This is a summary of the *The 21st Century Investor: Ceres Blueprint for Sustainable Investing*, which can be found in its entirety at www.ceres.org/investorblueprint.

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This summary of *The 21st Century Investor: Ceres Blueprint for Sustainable Investing* (the “Ceres Blueprint”) guides investors along a path to becoming what we call *sustainable investors*: investors who understand that the 21st century economy will be shaped by powerful forces such as climate change, population growth, rising demand for energy, declining supplies of fresh water and other natural resources, and protection of human rights and worker health and safety. To serve current and future beneficiaries and maximize risk-adjusted returns, sustainable investors will need to mitigate the risks and seize the opportunities arising from these sustainability challenges.

The *Ceres Investor Blueprint* follows the 2010 publication of *The 21st Century Corporation: The Ceres Roadmap for Sustainability*, a virtual owner’s manual for companies seeking to thrive in this new world of risk and opportunity. Today, hundreds of companies are using the report as a guide for becoming sustainable corporations.

By operating and investing sustainably, companies and investors will be contributing significantly to the creation of a sustainable economy—one that meets the needs of people today without compromising the ability of future generations to meet their needs. Investors, particularly large institutional investors, exercise great power through the deployment of capital. When they integrate sustainability risks and opportunities into their decision-making, they aren’t just being smart investors; they’re helping ensure a prosperous economy for future generations. That’s good for their beneficiaries and the planet.

Many institutional investors around the world are already moving to become sustainable investors. The Investor Network on Climate Risk (INCR), which comprises more than 100 investors managing over $11 trillion under management and the UN supported Principles for Responsible Investment (PRI), whose signatories manage more than $30 trillion, are just two of a growing number of global investor groups that reflect a deepening understanding within the investment community that sustainability risks are fundamental economic risks that will have great consequence for investors. The *Ceres Investor Blueprint* is designed to help investors act on their growing concern about sustainability by providing a set of 10 concrete action steps that will move them along a path towards becoming sustainable investors.

**Mindy S. Lubber**  
President, Ceres  
Director, Investor Network on Climate Risk

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**FOREWORD**

This is a summary of the *The 21st Century Investor: Ceres Blueprint for Sustainable Investing*, which can be found in its entirely at www.ceres.org/investorblueprint.
OVERVIEW

SUSTAINABILITY RISKS AND OPPORTUNITIES WILL SHAPE THE 21ST CENTURY ECONOMY

“Environmental and other sustainability issues are core to business performance in the 21st century.”
Anne Stausboll, CEO of the California Public Employees’ Retirement System (CalPERS)

Unprecedented risks to the global economy make this a challenging time for the 21st century investor—institutional asset owners and their investment managers—most of which have multi-generational obligations to beneficiaries. Climate change, resource scarcity, population growth, energy demand, ensuring the human rights of workers across global supply chains, and access to fresh water are some of the major issues challenging our ability to build a sustainable economy, one that meets the needs of people today without compromising the needs of future generations.

These sustainability risks will have far-reaching economic implications that investors cannot ignore. In the decades to come, they will challenge businesses and affect investment returns across all asset classes. As recent events have shown, waiting to respond is not an option. Globally, weather-related disasters—especially droughts and heat waves—are already escalating due to climate change. Extreme weather accounted for more than 90 percent of the natural catastrophes worldwide in 2012, with the biggest losses being in the United States. In 2012, U.S. insured losses from Hurricane Sandy, a historic drought and other climate-influenced extreme weather topped $58 billion. Rising sea levels, which multiply the damages that arrive with higher storm surges, also threaten real estate and vital infrastructure along the coasts.

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Other pressures are increasing as well. Many countries and continents are on course to suffer major freshwater deficits in the next two decades. A recent McKinsey study estimates that by 2030 global water demand will outpace supply by 40 percent. Uncertain supplies—whether polluted sources, a lack of water, or too much at once—has obvious reverberations across global supply chains and can cause serious business interruptions that pose investment risk.

These sustainability risks also present enormous opportunities for businesses and investors. For example, the International Energy Agency has estimated the global clean energy investment opportunities in renewable power, energy efficiency and cleaner transportation at $5 trillion within the next decade. Climate change adaptation will also require enormous infrastructure investments and will necessitate changes in power generation and distribution, transportation, food production and water supply, creating opportunities estimated by Mercer to be as high as $5 trillion over the next 15 to 20 years.

WHAT IS SUSTAINABLE INVESTING?

“Environmental, social and governance factors can affect the risk and return performance of investment portfolios to varying degrees across companies, sectors, regions and asset classes.”

Anne Simpson, Senior Portfolio Manager and Director of Global Governance of the California Public Employees’ Retirement System

To be clear, sustainable investing is not about investing to achieve environmental or social goals and it does not ask investors to accept compromised returns (see, “The Business Case for Sustainable Investing,” p. 3). To the contrary, it is about integrating ESG information with conventional financial analysis so that investment decisions are based on awareness of the full range of risks and opportunities—consistent with fund objectives to maximize risk-adjusted returns and create long-term value.

In addition to identifying and investing in companies and other assets with proven sustainability performance, sustainable investing also includes, among other things:

- analyzing ESG risks in every asset class and mitigating these risks across the whole portfolio;
- understanding the economic impact of increasingly common severe weather events that are causing hundreds of billions in economic losses every year;
- financing the energy technologies of the future and understanding the risks in water infrastructure bonds in a world that can no longer take ample supplies of fresh water for granted;
- preparing for the impacts of new regulatory frameworks that will inevitably catalyze a shift away from fossil fuels to renewable energy sources. (If that shift does not occur, unchecked climate change will cause economic havoc that will likely dwarf the global financial crisis of 2008).

These are just some of the “sustainability” risks and opportunities that often elude traditional financial analysis and, for too many investors, are still beyond even their peripheral vision.

WHAT IS A SUSTAINABLE INVESTOR?

“Our goal is simple: we want long-term sustainable economic growth. And we have found from experience that comprehensively integrating environmental, social and governance considerations into the investment process is essential to achieving that goal.”

Thomas DiNapoli, New York State Comptroller, Trustee, New York State Common Retirement Fund

This Blueprint is intended to help guide institutional investors (and their trustees, managers and consultants) through this new world of risk and opportunity. It recommends 10 action steps investors can take to help them become “sustainable investors”; that is, investors managing sustainability risks and opportunities so they can meet their obligations to current beneficiaries without compromising their ability to meet the needs of future beneficiaries.

While there are many ways that investors and other market players are focusing on sustainable investing, one of the most common frameworks is analyzing “environmental, social and governance factors,” or ESG factors. ESG analysis and integration is a key theme throughout this Blueprint for bringing sustainability issues into investment decision-making.
TOOLS FOR SUSTAINABLE INVESTING

There are many resources available to help investors integrate sustainability issues into their decision-making. Data concerning environmental, labor and operational practices is widely available, as are comparative rankings of companies based on ESG performance. The participation of investors in investor groups focused on sustainable investment—such as the Investor Network on Climate Risk, Principles for Responsible Investment, Forum for Sustainable and Responsible Investment, and European, Australian and Asian investor groups on climate change—is testament to the rising importance of these new tools for managing emerging ESG risks.

Some sustainability issues are material to all investors: the far-reaching economic effects of climate change, for example, will affect every investor. Others may be material to some investors and not others depending upon the composition of their portfolios. But, regardless of the particular mix of investments that will make some sustainability issues material to some investors and not others, the fundamental obligations of institutional investors (and their trustees), who act as fiduciaries for their beneficiaries, are unchanged. The duties of good faith, loyalty and prudence require consideration of all factors that can reasonably be expected to impact the fund’s ability to meet its obligations to current and future beneficiaries.

FIDUCIARY DUTY

“To ignore the risks around climate and sustainability in your portfolio could be and will be characterized as a dereliction of your fiduciary duties.”

Kevin Parker, former Global Head, Deutsche Asset Management

Fiduciaries who manage institutional assets owe a duty of utmost good faith, loyalty and prudence to the beneficiaries whose money they are managing. Integrating material ESG factors into investment decision-making as a means of managing risk and seeking appropriate investment opportunities is fully consistent with the fiduciary duty of institutional investors. Environmental and social variables such as climate change, population growth, resource scarcity and attention to worker and human rights can no longer be treated as extraneous “non-financial” matters.

Indeed, failure to consider material ESG factors could constitute a breach of fiduciary duty because the objective of ESG analysis is to maximize long-term risk-adjusted returns, not to achieve social or environmental objectives. A thorough 2005 legal analysis by the international law firm Freshfields surveyed the law of fiduciary duty in a number of leading jurisdictions, including the U.S., and concluded that the duty of prudence may require investors to consider relevant ESG factors in making investment decisions. The duty of loyalty also requires impartial consideration of the interests of all beneficiaries, encompassing both longer-term investment and fund performance and shorter-term investment objectives.

THE BUSINESS CASE FOR SUSTAINABLE INVESTING

The value of incorporating sustainability principles into business strategies and investment decisions is strongly supported by an increasing body of academic research and industry evidence, most of it focused on public equities:

- An analysis of more than 160 academic studies, research papers and meta-studies by Deutsche Bank Climate Advisors in 2012 found that 89% showed companies with high ESG performance ratings outperformed their industry peers, and 100% of the studies concluded that companies with high ratings for Corporate Social Responsibility (CSR) and ESG factors had lower capital costs for debt and equity.

- In an 18-year study (1993-2011) by Robert Eccles and George Serafeim of Harvard Business School, 90 companies with strong sustainability policies and practices outperformed a similar sampling of 90 firms having low sustainability standards. “The annual above-market average return for the high-sustainability sample was 4.8% higher than for their counterparts and with lower volatility. The high-sustainability companies also performed much better as measured by return on equity and return on assets.”

- In a study of more than 450 companies between 2001 and 2010, Sustainable Asset Management found that a portfolio of sustainability leaders outperformed an overall sample by 1.74% annually, while a portfolio of sustainability laggards underperformed the overall sample by 1.87% annually.

- In its 2011 white paper, RCM Capital Management found that over a five-year period (2006-2010) a portfolio of the top quintile of global best-in-class ESG companies outperformed the benchmark MSCI World Equal Weighted Index by 1.7%, while the worst-in-class portfolio underperformed the benchmark by 1.0%.

- Of the 36 academic studies Mercer analyzed in two reports, more than 20 showed a positive link between ESG factors and performance. Mercer’s conclusion: “…argument(s) that integrating ESG factors into investment analysis and decision-making will only lead to underperformance simply cannot be made.”
“Every investor needs to work through these 10 steps. By asking these questions, each investor will figure out what issues are material to their particular investment objectives and how to ensure that they are mitigating investment risks and seizing opportunities that might otherwise go unnoticed.”

Nancy Kopp, Treasurer, State of Maryland

Based on more than a decade of experience working with institutional investors, and extensive consultation with a broad cross-section of asset owners and managers, this Blueprint recommends 10 action steps for institutional investors seeking to become sustainable investors. While these steps are presented in what we believe is a logical sequence, they can be undertaken in any order.
Step 1: Establish a Commitment to Sustainable Investment Through a Statement of Investment Beliefs

It is essential that trustees and board members, who have ultimate responsibility for meeting a fund's obligations to its beneficiaries, articulate a set of principles upon which managers, consultants and staff will make investment decisions. Formulating a Statement of Investment Beliefs forces trustees to reckon with a broad set of issues that will impact the performance of the fund. That statement should recognize the impact sustainability issues are having and will have on the economy and on the fund's investments, and commit the fund to integration of ESG analysis of existing and potential investments. Asset managers should likewise establish investment beliefs to signal to clients and prospects that ESG is imbedded in their work.

Many leading institutional investors have integrated sustainability into investor belief statements. For example:

The California State Teachers' Retirement System (CalSTRS) Board of Trustees links ESG factors to the board's fiduciary duty:

As a significant investor with a very long-term investment horizon and expected life, the success of CalSTRS is linked to global economic growth and prosperity. Actions and activities that detract from the likelihood and potential of global growth are not in the long-term interest of the Fund. Therefore, considerations of environmental, social, and governance issues (ESG), as outlined by the CalSTRS 21 Risk Factors, are consistent with the Board fiduciary duties.

The Ontario Municipal Employees' Retirement System (OMERS) explicitly incorporates ESG factors into its investment analysis for reasons of long-term financial performance:

[We believe] that well-managed companies are those that demonstrate high ethical and environmental standards and respect for their employees, human rights, and the communities in which they do business, and that these actions contribute to long-term financial performance. As part of its due diligence in researching investments and monitoring performance, [OMERS] incorporates environmental, social and governance factors into its decision-making processes.

Step 2: Establish Board Level Oversight of Sustainability Policies and Practices

Trustees and board members must "own" the investment decision-making process. Once a commitment is made to sustainable investing by integrating ESG analysis in the investment process, trustees must continue to take an active role to ensure that decisions made by the investment staff concerning asset allocation, portfolio composition and the fund's consultants and external managers are consistent with the fund's commitment to sustainability.

The active involvement of trustees in ESG integration sends a strong message to investment and governance staff—as well as consultants and asset managers—that investment risks and opportunities are being carefully examined in ways that "investing as usual" may not account for. It also alerts investment consultants and managers that the fund will hold providers accountable for integrating ESG factors in their investment practices.
Step 3: Identify Sustainability Issues Material to the Fund

Each investor must identify those sustainability issues and related risk factors that it deems sufficiently material to influence investment decisions. Generally, under U.S. law a piece of information is material in an investment context if there is a substantial likelihood that a reasonable person would consider it important. ESG analysis can often reveal such material facts that have gone unnoticed using traditional financial analysis. Some sustainability issues, such as climate change, are likely to prove material to virtually every investor in every asset class and in most business sectors. Investors should consider whether other ESG issues are uniquely material to their funds, such as water and natural resource scarcity or worker and human rights exposure. Many of these issues are flagged in a 2010 guidance report on materiality by Harvard’s Initiative for Responsible Investment.

Step 4: Evaluate Asset Allocation for Material Sustainability Risks

Trustees should review current asset allocation strategies to determine whether they are prepared for risks arising from climate change, increased demand for energy, affordable access to water and other resources, and other material sustainability risks. Strategic Asset Allocation (SAA), which diversifies risk across traditional and alternative assets, is generally effective in mitigating risks associated with most ESG factors. Climate change risk, however, because it is ubiquitous, poses challenges to traditional asset allocation approaches. When carbon emissions become taxed or regulated, the entire portfolio will be affected if every asset class has investment exposure to carbon emitters (oil/gas producers, utilities, transportation). That risk extends as well to heavy users of fossil fuels, which, as prices increase, will experience reduced profit margins that will impact investment returns. For such pervasive risks that lack precedent, SAA’s reliance on historic quantitative analysis does not adequately diversify risk.

Climate-related physical impacts can also affect broad geographic areas and regional economies. In this regard, trustees should ask their consultants to “stress test” traditional allocation models by running sustainability scenarios. For example, a consultant might model factors such as a drought or a particular sea level rise prediction and assess the impact on the portfolio. These scenario overlays may expose risks that can then be mitigated.

One alternative approach has been developed by the consulting firm Mercer. Mercer’s 2011 report, *Climate Change Scenarios—Implications for Strategic Asset Allocation*, estimates that systemic risks from climate change policies could affect investment returns by as much as 10% over the next 20 years. To avoid such risks, Mercer suggests that investors consider diversifying across sources of risk rather than across traditional asset classes. According to one Mercer scenario, a typical portfolio seeking a 7% return could manage climate risks by shifting 40% of its portfolio to climate-sensitive assets (such as infrastructure, real estate, private equity, agriculture land, timberland and sustainable listed/unlisted assets).
Virtually any strategy can be adjusted to incorporate sustainability factors. Trustees and investment committees already make strategic decisions about active strategies versus passive ones, value versus growth, or large cap versus small cap. The only additional step is to incorporate ESG analysis into the strategy they’ve already chosen.

Institutional investors having broad market exposures can employ strategies that tilt investment concentrations toward companies with higher ESG scores. Such strategies can be structured to retain ownership of the whole market, a priority for so-called universal investors.

Many active managers, including SRIs, already use ESG analysis.

Other managers that do not routinely examine ESG factors can use data from ESG research providers. Major index providers all have ESG or sustainability themed offerings. If a particular strategy only exists in a non-ESG form, it can be customized to include whatever ESG or thematic component the investor would like to have. If the investor chooses a passive strategy, they may want to focus their proxy voting strategies for public equities, as well as their corporate dialogues for private equity and fixed income holdings, on ESG risks and opportunities in particular sectors.

A growing number of investors are building ESG criteria into their procurement of consultants and asset managers, including NYCERS, the State of Connecticut and the UAW Retiree Medical Benefits Trust. A practical place to start is requests for proposals (RFPs). RFPs should be designed to elicit information about a manager’s attitudes, expertise and mechanisms for evaluating ESG factors—and what their main drivers are for making investment decisions and managing risk. Prospective managers and consultants should be questioned about their ESG experience during interviews. Once the consultant or manager has been selected, the contract or investment management agreement should include expectations for incorporating ESG factors and the process for monitoring ESG implementation and performance.

Two important resources that address inclusion of ESG into criteria for RFPs and Investment Management Agreements are:

Aligning Expectations: Guidance for Asset Owners in Incorporating ESG Factors Into Manager Selection, Appointment and Monitoring (PRI publication, 2013); and the ICGN Model Mandate Initiative: Model Contract Terms between Asset Owners and their Fund Managers. (ICGN publication, 2012)
Reports that managers and consultants provide to trustees are key to monitoring investment behavior and compliance with the asset owner’s investment beliefs and policies, including expectations related to ESG criteria. Periodic reviews trustees and investment staff conduct with their investment managers and consultants should include explanations of how investment strategies use investment time horizons greater than one year; adhere to investment principles about ESG; and measure and incentivize integration of sustainable investment factors. Institutional investors should require managers and consultants to provide annual reviews of ESG implementation, investment decisions that ESG analysis has affected, and material sustainability risks, including exposure to climate risks and carbon-intensive assets that may be overvalued.

The Florida State Board of Administration manages the state’s public employees retirement investments. Its Investment Protection Principles include specific reporting requirements as part of the investment review process. The section on “Climate Change Related Investment Risks and Opportunities” asks investment managers to identify how “an issuer’s stance and practices related to climate change is assessed, evaluated and factored into our investment decision making processes.” Similarly, CalSTRS requires global equities managers to explain how they have incorporated CalSTRS “21 Risk Factors” in decision-making.

Many institutional investors regularly communicate and engage with their portfolio companies in a variety of ways concerning business practices and risk management. Most engagement is directed toward business practices that investors believe can affect long-term investment value. This should include disclosure of ESG risks, as well as policies, practices and goals for mitigating them. Many investors, including CalPERS and CalSTRS, are using The 21st Century Corporation: Ceres Roadmap for Sustainability, to guide their corporate engagement. Investor engagement, which has traditionally focused on publicly listed companies, is also expanding into fixed income, private equity and real estate markets.

Trustees should adopt and publish a policy concerning active ownership, and the trustees and staff should establish clear protocols for engagement that provide trustee oversight and authorize staff to act on material ESG issues. Trustees should also adopt Proxy Voting Guidelines that lead to appropriate and consistent votes being cast by fiduciary voters. The guidelines should include specific direction on how fund managers should vote on material ESG related issues. Managers should be informed about key proxy votes each proxy season and required to report on how they voted all their shares—not just their votes for a single client.

Investors can further enhance their corporate governance activities by coordinating company/industry dialogues and proxy campaigns with others investors through networks like Ceres’ Investor Network on Climate Risk and the Council of Institutional Investors Shareholder Activism Committee.

TIAA-CREF’s policy statement on corporate engagement states: “We believe that investors should encourage a long-term perspective regarding sustainability and social responsibility, which may impact the long-term performance of both individual companies and the market as a whole. We communicate directly with companies to encourage careful consideration of sustainable practices and disclosure. TIAA-CREF may support reasonable shareholder resolutions on social and environmental topics that raise relevant economic issues for companies.” TIAA-CREF, Policy Statement on Corporate Governance, 6th Edition, page 17.

The AFL-CIO’s “Key Votes Survey” is one accountability tool for managers. This annual survey identifies key proxy resolutions each proxy season and then reports how each asset manager scored as a percentage of votes that were with or against the AFL-CIO’s recommendations.
Christopher Ailman, CalSTRS’ chief investment officer, describes some approaches his team has taken to evaluate ESG factors in public and private equities, fixed income and real estate:

From an investment perspective, each asset class in the CalSTRS Investment Portfolio considers both environmental-related opportunities and environmental-related risk management tools. The Global Equity portfolio includes a sustainable manager strategy and staff actively engages its managers on environmental, social and governance (ESG) considerations. The Fixed Income portfolio is a lead purchaser of green bonds and has developed an internal screen to measure its portfolio’s degree of sustainability. The Real Estate portfolio is focusing on improving energy and water efficiency and the Private Equity portfolio includes a commitment to clean technology.

Since institutional investors’ investment performance is highly dependent on the U.S. and global economy, they and their asset managers should advocate for capital market reforms and policy initiatives that promote sustainable investment, sustainable capital markets and a sustainable economy. The kinds of policies they should be supporting in this regard include: 1) increased disclosure of relevant ESG risks in financial filings, 2) tax and regulatory policies that mitigate climate change and support investment in sustainable sources of energy, 3) stronger stock exchange requirements for ESG-related disclosure by listed companies, 4) more systematic and transparent incorporation of material ESG factors in credit rating agency opinions, and 5) stronger collaboration with other investors through organizations such as INCR, PRI, CII, US-SIF, ICGN and the Global Investor Coalition on Climate Change regarding sustainable capital markets initiatives.

Investor advocacy, which is often conducted in collaboration with other investors through organizations such as those identified above has achieved positive results. For example, investor action contributed to the SEC’s decision in 2010 to issue guidance concerning disclosure of risks related to climate change. In August 2012, stringent new fuel economy and greenhouse gas vehicle standards were adopted in the U.S., which will nearly double average fuel economy by U.S.-made cars and trucks. U.S. automakers and investors played an important role in the debate leading up to adoption of the new standards. Investors were also helpful in achieving a short-term extension of a federal tax credit for producing wind-generated energy. The one-year extension was approved in early January 2013.

Twenty years from now, we will have either successfully transitioned from our current economic growth paradigm to a new model of sustainable capitalism or we will be suffering the calamitous consequences of our failure to do so.”

Joe Keefe, President & CEO, Pax World Management

Step 9: Support Policies and Market Initiatives that Promote a Sustainable Global Economy

Step 10: Integrate Sustainable Investment Criteria Across All Asset Classes and Strategies
Ceres is a nonprofit organization mobilizing business leadership on sustainability issues such as global climate change. Ceres directs the Investor Network on Climate Risk, a network of more than 100 investors with collective assets of more than $11 trillion.

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