.

ESG4Real contains the following requirements applicable to asset owners:

- Investment policy.
- Evaluation of asset managers on RI practices.

To receive licensing compliance with the described requirements is needed, as pictured in Figure 1 .



**Figure 1. Licensing requirements of ESG4Real**

Compliance with the requirements is needed at time for quality check, which implies that policies and processes need to be *implemented* at time for quality check and it is hence not sufficient to have plans for realizing compliance with requirements that are not yet implemented. Asset owners are required to remain in conformance with the requirements to maintain their license.

### 4.2 ESG4Real requirements in the asset owner investment process

ESG4Real requirements influence activities in the asset owner's investment process. Different adjustment efforts may be needed depending on ESG maturity and to what extent the asset owner already has implemented strategies and processes that comply with the requirements. Figure 2 describes where in the investment process the requirements apply and provides suggested activities to comply with ESG4Real.

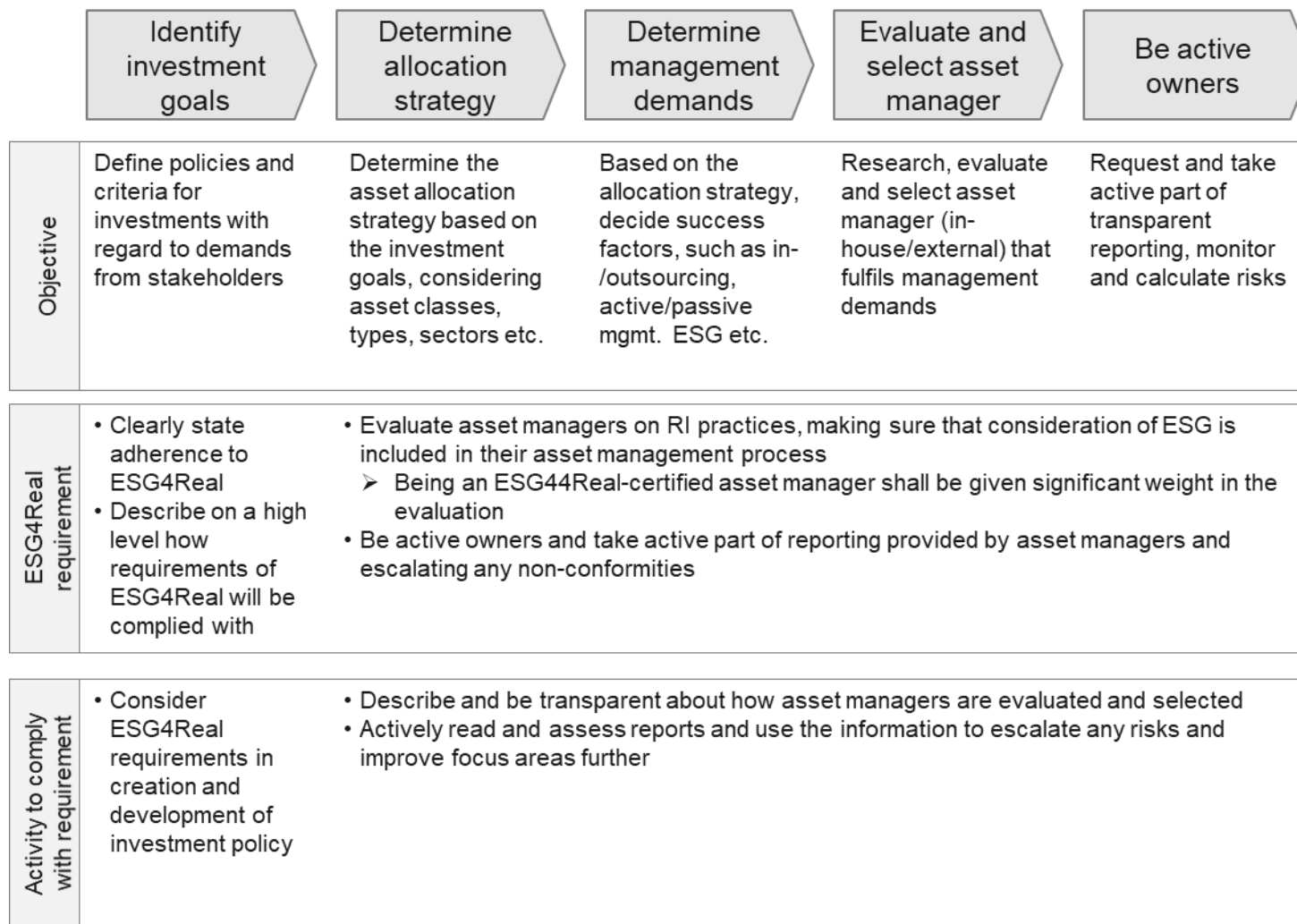


Figure 2. ESG4Real requirements in the asset owner investment process

#### 4.2.1 Investment policy<sup>1</sup>

Definition and objective:

- The investment policy formalizes an institution's goals, objectives, and guidelines for asset ownership and describes the strategies that the asset owner demand the manager to employ in order to meet these objectives. It is instrumental in ensuring that the goals regarding ESG and RI are formulated and reached.
- The objective of the tool is to ensure that ESG activities of the asset owner and the asset manager are included in investment decisions and that demands and performed actions are clearly communicated between asset owners, asset managers and other potential stakeholders.

Mandatory requirements:

- Asset owners are required to include specific and transparent descriptions of responsible investment practices in their investment policies and how they contribute to compliance of ESG4Real.
- It is mandatory for asset owners to:
  - o Clearly state adherence to ESG4Real and if desired refer to ESG4Real introduction material
  - o Describe on a high level how requirements of ESG4Real will be complied with regarding the ESG model and design of processes and reporting standards
- The investment policy is to be updated regularly and any changes communicated swiftly to stakeholders.

Activities needed for compliance:

- For reference and inspiration on investment policies, please see PRI guidance for asset owners on investment policies<sup>2</sup>.

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<sup>1</sup> Please note that the investment policy may refer to other investment steering documents that regulate the policies for responsible investment practices

<sup>2</sup> PRI (2016) *Investment Policy: Process & Practice A guide for asset owners* available at [https://www.unpri.org/download\\_report/24553](https://www.unpri.org/download_report/24553)



#### 4.2.2 Evaluate asset managers on RI practices

Definition and objective:

- Evaluate asset managers on RI practices means that asset owners assess an external or internal asset manager and consider their integration of ESG into the asset management.
- The objective of this requirement is to ensure that asset owners have a good understanding of the manager's investment approach and portfolio construction decisions. This will enable and foster employment of asset managers that are serious about the RI work and have investment beliefs in line with ESG4Real.

Mandatory requirements:

- It is mandatory for asset owners to have descriptions of how asset managers are evaluated on RI practices, making sure that ESG is considered when choosing asset managers. ESG4Real-certified asset managers shall be given a significant positive weight in the evaluation
- Asset owners are required to take active part of reporting provided by selected asset managers and escalating any non-conformities found.
- It is necessary to be able to demonstrate the actual application of the evaluation in practice by giving information on e.g.:
  - o Responsible person/team for the evaluation and its responsibilities and activities
  - o Examples of evaluations of asset managers and results

Activities needed for compliance:

- Asset owners are required to describe and be transparent about how asset managers are evaluated.
- The evaluation activities may be designed according to organizational needs and prerequisites.
- For reference and inspiration about evaluating asset managers, please see UNPRI guide on evaluation of asset managers<sup>3</sup>.

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<sup>3</sup>PRI (2016) *A practical guide to ESG integration for equity investing* available at [https://www.unpri.org/download\\_report/22600](https://www.unpri.org/download_report/22600)

# 5 Requirements of ESG4Real - certification of asset managers

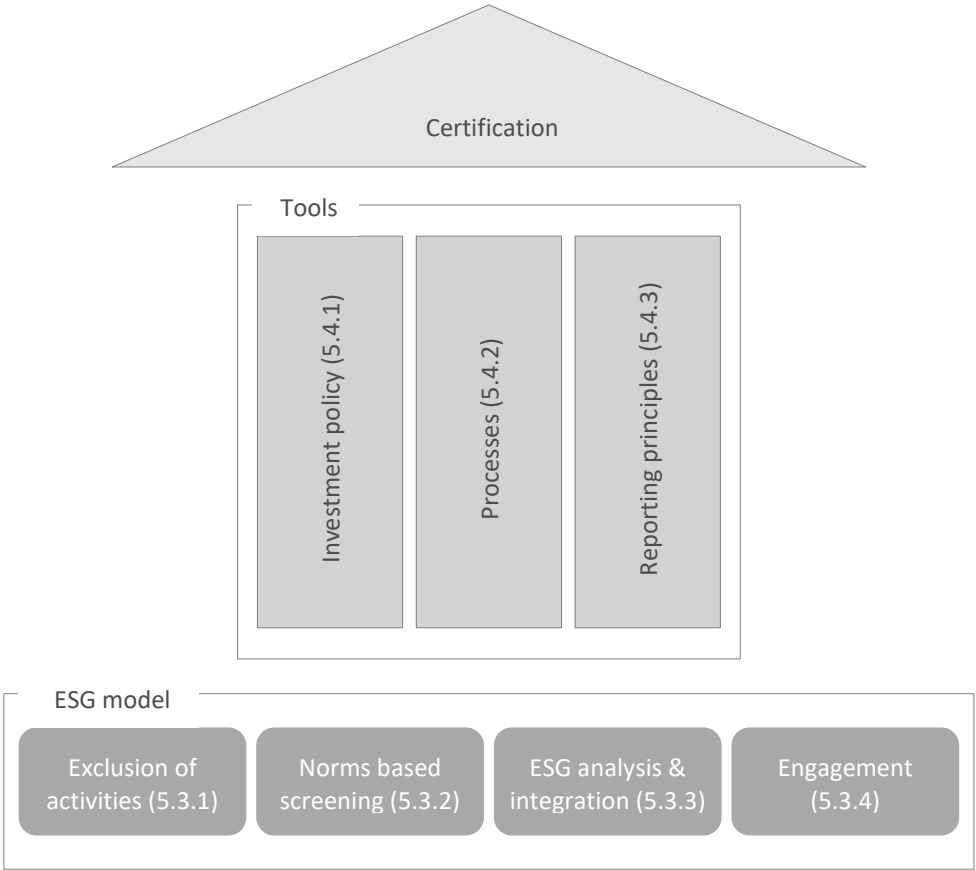
## 5.1 Overview

This chapter describes in detail the *mandatory* requirements an asset managers needs to comply with in order to become certified according to the ESG4Real standard.

ESG4Real contains requirements applicable to asset managers in two blocks:

- **ESG model** containing requirements in four ESG instruments.
- **Tools for implementation and compliance** containing three tools that are to be used to demonstrate compliance with the requirements in the ESG model.

To receive certification, compliance with the ESG model and use of Tools for implementation and compliance is required, as pictured in Figure 3. (Reference to chapters in parenthesis).



**Figure 3. Certification requirements of ESG4Real**

ESG4Real contains requirements on a mandatory and recommended level (Please refer to “Description of ESG4Real Standard recommended requirements” for recommended level). To be certified, ability to show compliance with the requirements on the *mandatory* level *at time for audit* is needed. This implies that all required strategies and activities need to be *implemented* at time for audit and it is hence not sufficient to have plans for realizing compliance with requirements that are not yet implemented. Asset managers are required to remain in conformance with the mandatory

requirements to maintain their certification. Table 1 summarizes the requirements at the mandatory and recommended level. Additional requirements from either an asset owner or asset manager may be added upon the mandatory or recommended level, but only the mandatory level is certified by ESG4Real.

Level of ambition		
<b>Required for certification</b>		
	Mandatory	Recommended
<b>ESG model</b>		
Exclusion of activities, see 5.3.1	1 activity	8 activities
Norms based screening, see 5.3.2	4 norms and conventions	10+ norms and conventions
ESG analysis and integration, see 5.3.3	Strategy for ESG analysis & integration incl. analysis of 24 ESG criteria	Enhanced strategy & analysis of any recommended ESG criteria
Engagement see 5.3.4	Reactive engagement strategy for handling breaches	Proactive engagement strategy
<b>Tools</b>		
Investment policy, see 5.4.1	Statement of compliance with ESG4Real	Statement of compliance with ESG4Real
Processes, see 5.4.2	Description and demonstrated practices	Description and demonstrated practices
Reporting principles, see 5.4.3	Reporting according to mandatory disclosure	Reporting according to mandatory disclosure

**Table 1. Mandatory and recommended requirements of ESG4Real relating to asset managers**

ESG4Real applies a comply/explain approach to an asset manager’s fulfilment of requirements, which means that the starting point is that all requirements are to be complied with, however deviations are acceptable if the asset manager can explain why the requirement is not applicable or relevant. This gives room for flexibility, reflecting that it is impractical to define in detail the behaviour necessary from all asset managers to achieve compliance. For further description, see Appendix.

**5.2 ESG4Real requirements in the asset manager investment process**

The requirements of ESG4Real influence different activities in the general investment process. Depending on the ESG maturity and to what extent the asset manager has already implemented strategies and processes that are compliant with the requirements, different adjustment efforts may be needed. Figure 4 describes where in the general asset management process the requirements apply and gives suggested activities to comply with the requirements.

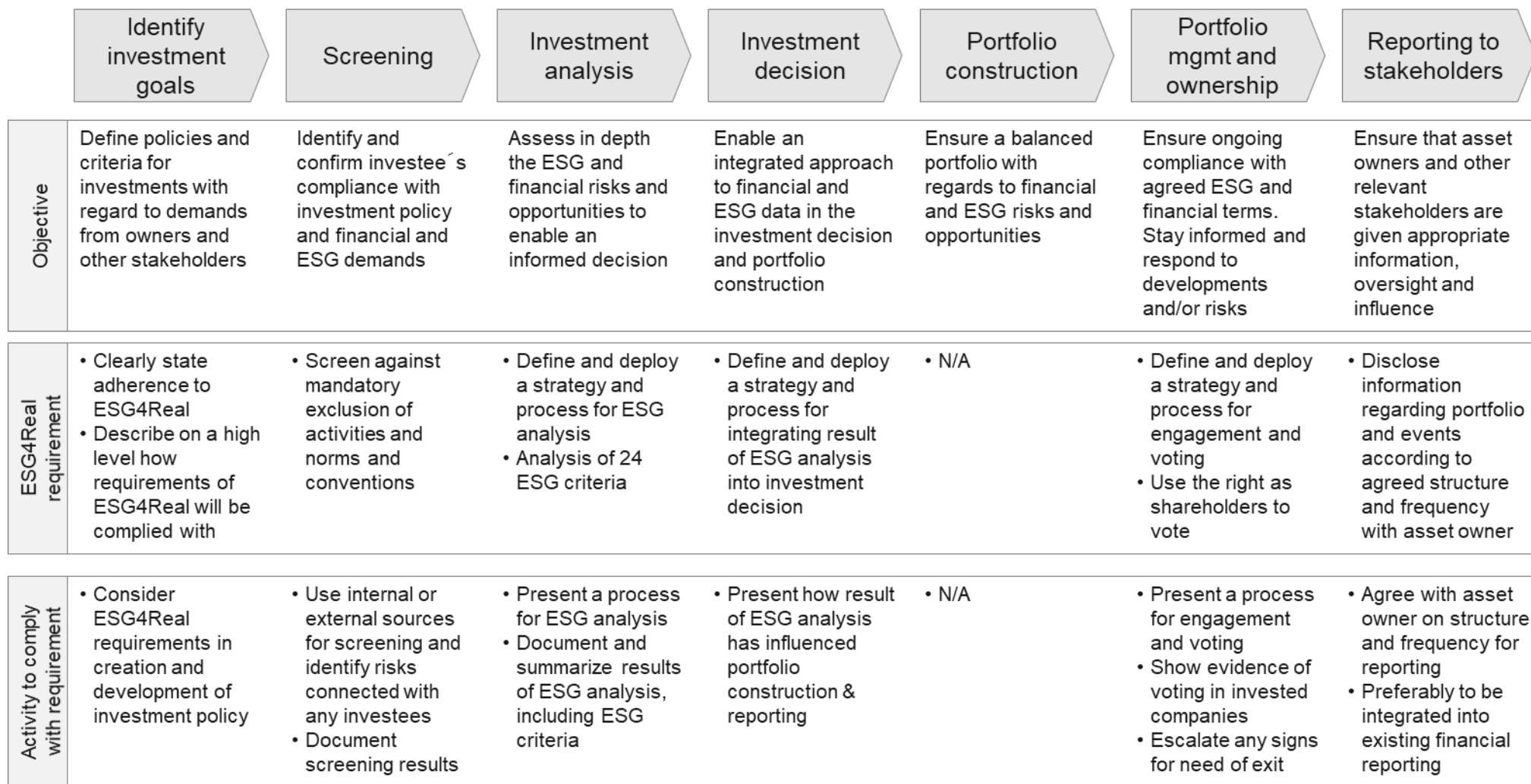


Figure 4. ESG4Real requirements in the general asset management process

### 5.3 Description of ESG model

The ESG model is designed as a minimum level of responsible investment practices. Requirements are defined on a mandatory level within the following ESG instruments:

- Exclusion of activities.
- Norms based screening.
- ESG analysis and integration.
- Engagement.

#### 5.3.1 Exclusion of activities

Definition and objective:

- Exclusion of activities refers to exclusion of companies based on criteria defined by activities in specific sectors, industries or products areas. Objective is to ensure that no investments are made in companies with direct and/or indirect involvement in activities in questionable sectors, products or industries.

Mandatory requirements:

- ESG4Real defines a set of mandatory exclusions that asset managers need to comply with.
- Requirement for exclusion is direct and/or indirect involvement of the company within a listed activity.
- Companies with a *confirmed violation* of any item in the mandatory list in Table 2 are to be excluded within 1 year of confirmed violation date. See chapter 5.5 for practical implications. Due to the different definitions of “confirmed violation”, asset managers are required to clearly state which definition is used (may come from of an external data provider or internal definition)
- Current investments are to be screened at least 2 times per year

Demand		Sector	Threshold
Mandatory exclusions	Companies with direct and/or indirect involvement in these sectors will not be eligible for investment	Controversial weapons*	0%

\* Anti-personal landmines, biological weapons, chemical weapons, cluster munitions, depleted uranium ammunition, incendiary weapons, laser-blinding weapons, non-detectable fragments. Scope includes any type of activity related to the weapon and its **key** components (i.e. not e.g. paint). Activities include e.g. production, transport and storage.

**Table 2. Mandatory exclusions**

Activities needed for compliance:

- The requirement implies that companies must be regularly screened and analysed with regards to their activities in the listed sectors, industries or product areas.
- Asset managers are required to have established a strategy and internally or externally executed processes for screening and reporting of investment decisions. It is advised that the screening (whether internally or externally executed) has the following characteristics as required by Arista 3.0 i.e. data screening companies are to be Arista 3.0-certified or have the corresponding qualities.<sup>4</sup> See below for example of characteristics:<sup>5</sup>
  - Is independent, i.e. includes more information than only information from the company directly. Such information could come from NGO's, regulatory sources (i.e. governmental agencies created to oversee specific industries and practices) and/or other external stakeholders (e.g. OECD and ILO)
  - Uses up-to-date information
  - Considers the global activities and impact of the company, not just the headquarters
  - Balances between quantitative and qualitative indicators, management oriented and performance indicators, reference to past and current performance to take into consideration improvement/deterioration of the company
  - Applies methodology equally to comparable companies
  - Is transparent about the research methodology
- Asset managers must ensure that they are able to provide transparent descriptions and results of screening processes and exclusion decisions to asset owners, please see "ESG4Real Control points" for further guidance.

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<sup>4</sup> [http://www.aristastandard.org/content\\_files/file/Qs%202012/ARISTA30final09102012final.pdf](http://www.aristastandard.org/content_files/file/Qs%202012/ARISTA30final09102012final.pdf)

<sup>5</sup> Inspired by ARISE (2012) ARISTA 3.0 *Voluntary Quality Standard for Responsible Investment Research*, available at [http://ESGrqs.dev.lightbridge.be/content\\_files/file/Qs%202012/ARISTA30final09102012final.pdf](http://ESGrqs.dev.lightbridge.be/content_files/file/Qs%202012/ARISTA30final09102012final.pdf)

5.3.2 Norms based screening

Definition and objective:

- Norms based screening refers to the screening of investees against minimum standards of business practice based on norms, conventions and agreements related to RI and ESG issues.
- The objective of this requirement is to exclude companies that are violating e.g. human rights, labour rights, governance ethics and environmental standards by placing demands on screening of investees’ compliance with a set of norms and conventions.

Mandatory requirements:

- ESG4Real defines a mandatory list of internationally recognized and widely applicable norms, conventions and agreements that asset managers are required to screen against and consider when assessing investees’ performance on ESG issues.
- In addition to mandatory norms and conventions, it is assumed that current and applicable national and international laws are followed. It is the responsibility of asset manager’s to ensure compliance.
- Table 4 lists the norms, conventions and agreements that are mandatory to screen against:
  - o Companies with a *confirmed violation* of any item in the mandatory list are to be engaged with or excluded. Please refer to chapter 5.5 Practical implications of compliance with the ESG model for description of when to conduct engagement and/or exclusions. ESG4Real does not provide specific demands on how to conduct engagement, but shall follow the asset manager’s engagement strategy, which must be clearly communicated to asset owners
  - o Seeing that there are different definitions of the term “confirmed violation”, asset managers are required to state which definition that is used. It may be the definition of an external data provider, or one that is internally defined
  - o See Appendix for references to further information about the norms and conventions
- Current investments are to be screened at least 2 times per year

Mandatory norms, conventions and agreements
<ul style="list-style-type: none"> <li>• UN Global Compact               <ul style="list-style-type: none"> <li>- Rio Declaration on Environment and Development</li> <li>- UN Convention Against Corruption</li> <li>- Universal Declaration of Human Rights</li> <li>- ILO Declaration on Fundamental Principles and Rights at work (incl. ILO Core Conventions)</li> </ul> </li> <li>• UN Guiding Principles for Business and Human Rights</li> <li>• OECD guidelines for multinational enterprises</li> <li>• Paris Agreement (risks and opportunities an investee is faced with as the agreement is ratified)</li> </ul>

**Table 3. Mandatory norms and conventions**

Activities needed for compliance:

- Asset managers are required to have established a strategy and internally or externally executed processes for norms based screening. It is advised that the screening (whether internally or externally executed) has the following characteristics:
  - o Is independent, i.e. includes more information than only information from the company directly. Such information could come from NGO’s, regulatory sources (i.e. governmental

agencies created to oversee specific industries and practices) and/or other external stakeholders (e.g. OECD and ILO)

- Uses up-to-date information
- Considers the global activities and impact of the company, not just the headquarters
- Balances between quantitative and qualitative indicators, management oriented and performance indicators, reference to past and current performance to take into consideration improvement/deterioration of the company
- Applies the same methodology for comparable companies
- Is transparent about the research methodology<sup>6</sup>
- Common practice is to purchase data from external rating agencies and collect data from NGOs. In such cases asset managers are required to assess results in internal analysis and determine the relevance and impact of the data.
- Due to the potentially different screening results that may arise from using different external data providers and/or internal data collection methods and analyses, eligible holdings in the portfolio may differ. An additional influencing factor is how the term “confirmed violation” is defined by the data source, seeing that there is no universal definition. This means that a specific company may be eligible to invest in according to one data source and analysis, while it may not be according to another. Therefore compliance will be assessed based on which data sources that have been used and their definition of a confirmed violation to conclude if the portfolio excludes according to the listed norms, conventions and agreements.
- Asset owners are responsible for determining if the source fulfills their requirements regarding e.g. reliability, independence and definition of confirmed violation.
- Asset managers must ensure they are able to provide transparent descriptions and results of screening processes to asset owners, please see “*ESG4Real Control points*” for further guidance.

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<sup>6</sup> Inspired by ARISE (2012) ARISTA 3.0 *Voluntary Quality Standard for Responsible Investment Research*, available at [http://ESGrqs.dev.lightbridge.be/content\\_files/file/QS%202012/ARISTA30final09102012final.pdf](http://ESGrqs.dev.lightbridge.be/content_files/file/QS%202012/ARISTA30final09102012final.pdf)



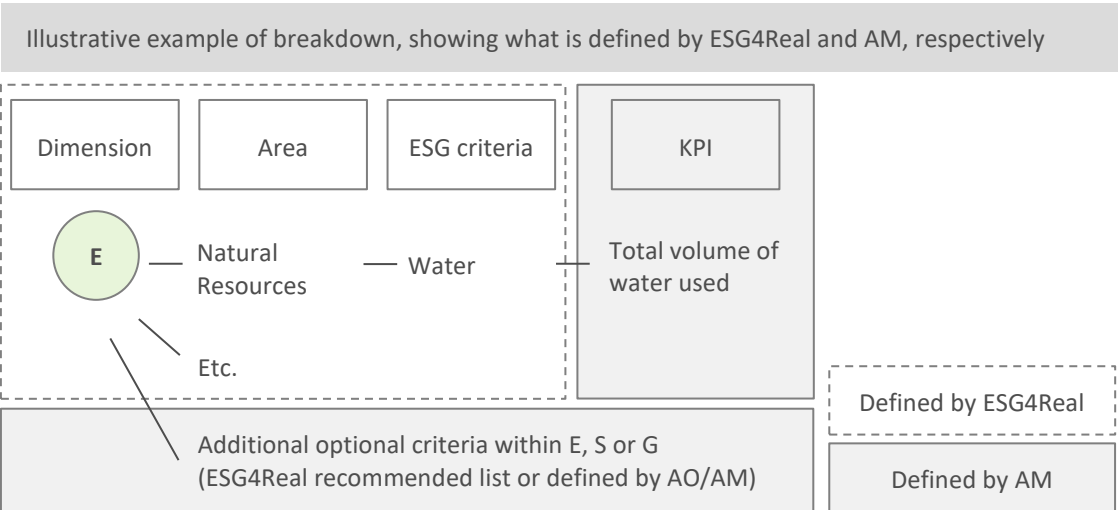
5.3.3 ESG analysis and integration

Definition and objective:

- ESG analysis refers to consideration of E, S and G factors with the aim to single out companies that are performing positive or best-in-class relative to their industry peers. It encompasses the use of qualitative and quantitative ESG information in investment processes to assess what management and business risks and opportunities a company faces, with the objective of enhancing the investment decision making.
- ESG integration refers to systematic and explicit inclusion of the result of the ESG analysis into the traditional financial analysis.
- The objective of this requirement is to ensure that E, S and G factors are considered, analysed and equally balanced in the investment decision by placing demands on that there is an established strategy and process for ESG analysis and integration.

Mandatory requirements:

- It is required on the mandatory level that a strategy for ESG analysis and integration is deployed.
  - o Complexity and comprehensiveness of the strategies may differ according to the asset manager’s investment techniques, competence and available resources
- Figure 5 describes the breakdown from ESG dimension to ESG criteria and KPI. The ESG dimension is either Environment, Social or Governance. Within these dimensions there are several areas, e.g. Natural resources, Pollution & Waste or Human rights. These areas are further broken down into specific ESG-criteria e.g. Water or Packaging material. The ESG criteria are derived and defined by ESG4Real. The ESG criteria may be further broken down into measurable KPIs, defined by the asset manager and any optional criteria may be added by the asset owner or asset manager.
- The analysis shall incorporate assessment of an ESG4Real set of mandatory ESG criteria, applied on a comply/explain basis, please see Table 4.
- ESG criteria are to be analysed at least 2 times a year for current investments



**Figure 5. Example of breakdown of ESG dimension to ESG criteria and KPI, showing what is defined by ESG4Real and AM, respectively**

Dimension	Area	#	Mandatory ESG criteria
Environmental	Climate Change	1	Emissions
		2	Energy
	Natural resources	3	Biodiversity and land use
		4	Water
	Pollution & Waste	5	Material
		6	Waste management
Governance	Corporate Governance & Behaviour	7	Anti-corruption
		8	Business ethics
		9	Executive remuneration
		10	Governance structure diversity & independence
		11	Grievance mechanisms
		12	Supply chain standards
Social	Community Relations	13	Local communities
	Customer Relations	14	Customer health and safety
		15	Customer privacy
		16	Product and service marketing
	Employee Relations	17	Compensation and benefits
		18	Employee demographics and diversity
		19	Occupational health and safety
		20	Training and qualification
	Human Rights	21	Child labour
		22	Freedom of association and Collective Bargaining
		23	Indigenous people
		24	Non-discrimination

\*For full description of criteria, please see "ESG4Real ESG criteria"

**Table 4. Mandatory ESG criteria**

Activities needed for compliance:

- Asset managers are required to have established methods based on internally or externally sampled data for ESG analysis and integration to enable transparency towards asset owners regarding how and on what grounds investment decisions are made. It is advised that the data sources (whether internal or external) has the following characteristics:
  - o Is independent, i.e. includes more information than only information from the company directly. Such information could come from NGO's, regulatory sources (i.e. governmental agencies created to oversee specific industries and practices) and/or other external stakeholders (e.g. OECD and ILO)
  - o Uses up-to-date information
  - o Considers the global activities and impact of the company, not just the headquarters
  - o Balances between quantitative and qualitative indicators, management oriented and performance indicators, reference to past and current performance to take into consideration improvement/deterioration of the company
  - o Applies methodology equally to comparable companies

- Is transparent about the research methodology<sup>7</sup>
- Use of different sources/data providers and choice of methods is likely to give different ratings/results, which is acceptable. Focus is on having established a justified process and being able to explain and motivate why and how an investment decision has been made.
- Integration techniques are to be selected and designed according to asset class, investment strategy and levels of knowledge.
- For reference and inspiration on different ESG strategies, please see UNPRI guides for ESG integration and CDC's toolkit for fund managers<sup>8</sup>.
- For reference and inspiration regarding KPIs for ESG criteria, please see GRI Standards, DVFA/EFFAS KPIs for ESG and SD KPI Standard<sup>9</sup>.

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<sup>7</sup> Inspired by ARISE (2012) ARISTA 3.0 *Voluntary Quality Standard for Responsible Investment Research*, available at [http://ESGrqs.dev.lightbridge.be/content\\_files/file/QS%202012/ARISTA30final09102012final.pdf](http://ESGrqs.dev.lightbridge.be/content_files/file/QS%202012/ARISTA30final09102012final.pdf)

<sup>8</sup> PRI (2016) *A practical guide to ESG integration for equity investing* available at [https://www.unpri.org/download\\_report/22600](https://www.unpri.org/download_report/22600), PRI (2014) *Fixed Income Investor Guide* PRI available at [https://www.unpri.org/download\\_report/15026](https://www.unpri.org/download_report/15026), CDC (2015) *ESG Toolkit for Fund Managers* available at <http://toolkit.cdcgroup.com/esg-in-the-investment-cycle/ownership-and-monitoring>

<sup>9</sup> GRI (2016) *GRI Standards 102 General Disclosures* available at <https://www.globalreporting.org/standards/gri-standards-download-center/>, DVFA/EFFAS (2010) *KPIs for ESG 3.0* available at [http://www.effas-esg.com/wp-content/uploads/2011/07/KPIs\\_for\\_ESG\\_3\\_0\\_Final.pdf](http://www.effas-esg.com/wp-content/uploads/2011/07/KPIs_for_ESG_3_0_Final.pdf), SD-M® GmbH (2016) *SD KPI Standard 2016-2021* available at [http://www.sd-m.de/files/SD-KPI\\_Standard\\_2016-2021.pdf](http://www.sd-m.de/files/SD-KPI_Standard_2016-2021.pdf)

### 5.3.4 Engagement

Definition and objective:

- Engagement refers to interactions between the asset manager and investees on ESG issues.
- Engagement aims to influence (or identify need for) ESG practices and/or improve ESG disclosure.
- The objective is to ensure that asset managers are active and responsible, influencing companies proactively or reactively by conducting engagement and using their right as shareholders.
- Examples of engagement activities are voting, engaging with board, letters/calls.

Mandatory requirements:

- It is mandatory for asset managers to describe and employ a strategy for reactive engagement, suitable for their current asset classes and level of ESG maturity. Strategy or process is expected to include at least:
  - o Objectives, goals and scope of the engagement
  - o Monitoring activities of performance and risks of companies to keep track of any breaches
  - o Measurement of activities to enable assessment of if objectives are met and decide if engagement should be terminated or continued
- It is mandatory for asset managers to engage with companies that are breaching any requirements of the ESG4Real model, or divest.
- It is mandatory to discontinue engagement and divest holdings in a company that is unwilling to respond to engagement activities, please see chapter 5.5 for practical implications of compliance of ESG4Real for further details about time limits for engagement

Activities needed for compliance:

- Asset managers shall have strategies for how engagement is conducted and followed-up upon
- Engagement methods may vary depending on strategy, competence levels and resources. Asset managers are expected to design a method that can be controlled, suits the interest of its stakeholders and is intended to deliver a demonstrable change in the behaviour of a company.
- It is crucial to be able to show the result of the performed engagement so as to eliminate the existence of engagement that is easy to conduct but with limited or no effect, e.g. sporadic sending of letters or other methods with potential low effect.
- For reference and inspiration on engagement strategies, please see publications by BlackRock & Ceres, The Conference Board, SASB, CDC, Eurosif and Sustainalytics & Cass Business School <sup>10</sup>.
- For examples of engagement policies, please see, ROBECO, Mirova and Kempen<sup>11</sup>

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<sup>10</sup> Blackrock & Ceres *21<sup>st</sup> Century Engagement* available at <https://www.blackrock.com/>, The Conference Board *2014 Guidelines for investor engagement* available at <https://www.conference-board.org/>, SASB (2016) *Engagement guide for asset owners and asset managers* available at <https://library.sasb.org/engagement-guide/>, CDC (2015) *Toolkit for Fund Managers* available at <http://toolkit.cdcgroup.com/>, Eurosif (2013) *Shareholder Stewardship: European ESG Engagement Practices 2013* available at <http://www.eurosif.org/wp-content/uploads/2014/06/eurosif-report-shareholder-stewardship.pdf>, Sustainalytics & Cass Business School (2016) *Engagement: Unlocking the black box of value creation* available at <http://www.sustainalytics.com/knowledge-center/#ourpublications>

<sup>11</sup>Robeco Engagement Policy available at <https://www.robeco.com/>, Mirova Engagement Policy <http://www.mirova.com/>, Kempen Engagement Policy available at <http://www.kempen.nl/>

## 5.4 Description of required use of Tools for implementation and compliance

Tools for asset managers in demonstrating implementation and compliance with the requirements in the ESG model includes are listed below. Please note that all tools shall be fully implemented and in use at time for audit and certification.

- Investment policy
- Processes
- Reporting principles

### 5.4.1 Investment policy<sup>12</sup>

Definition and objective:

- The investment policy formalizes an institution's goals, objectives and guidelines for asset management and describes the strategies that the manager should employ to meet these objectives. It is instrumental in ensuring that the goals of ESG and RI are formulated and reached.
- The objective of the tool is to ensure that ESG activities of the asset owner and the asset manager are included in investment decisions and that demands and performed actions are clearly communicated between asset owners, asset managers and other potential stakeholders.

Required use of tool:

- Both asset owners and asset managers are required to include specific and transparent descriptions of responsible investment practices in their investment policies and how they contribute to compliance of ESG4Real.
- It is mandatory for asset owners and asset managers to:
  - o Clearly state adherence to ESG4Real and if desired refer to ESG4Real introduction material.
  - o Describe on a high level how requirements of ESG4Real will be complied with regarding the ESG model and design of processes and reporting standards.
- It is recommended for asset owner and asset managers to include on top of ESG4Real demands, description of individual ESG considerations.
- The investment policy shall be up to date and any changes communicated swiftly to stakeholders

Activities needed for compliance:

- For reference and inspiration on investment policies, please see PRI guidance for asset owners on investment policies<sup>13</sup>.

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<sup>12</sup> Please note that the investment policy may refer to other investment steering documents that regulate the policies for responsible investment practices

<sup>13</sup> PRI (2016) *Investment Policy: Process & Practice A guide for asset owners* available at [https://www.unpri.org/download\\_report/24553](https://www.unpri.org/download_report/24553)

## 5.4.2 Processes

### Definition and objective:

- Processes for ESG refer to the sequence of interdependent and linked procedures which use available resources to produce output in form of e.g. analysed or screened companies according to the requirements in the ESG model.
- The objective of this tool is to ensure that requirements in the ESG model can be shown to have been implemented and complied with in practice.

### Required use of tool:

- It is mandatory for asset managers to have clear descriptions of processes for operationalizing the strategies and methods for:
  - o Exclusion of activities
  - o Norms based screening
  - o ESG analysis and integration
  - o Engagement
- It is necessary to be able to demonstrate deployment of the processes in practice that is broad enough to be *representing the ruling way of working*. Evidence need to be provided such that it is shown how the process contributes to the desired outcome of the RI work and compliance with the requirements in the ESG model by providing information and documentation on e.g.:
  - o Responsible person/team for implementing processes
  - o If there is a dedicated ESG team, if yes; its responsibilities, how it works with the investment team and team meetings notes, location
  - o Specific examples of screening and obtained and used ESG data
  - o Specific examples of engagement and how it has impacted investment decision

### Activities needed for compliance:

- Asset managers are required to describe and be transparent about which processes that are applied in order to be compliant with the demands of the ESG model.
- Processes may be designed according to organizational needs and prerequisites and potential demands from asset owners.
- For reference and inspiration on ESG processes, please see CDC<sup>14</sup>.

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<sup>14</sup> CDC (2015) *ESG Toolkit for Fund Managers* available at <http://toolkit.cdgroup.com/>

5.4.3 Reporting principles

Definition and objective:

- Reporting provides information on a specific event or activity for a given time period from asset managers to asset owners. The reporting principles aim to ensure that appropriate information regarding ESG practices and results are regularly disclosed by asset managers to asset owners.

Required use of tool:

- Asset managers are required to disclose information on the mandatory items regarding compliance of the ESG model. Additional reporting is encouraged and recommended in cases where there are material aspects that may be of interest for asset owners or other stakeholders.
- Table 7 lists the mandatory areas and items to be reported on.

Mandatory disclosure	Reporting content
Exclusion of activities	<ul style="list-style-type: none"> <li>• Outcome (comply/explain basis)</li> <li>• Progress from last reporting period. Identified risk areas and planned actions for reducing these (e.g. signs of violations)</li> </ul>
Norms based screening	
ESG analysis and integration	<ul style="list-style-type: none"> <li>• Clear description of outcome of ESG analysis and integration that enables an assessment of on what grounds companies are eligible for investment</li> </ul>
Engagement	<ul style="list-style-type: none"> <li>• Clear description and rationale for engagement activities and their impact</li> <li>• Reasons for discontinued/continued engagement</li> </ul>
Other mandatory items	Requirement
Format, structure	Agreed with asset owner
Time frames and frequency	Agreed with asset owner
Data boundaries & sources	Clearly specified by asset manager
Language, communication	Agreed with asset owner

**Table 7. Mandatory reporting areas and items**

Activities needed for compliance:

- Asset managers are required to have clear and consistent reporting practices and disclosure of compliance with the ESG model. Quality of the information is important to enable stakeholders to make sound and reasonable assessments of performance and take appropriate actions.
- For reference on reporting formats, see GRI, Accounting for sustainability, IIRC, SASB and WICI<sup>15</sup>.
- For examples of reporting see Aegon, Swedbank (example of GRI reporting) and Triodos (example of e.g. engagement reporting)<sup>16</sup>

<sup>15</sup> GRI (2016) *GRI Standards*, available at <https://www.globalreporting.org/>, Accounting for sustainability *Connected Reporting Framework*, available at <https://www.accountingforsustainability.org/>, IIRC (2013) *The international <IR> Framework*, available at <http://integratedreporting.org/>, SASB standards available at <https://www.sasb.org/>, WICI (2016) *WICI Intangibles Reporting Framework* available at <http://www.wici-global.com/>

<sup>16</sup> Aegon Responsible Investment Report 2015 available at <https://www.aegon.com/>, Swedbank GRI Report 2016 available at <https://www.swedbank.com/>, Triodos SRI Report 2016 available at <https://www.triodos.com/>

### 5.5 Practical implications of compliance with the ESG model

This chapter describes the practical implications for an asset manager aiming to be compliant with the requirements of the ESG model. It relates to the actions that are required considering a current investment and new investment respectively. Depending on if an asset managers is in the context of a *current* or *new* investment, the implications of complying with the requirements in the ESG model differ. The differences regard when engagement is allowed and when exclusions must be made, including allowed time frames for engagement and exclusions. Table 8 shows the practical implications of compliance within each ESG instrument for current and new investments.

	Current investments	New investments
Exclusion of activities	<ul style="list-style-type: none"> <li>• Screening at least 2 times a year</li> <li>• Exclusion process must be started as soon as an activity in an excluded sector is detected and confirmed</li> <li>• Exclusion must be finalised within 1 year</li> <li>• Engagement is not allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Investments in companies with activities in excluded sectors are not allowed</li> <li>• Engagement is not allowed</li> </ul>
Norms based screening	<ul style="list-style-type: none"> <li>• Screening at least 2 times a year (current investments)</li> <li>• In case of confirmed violations engagement is allowed if               <ul style="list-style-type: none"> <li>- It is comprehensive*</li> <li>- It is planned, with continued follow-up</li> <li>- Has the aim to have company taken of black list (issue resolved)</li> </ul> </li> <li>• Maximum time limit for engagement is two years and must be motivated on a comply/explain basis</li> <li>• In case of exclusion, divestment is to be made within six months of exclusion decision</li> </ul>	
ESG analysis and integration	<ul style="list-style-type: none"> <li>• Analysis of criteria at least 2 times a year (current investments)</li> <li>• Shall follow asset manager’s strategy and process for ESG analysis and integration</li> </ul>	
Engagement	<ul style="list-style-type: none"> <li>• Presupposes monitoring and screening of companies according to demanded requirements of ESG4Real</li> <li>• Shall follow asset manager’s strategy for engagement</li> </ul>	<ul style="list-style-type: none"> <li>• Proactive engagement may be conducted to influence a potential investee towards a desirable direction</li> </ul>

\*A comprehensive engagement includes multiple, substantive, detailed discussions or interactions with a company (e.g. letters, meetings and calls) relating to a particular ESG issue.<sup>17</sup>

**Table 8. Practical implications of compliance with the ESG model**

<sup>17</sup> UNPRI (2016) *Reporting Framework Main definitions* available at [https://www.unpri.org/download\\_report/6309](https://www.unpri.org/download_report/6309)



## 6 Appendix

### 6.1 Terminology

Term	Definition
Actively managed strategies	Investment strategies or funds where the manager builds quantitative computer based models and/or use qualitative models and judgement to determine whether an investment is attractive or not <sup>18</sup> .
Certificate	Document issued by a certification body to an asset manager complying with the requirements of the ESG model and use of tools for implementation and compliance. Gives the permission to use ESG4Real trademark in marketing and communication to stakeholders.
Comply/explain approach	<ul style="list-style-type: none"> <li>• ESG4Real does not predict a “one size fits all” approach for all requirements. Deviations from requirements are acceptable if the asset manager considers there are more suitable ways for it to comply with the requirements or have sound explanations to why the requirement is not complied with. This gives room for flexibility, reflecting that it is impractical to define in detail the behaviour necessary from all asset managers to achieve compliance.</li> <li>• To avoid “box ticking”, issuers must consider their own individual circumstances, the size and complexity of their operations and the nature of the risks and challenges they face.</li> <li>• Where an asset manager considers a requirement not to be applicable or relevant to comply with they may instead explain and give reasons to its asset owners and shareholders why the requirement is not complied with.</li> <li>• Asset owners should not consider departures from requirements as breaches. They should carefully consider and evaluate explanations given by asset managers in the “comply or explain” process.</li> <li>• An informed, constructive dialogue between asset managers and asset owners is important to make sure that there is a mutual understanding of reasons to compliance and explanations<sup>19</sup>.</li> </ul>
Engagement	Interactions between the investor and current or potential investees (which may be companies, governments, municipalities, etc.) on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosure <sup>18</sup> .
Environmental (E)	Issues relating to the quality and functioning of the natural environment and natural systems <sup>18</sup> .
ESG analysis	<ul style="list-style-type: none"> <li>• Consideration of E, S and G factors with the aim to single out companies that are performing positive or best-in-class relative to their industry peers.</li> <li>• Encompasses the use of qualitative and quantitative ESG information in investment processes to assess what management and business risks and opportunities a company faces, with the objective of enhancing investment decision making<sup>18</sup>.</li> </ul>

<sup>18</sup> PRI (2016) *PRI Reporting Framework Main definitions*, available at: [https://www.unpri.org/download\\_report/6309](https://www.unpri.org/download_report/6309)

<sup>19</sup> Hong Kong Stock Exchanges (2010) *Appendix 14 Corporate Governance Code and Corporate Governance Report*, available at: [https://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix\\_14.pdf](https://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix_14.pdf)

Term	Definition
ESG integration	The systematic and explicit inclusion by investment managers of environmental, social and governance factors into traditional financial analysis <sup>18</sup> .
Exclusion of activities	The exclusion from a fund or portfolio of certain sectors, industries or practices based on activities <sup>18</sup> .
Governance (G)	Issues relating to the governance of companies and other investee entities <sup>18</sup> .
License	Document issued by RIA company to an asset owner complying with the requirements of the ESG4Real standard applicable to asset owners. Gives the permission to use ESG4Real label in marketing and communication to stakeholders.
Material topic	A topic that reflects a reporting organisation's significant ESG impacts or that substantively influences the assessments and decisions of stakeholders <sup>20</sup> .
Norms based screening	Screening of investments against minimum standards of business practice based on international norms and conventions <sup>18</sup> .
Passively managed strategies	Investment strategies which mirror the performance of an index and follow a pre-determined buy and hold strategy that does not involve active forecasting. Examples include investments in broad capital market indices, ESG weighted indices, themed indices, passively managed ETFs or indices with ESG-based exclusions <sup>18</sup> .
RI	Responsible investments
Social (S)	Issues relating to the rights, well-being and interests of people and communities <sup>18</sup> .
Voting	Voting on management and/or shareholder resolutions as well as filing shareholder resolutions <sup>18</sup> .

<sup>20</sup> GRI (2016) *GRI standards glossary*, available at: <https://www.globalreporting.org/standards/gri-standards-download-center/>

## 6.2 References to further information about the norms and conventions

Mandatory norm/convention/agreement	Available at
UN Global Compact	<a href="https://www.unglobalcompact.org/">https://www.unglobalcompact.org/</a>
UN Guiding Principles for Business and Human Rights	<a href="http://toolkit.cdcgroup.com/esg-in-the-investment-cycle/ownership-and-monitoring">http://toolkit.cdcgroup.com/esg-in-the-investment-cycle/ownership-and-monitoring</a>
OECD guidelines for multinational enterprises	<a href="http://www.oecd.org/corporate/mne/">www.oecd.org/corporate/mne/</a>
Paris agreement	<a href="http://unfccc.int/paris_agreement/items/9485.php">http://unfccc.int/paris_agreement/items/9485.php</a>