

Earth Summit 2012

**Towards a convention on
corporate sustainability
reporting at Rio+20**

INTERNATIONAL POLICY FRAMEWORK

Aviva has convened a Corporate Sustainability Reporting Coalition of more than 40 like minded organizations, including institutional investors managing approximately \$2 trillion.

This coalition calls on United Nations member-states to adopt at the 2012 Earth Summit a binding international commitment to develop national regulations which mandate the integration of material sustainability issues in the Annual Report & Accounts; and which provides effective mechanisms for investors to hold companies to account on the quality of their disclosures, including for instance through an advisory vote at the AGM.

CONTEXT

Markets are driven by information. If the information they receive is short term and thin then these characteristics will define our markets. Increasingly, it is becoming understood that if companies do not provide an assessment of the broader Environmental, Social and Governance (ESG) risks and opportunities to which their business model is exposed how can the market assess the sustainability of that company's growth?

Progressive companies around the world have themselves come to understand that long term value is enhanced by embedding long-term sustainability into their business strategy and by fully disclosing their progress to investors.

And in recent years, the issue of non-financial reporting has drawn an increased attention both at the EU and international level. EU institutions, national governments and various initiatives involving business representatives under the UN umbrella have been looking for mechanisms which would lead to more companies reporting information about their ESG performance. At the same time, an increasing number of companies voluntarily disclose ESG information in their reports.

At present however, there is no globally accepted rule requiring reporting of ESG performance. Despite the large number of companies publishing such reports, the vast majority of companies fail to do so; in fact more than 75% of the companies covered by Bloomberg do not currently disclose their sustainability performance.

SUSTAINABILITY AND LONG TERM SUCCESS

At Aviva, we believe there is only one way to deliver prosperity and peace of mind for our customers: responsibly, sustainably and with integrity. We believe that positive and sustainable commercial outcomes only come from a properly joined-up understanding of our commitments to our people, our customers, our environment and the communities in which we work. We believe a well-managed, responsible business will perform better and create more sustainable value over the long term.

This assertion has been borne out by Goldman Sachs who analysed the relationship between how companies address ESG issues and the returns they generate. It contended that in a number of sectors there is a direct correlation between sustainable business practices and the longer-term financial success of that company.

Further still, a 2007 study by German bank WestLB reviewed the materiality of ESG factors on 540 European firms and found evidence of a link between extra-financial risk, cost of capital to a firm and shareholder value. The report suggested that compiling a sustainability report was among the most

important catalysts for change – contributing to accumulation of knowledge, questioning of processes and the establishment of suitable structures and practices.

We proffer that the production of a sustainability strategy by a company will create the right kind of discussions within boardrooms, throughout firms and encourage investors to think about the sustainability of the firm. This will help capital to be allocated to more sustainable, responsible companies and strengthen the long term sustainability of the financial system.

STATE OF PLAY AT EU LEVEL

In the EU, the requirement to report on non-financial information is contained in the Fourth Company Law Directive. This Directive requires companies to include non-financial key performance indicators, including information relating to environmental and employee matters. Given the way this provision is phrased, it leaves a broad discretion to companies when deciding whether or not to include ESG information in their reports.

The European Commission announced in the Single Market Act (April 2011) that it will introduce new legislation on transparency of environmental and social information provided by companies.

STATE OF PLAY AT A NATIONAL LEVEL (EUROPE)

At a national level within Europe, the most prominent example of a legal provision on social responsibility reporting is the Danish Financial Statements Act 2009, requiring companies to include information on their social responsibility performance (including environmental performance), or to justify the absence of such information.

This legally binds 1,100 of the largest Danish companies to produce a corporate responsibility report – or explain why they will not do so. The report should include policies and actions, as well as what has been achieved by the individual company as a result of their work with corporate responsibility. The reporting provision is also relevant for financial sector companies, and adherence to the Global Compact or the PRI is considered sufficient for compliance.

In the UK, the Company Act of 2006 contains a provision comparable to the one embedded in the Fourth Company Law Directive - a requirement to disclose environmental and social information to the extent necessary to understand the development, performance or position of the company's business.

In France, the amendments to the Commercial Code (2010) require listed companies and companies with balance sheets or number of employees above a certain threshold to report on their CSR performance, including information on the way in which the company takes account of the social and environmental consequences of its activity as well as its societal commitments for sustainable development.

In Norway the Public Companies Act requires business corporations to include in their annual reports information on activities that could have an influence on the environment and steps taken to prevent negative impacts.

In Sweden and Spain, legislation requires companies with government participation to publish corporate governance and sustainability reports.

Many other countries, such as Germany, the Netherlands, Austria, and Belgium rely on voluntary sustainability reporting by companies with governmental bodies providing various non-mandatory guidelines.

STATE OF PLAY AT INTERNATIONAL LEVEL

At international level, there have been a number of initiatives under the UN umbrella promoting sustainability reporting. Such initiatives include UN Global Compact, United Nations Environment Programme Finance Initiative (UNEP FI) and the United Nations Principles for Responsible Investment (UN PRI).

Sustainable Stock Exchanges, an initiative by PRI, UNCTAD and Global Compact has been urging all stock market listing authorities to make it a *listing requirement* that companies consider how responsible and sustainable their business model is and put a forward-looking sustainability strategy to the vote at their AGM.

Aside from a few notable examples such as the Singapore, Johannesburg and Istanbul Exchanges, there has yet to see a serious commitment from stock exchanges to make changes to their listing rules. Aviva Investors research¹ has found that a majority (57%) of exchanges do not provide sustainability reporting guidance for listing companies.

Participation in these initiatives remains strictly voluntary and for example, so far less than two per cent of listed companies have opted into the Global Compact.

It is our belief from the feedback we've received that stock markets require the support from governments and regulators before they will take the steps we are asking for. This is why we believe this is a relevant issue for the global forum of the Earth Summit.

RIO 2012 EARTH SUMMIT

The United Nations Conference on Sustainable Development also referred to as Rio +20 will take place in Rio de Janeiro, Brazil on 4-6 June 2012. The objectives of the summit are to secure new political commitment to sustainable development, address new and emerging challenges and assess progress made towards internationally agreed goals on sustainable developments.

MOVEMENT FOR CHANGE

It is now almost twenty years since the first Earth Summit, as such we believe next year offers a momentous opportunity to move this agenda forward at an international level. This document makes a modest, market-based proposal that we believe represents the next step towards sustainable capital markets.

We hope that stakeholders - individuals, financial institutions, companies and representatives of civil society - will support this idea in their own work and lend their weight to this initiative in advance of Rio in June next year.

¹ "Sustainable Stock Exchanges – Real Obstacles, Real Opportunities", (2010)

OUR PROPOSAL

We are asking for Earth Summit delegates to commit to develop a convention on Corporate Sustainability reporting. The Rio summit would ideally be a commitment to develop national regulations which mandate the integration of material sustainability issues in the Annual Report & Accounts; and which provides effective mechanisms for investors to hold companies to account on the quality of their disclosures, including for instance through an advisory vote at the AGM.

We believe that an international policy framework should adhere to four key principles:

1. *Transparency* - Companies should be required to integrate material sustainability issues within their report and accounts – or to explain to the market why they cannot do this
2. *Accountability* – There should be effective mechanisms for investors to hold companies to account on the quality of their disclosures, including for instance through an advisory vote at the AGM.
3. *Responsibility* - Board duties should explicitly include setting the company's values and standards and ensuring that its obligations to its shareholders and other stakeholders are understood and met.
4. *Incentives* - Companies should state in remuneration reports whether the remuneration committee consider ESG factors which are of material relevance to the sustainability and long term interests of the company when setting remuneration of executive directors; aligning remuneration with the interests of shareholders and other key stakeholders, including customers and employees.

Corporate boards should be required to consider the future sustainability of the firm that they govern. The sustainability strategy should include performance targets; recent trend data and some level of external assurance. We would expect it to consider factors such as: use of natural resources; levels of workforce training; impact on local communities; the business model and the regulatory context. Companies will also have the option of publishing the explanation as to why the board considers such a strategy to be unnecessary.

Companies should then present the Corporate Sustainability Strategy to a separate advisory vote at its annual general meeting. The main purpose of which would be to create the right kind of discussions within boardrooms, throughout the business and between the company and its shareholders - encouraging investors to think about the sustainability of the firm.

Importantly, this initiative is a market based mechanism that promotes enhanced self regulation within the market. individual nations would be free to choose whether to implement this in primary legislation, in their regional Company Law, or via the listing authorities.

AVIVA'S CREDENTIALS

- Was the first company in the UK – and first financial services company in the world – to put its corporate responsibility report to a separate shareholder vote at its AGM in 2010.
- Are in top 10% of sustainable companies globally (Dow Jones Sustainability Index); ranked number 1 insurer in the FTSE4GOOD ESG Index Series.
- Is one of only 54 companies across the world to be recognised for our commitment to sustainability (UN Global Compact LEAD membership).
- Is a founding member of the UN Principles for Responsible Investment (UNPRI) programme.
- With UNPRI, UNCTAD and Global Compact has been a major partner in the Sustainable Stock Exchanges initiative since 2008.
- Have been closely involved in the Accounting for Sustainability (A4S) initiative since 2006.
- Is a founder member and responding organisation to the Carbon Disclosure Project.

APPENDIX A - POLICY FREQUENTLY ASKED QUESTIONS

1. What is the main purpose of this initiative?

The main purpose of the proposed sustainability reporting requirement - and the associated AGM vote - is to enable investors to integrate ESG issues into their investment analysis on a systematic and global basis. Improving the sustainability of the market, will enhance the value of investment portfolios in the long term.

In order to achieve this long term aim, we first tried to increase the awareness among all exchanges of the investor desire for this kind of information reporting. However, responses have been generally slow.

More generally, the drive for enhanced disclosure focuses corporations on their performance in this area. At its best, disclosure is a powerful motivational management by highlighting areas of underperformance that are important to the long-term health of the business.

2. How is the promotion of sustainability reporting relevant to shareholder value creation?

Signatories to the PRI agree *“that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios”* (Source: PRI Principles, paragraph 1).

We believe that a systematic approach to reviewing the standards, values and sustainability risks and opportunities of the business and ensuring that the business knows what is expected helps define and maintain a healthy long term organisational culture, where people have pride in their business, care for their customers and are highly motivated at their work. Understanding the potential impacts on the firm from diminishing access to raw materials is also important to the long term health of the business.

A significant number of buy and sell side firms are integrating these issues into valuation. However, without performance reporting, this is extremely difficult.

To cite two examples:

Goldman Sachs is one of the firms to have carried out analysis of the relationship between how companies address these ESG issues and the returns they generate. It contends that in a number of sectors there is a direct correlation between sustainable business practices and the longer-term financial success of that company (Source: GS Sustain: Challenges in ESG Disclosure, October 2009).

WestLB also published a study the materiality of extra-financial factors based on a sample of 540 European firm. It found evidence of a link between extra-financial risk, cost of capital to a firm and shareholder value. The report suggested that compiling a sustainability report was among the most important catalysts for change – contributing to accumulation of knowledge, questioning of processes and the establishment of suitable structures and practices (Source: Garz, H & Volk, C. What really counts: The materiality of extra-financial factors, WestLB, February 2007).

3. Don't most listed companies now produce some kind of sustainability report and strategy?

No.

In terms of the sustainability performance report, Bloomberg has populated its terminals with ESG data on many of the companies that they cover. Less than a quarter of the almost 20,000 companies that they examined published data of sufficient quality and consistency to be used in that exercise (Source: Bloomberg).

While emerging market exchanges score particularly poorly on this measure, there are no developed economy exchanges where it is possible to see how all companies are performing on a range of material ESG issues.

Similarly, Goldman Sachs highlights that *“While the volume of reporting has increased significantly, a material number of companies do not report even relatively undemanding data points. Regionally, disclosure tends to be less complete in emerging markets in particular. Where data is reported, analysis is challenged by differences in reporting standards and guidelines across regions and companies... more widespread disclosure across companies and reporting on a wider range of issues, on a consistent basis, will be key to ensuring investors are able to fully assess the effectiveness with which companies are addressing breadth of issues facing their industries.”*

(Source: GS Sustain: Challenges in ESG Disclosure, October 2009).

Regarding the key difference between a sustainability report and a sustainability strategy, a report is backward looking and reports on performance to date - ideally with 3-5 year trend analysis. Whereas a sustainability strategy looks out 20-30 years or more and considers how the company will ensure that it remains a going concern over this time period and beyond. Depending on the sector, questions that we look to see covered include, for example, what natural resources does the company depend on, and how can they be sustained indefinitely. What levels of training within the workforce does the company require, and how can it ensure that this is in place. How can the local communities within which the business operates develop economically and contribute to the longer term development of the company. Does the business model of the company need to evolve in order to ensure that it helps to meet the needs of the present, without encumbering the ability of future generations to meet their own needs? What is the regulatory context regarding sustainable development issues likely to look like, and how will this change corporate cash flows? How can the company maximize the opportunities for creating and sustaining a competitive advantage?

4. Are you setting out a standard that all companies must adopt?

No. We merely ask for the support of governments to make corporate sustainability reporting a “comply or explain” requirement and for this report or explanation, in whatever form it takes, to be put to shareholder approval at the AGM. However, we are not dictating the form it should take.

This will provide corporations with the freedom to define their own reporting and where they determine that it is not necessary, outline why. This will also ensure that the report is based on the board’s best thinking.

Those companies yet to explore reporting in this area may review the excellent work already done in this area by the Global Reporting Initiative, the Global Compact, UNCTAD, and the International Integrated Reporting Committee - all of whom have produced useful guidance on reporting on ESG issues.

5. Won’t producing these reports and presenting them to the AGM cost companies an excessive amount of time and money?

For those companies already producing a sustainability or corporate responsibility report, the additional costs of presenting it to the AGM are trivial. For example, Aviva PLC tabled its Corporate Responsibility vote to the 2010 AGM. The costs in time were no more than 5 person days, and less than £5k. This report won the support of 99.97% of the investors that voted. For a company with a market capitalisation of c.£10 billion, the benefits of tabling the report at the AGM were significantly greater than the costs which we would also expect to decline in future years (Source: Aviva plc).

It is true that those companies not disclosing any data will have more significant costs in terms of time and money. However, we would argue that the consideration and publication of such a report - as well as the production of the associated management information - will help companies to identify efficiency savings and create value for shareholders.

6. What about small companies?

Small and/or low impact companies would be expected to publish little if anything. They would simply be expected to explain that they do not yet consider sustainability issues to be sufficiently material to their business and their current focus is on short term business development as opposed to long term sustainability.

7. What evidence is there that investors will use this data?

There is considerable evidence that investors require this information. In addition to companies complaining ever more strongly about questionnaire fatigue, there has also been seen some major investment such as Thompson Reuters and Bloomberg adding to the data set that they provide investors.

Within 60 days after the launch of the product on Bloomberg terminals 11.5m hits on the ESG data points were recorded. At the time of writing, Bloomberg estimates that about one thousand users now use Bloomberg just for ESG analysis. They also report that the number of users is increasing with more conventional asset managers approaching Bloomberg regarding the product.

In addition, several mainstream investment houses are incorporating this information directly into their investment recommendations. For example, Cheuvreux, a member of the UN PRI, has a clear public commitment to addressing all ESG issues when they analyse companies. They regularly highlight these issues directly within their mainstream research.

Similarly, the Goldman Sachs report previously cited contends that a positive relationship can be found between the way companies address relevant ESG issues and the returns they generate.

8. We know that many investors are disengaged in the ownership process. Why do you think investors will engage with companies on these issues?

It is true that many investors fail to carry out the obligations of ownership. In itself this is a problem that needs to be corrected by policy makers around the world.

However, there is already a commitment from all the signatories to the PRI – which represents over \$25 trillion in assets under management - to engage in discussions with companies to promote enhanced ESG disclosure and better performance by companies.

In order to facilitate this, it is highly likely that service providers will produce products that help investors analyse this information and decide how to vote at the AGM. Indeed, a voting service that provides investors with voting recommendations on Sustainability Reports has already been launched by EIRIS and PIRC in the UK, and GMI in the US

9. Should this vote be advisory or binding on the company?

We can see the case for either and believe it should be left to Member States to make this judgment based on their own jurisdiction. However, we understand the perspective of investors who prefer all votes to be binding. The question for us is what would the appropriate sanction be on companies where a binding vote did not pass? If a vote on a Sustainability Report received less than 50%, then it is not clear what the tangible action would be. A binding vote would require the exchange to define in legislation precisely what would happen subsequent to a defeated vote. Companies could, for example, be required to commission and independent review of their report but costs of such a review, particularly to small companies, could be punitive.

We think that these questions should be best answered by the policy makers when making a regional assessment on our voting proposal.

The critical point in the vote is that it is the mechanism that engages companies and investors in a dialogue that, over time, will lead to more oversight of company performance and more comparability between companies.

10. What needs to change within the system if it were to adopt your recommendation?

This will vary for different jurisdictions. For example, where the regional code of Corporate Governance is embedded within the listing rules then this document could be updated, requiring the support of all the bodies that govern this code. Where it is guided by the exchange itself, then the exchange can update the code itself. Where guided by primary legislation, then this will need to be changed.

11. Why have you focused on asking boards to publish their thinking rather than for example proposing a sustainability reporting regulation?

We do not think it possible to craft a regulation that specifies a sufficiently detailed reporting template on the rich diversity of corporations around the world. Consequently, we have decided against proposing heavy handed regulation that tries to enforce one reporting template. This is also because regulation is often slow moving, lags the market, and encourages a minimum compliance mentality within the company. We are seeking to stimulate a substantive board discussion on the risks and opportunities to a company arising from sustainable development, as well as the creation of their strategic response. We are also anticipating that some companies will seek to compete on the quality of their disclosure in this area (as, indeed, is already the case).

Equally, however, we do not have blind faith that markets will self regulate toward sustainability. The evidence for spontaneous progress on a purely voluntary basis is that it will be slow.

12. Are you proposing that companies are automatically de-listed from the exchange if they do not publish the data you are looking for?

No. It is certainly conceivable that stock exchange regulators could make it a market requirement that companies adequately disclose relevant ESG information or automatically be at risk of losing their listing. However, we believe it is more practical to propose a comply-or-explain model.

We are asking for all companies to publish a forward-looking sustainability strategy and put this – or the explanation as to why they will not do so - to shareholders to vote on at their next AGM. Where neither a report nor an explanation was forthcoming then, unless the company committed to take corrective action, this would lead to a de-listing.

Our experience with this model is that it leads to the production of the data, rather than de-listing.

Cheuvreux in its own broker analysis highlights that exchanges have a responsibility in this area, and that they would enhance their government relations by engaging with this agenda. As they put it, “The value that exchanges can add through better ESG reporting should be balanced with a responsibility to ensure market transparency and efficiency and to reduce market volatility, rather than offer increasing trading volumes. In our view, transparency and controlled volatility are key ways to respond to the G20 recent call for a more sustainable equity market.”

“When measuring the extent to which exchanges are engaged in this area, they highlight that “We believe the ESG performance of stock exchanges should be measured not just by their managerial efforts to reduce their direct environmental footprint or improve their human capital, but also by their commitment to the promotion of sustainable investment in two core areas: sustainable indices and extra-financial reporting... a voluntary extra-financial reporting framework could be used by exchange regulators to promote a global listing environment. Companies would be required to consider how responsible and sustainable their business model is, and to propose a forward-looking sustainability strategy to their AGM. We believe this would help exchanges to strengthen their role in promoting ESG.”

[Source: Cheuvreux: Sustainable Stock Exchanges: Leveraging the ESG Momentum. October 2009]

13. Why are regulators and policy makers interested in this idea?

Policy makers are increasingly focusing on the capital markets as a means to regulate corporate activity. Investors are increasingly being seen as reneging on their ownership obligations. This initiative is a market based mechanism that promotes enhanced self regulation within the market.

14. Could a principle-based international reference framework for reporting on Sustainability improve the comparability and relevance of CSR reporting?

Yes. We believe in four principles:

1. *Transparency* - that all companies should be required to integrate a sustainability strategy into their report and accounts – or to explain to the market why they can not do this
2. *Accountability* - This report or the explanation should be put to an investor vote. This vote should encourage investors to read the information, form an opinion, and provide feedback to the company.
3. *Responsibility* - Board duties should explicitly include setting the company's values and standards and ensuring that its obligations to its shareholders and other stakeholders are understood and met.
4. *Incentives* - Companies should state in remuneration reports whether the remuneration committee consider ESG factors which are of material relevance to the sustainability and long term interests of the company when setting remuneration of executive directors; aligning remuneration with the interests of shareholders and other key stakeholders, including customers and employees.

15. What would be the consequences of the adoption of more detailed reporting requirements (i.e. Key Performance Indicators)? Please consider what level of detail would be desirable and what could be a possible method in developing indicators.

We think it would be a mistake to attempt to create a one-size-fits-all approach to KPIs as this would preclude the need for boards to consider the issues (which is one of the key benefits we think a report would create). We recommend sector specific guidance, supported by a 'comply or explain' provision. It should also reference existing guidance such as the Global Reporting Initiative, the International Integrated Reporting Committee, the Global Compact and the various international norms such as the OECD Guidelines for Multinational Enterprises.

16. Which benefits could companies derive from in the medium or long term, and to what extent are these quantifiable?

For our part, we believe that a systematic approach to reviewing the standards, values and sustainability risks and opportunities of the business and ensuring that the business knows what is expected helps define and maintain a healthy long term organisational culture, where people have pride in their business, care for their customers and are highly motivated at their work. Understanding the potential impacts on the firm from diminishing access to raw materials is also important to the long term health of the business.

Where relevant to the future cash flows of a business – both income and expenditure – we can factor these into our models. We can also embed this kind of information into the qualitative view that every good active fund manager forms on the companies in which they invest.

17. Do you have evidence that non-financial reporting helps companies to better integrate social and environmental issues into business operations and strategies?

Yes. The most recent reference is "*The Consequences of Mandatory Corporate Sustainability Reporting*" Ionnou (London Business School) and Serafeim (Harvard Business School) [Part of your briefing pack]. This concludes that "*both sustainable development and employee training become a higher priority for companies, and that corporate governance improves. Furthermore [they] find that companies implement more ethical practices...*"

This supports Aviva Investor's own experience from embedding sustainability into our AGM voting since 2001 also demonstrates that those companies that consider these issues at the board level – because they are reporting this information to the market – are better at integrating sustainability issues into their operations.

18. What role do you think better disclosure of non-financial information could play in building higher level of trust in business and increasing the accountability of companies'?

Transparency to stakeholders via this kind of market disclosure is a significant step towards fostering trust. The voting mechanism that we are proposing will ensure that there is an accountability mechanism at the AGM. Clearly, other stakeholders should also have access to the company and the ability to feedback concerns.

19. What does this cost me to sign up?

Nothing, other than your time to respond to our request below ...

The measure we are proposing offers an opportunity not only to improve the long-term profitability of corporations, but to also improve returns to their investor. It should also improve the quality of markets they are listed on, increase macro financial stability and make a material contribution to the lives of those impacted, as we all are, by corporate activity.

Those institutions wishing to provide in principle support to the proposal should contact public.policy@aviva.com (Please title the email "Earth Summit Support.")

Thank you for taking the time to consider this proposal.