



PRIVATE SECTOR INVESTMENT AND SUSTAINABLE DEVELOPMENT

**The current and potential
role of institutional investors,
companies, banks and foundations
in sustainable development**



United Nations Global Compact



PRIVATE SECTOR INVESTMENT AND SUSTAINABLE DEVELOPMENT

About the United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to voluntarily align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate policies and practices. Launched in 2000, it is largest corporate sustainability initiative in the world, with over 8,000 companies and 4,000 non-business signatories based in 160 countries. www.unglobalcompact.org

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Established in 1964, UNCTAD promotes the development-friendly integration of developing countries into the world economy. UNCTAD's Division on Investment and Enterprise is recognized as a global centre of excellence on issues related to investment and enterprise for sustainable development. Built on several decades of successful experience, its staff provide international expertise in research and policy analysis, inter-governmental consensus-building, and technical assistance to over 150 countries. Its flagship product is the annual World Investment Report and its main global stakeholder event is the biennial World Investment Forum. www.unctad.org

About the Principles for Responsible Investment Initiative

The United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of Environmental, Social and Governance issues (ESG) for investors and support signatories to incorporate these issues into their investment decision-making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system. www.unpri.org

About UNEPFI

The United Nations Environment Programme Finance Initiative (UNEP FI) is a unique global partnership between the United Nations Environment Programme (UNEP) and the global financial sector founded in 1992. UNEP FI works closely with over 200 financial institutions who have signed the UNEP FI Statements as well as a range of partner organizations to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realize the adoption of best environmental and sustainability practice at all levels of financial institution operations. www.unepfi.org

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1 Introduction: A Call for Private Sector Involvement

This paper seeks to provide the Financing for Development process with a perspective on the role institutional investors, companies, and foundations can play in the design and implementation of a financing strategy for global sustainability. This will help bridge the terminology and investment approaches of institutional investors, companies, foundations, and governments. The paper highlights ongoing efforts among private investors to increase the impact of their investments. It concludes with a set of key actions facing investors, companies and foundations in their transition towards investment practices that contribute to sustainable development.

At the 1992 UN Conference on Sustainable Development, member States created the United Nations Framework Convention on Climate Change (UNFCCC). The members of the UNFCCC have been meeting annually at the Conference of Parties (COP). A number of parties have agreed to keep the global temperature rise below two degrees and expect to achieve a universal agreement on climate. Reaching such an agreement at the 2015 COP21 meeting in Paris will require a significant increase in global investment in climate change mitigation and adaptation measures, as well as assistance for low-carbon and climate-resilient growth in developing countries.

At the 2002 International Conference on Financing for Development, heads of State and government agreed on a broad vision on how to fund development under the Monterrey Consensus, covering domestic and international, public and private financial flows and their inter-relations. The Monterrey Consensus was reaffirmed in 2008 in the Doha Declaration and has been particularly instrumental in recognizing the importance of private flows to advance sustainable development. The International Conference on Financing for Development in Addis Ababa in July 2015 will assess the progress and address emerging issues related to financing sustainable development.

The Financing for Development (FfD) process is part of a long-term international process to finance sustainable development.

One of the main outcomes of the 2012 United Nations Conference on Sustainable Development (Rio+20) was the agreement by Member States to launch a process to develop a set of sustainable development goals and to mobilize resources from a variety of sources to promote sustainable development. An Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF) has been assessing financing needs, existing instruments and frameworks, and additional initiatives for an effective sustainable development financing strategy to achieve the Sustainable Development Goals (SDGs). The committee has emphasized the sheer magnitude of the financing needs for sustainable development and the important role of private sector investment.

There is a historic opportunity for private investment in sustainable development. 2015 will be an important milestone in the transition towards global sustainable development. Following the outcome of Rio+20, governments will define the future global development framework via a new set of SDGs. Governments are also expected to achieve a universal agreement on climate under the UN Framework Convention on Climate Change (UNFCCC). Through the third International Conference of Financing for Development, they will also design a broad vision of how to finance sustainable development.

Significant levels of financing are required to achieve sustainable development. UNCTAD estimates that the investment needed in key sectors related to the SDGs at the global level are approximately US\$5 trillion to US\$7 trillion per year. In developing countries alone, the estimated needs range from US\$3.3 trillion to US\$4.5 trillion, leaving an annual funding shortfall of around US\$2.5 trillion (Figure 1). Furthermore, according to a 2014 Ceres report, the world needs to invest an additional US\$44 trillion in clean energy - more than US\$1 trillion per year for the next 36 years - in order to avoid the worst effects of climate change.

Governments are calling on private actors to be part of the solution. The implementation of an ambitious post-2015 development agenda will require a significant increase in investment in sustainability priorities from all available sources, including public, private, international, and domestic arenas. Public finances, although central and fundamental to investment in sustainable development, cannot alone meet the demands for financing. There is a growing consensus about the importance of private investment to scale up sustainable development.

Total investment needs and private sector participation in key SDG sectors in developing countries

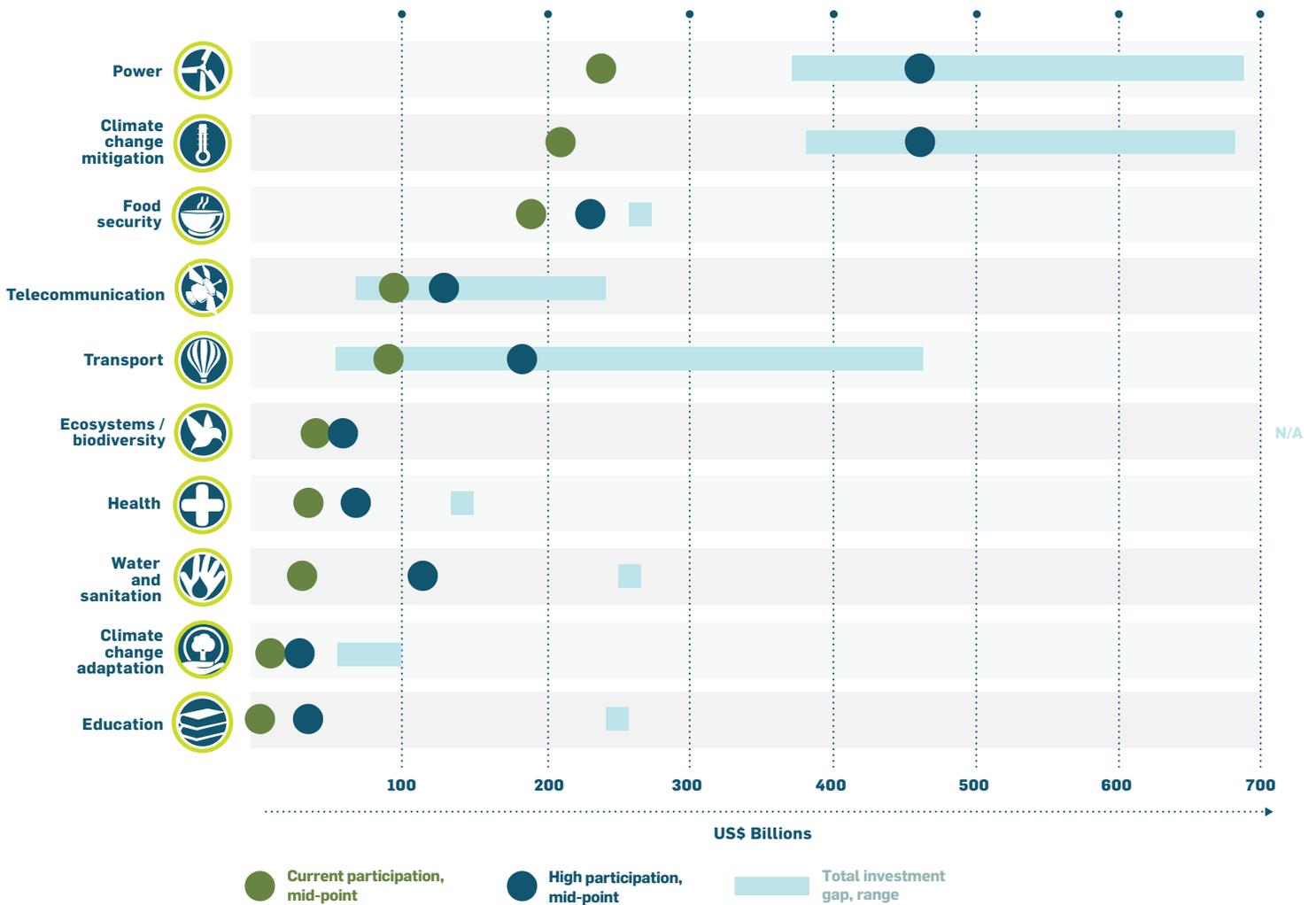


Figure 1. Investment needs for sustainable development and potential participation from the private sector in developing countries. UNCTAD World Investment Report 2014 - Investing in the SDGs: An Action Plan

2. The Role of Private Sector Investment in Sustainable Development

Private sector actors have an inherent interest in seeing sustainable development succeed. As companies, markets, and economies become more global and interdependent, businesses and investors are becoming increasingly aware of the overlap between public and private interests. They realize that their ability to prosper and grow depends on the existence of a prosperous and sustainable society. Conversely, they see that social and income inequality, as well as environmental damage, are already having negative material impacts on supply chains, capital flows, and employee productivity.

Institutional investors, companies, and foundations provide a large source of private capital available for investment and therefore need to be an integral part

of the design and implementation of the strategy to finance the post-2015 sustainability agenda. Companies in the real economy, the producers of goods and services, have a direct effect on sustainability areas such as climate, gender equality, jobs, infrastructure, and social services. Through the investment chain (Figure 2) institutional investors connect with sustainability issues through the projects and companies in which they invest by providing capital and by engaging as active owners. Institutional investors also invest directly in the real economy through property, infrastructure, forestry, and agriculture. Foundations and philanthropic initiatives provide capital for social enterprises and civil society organizations aimed directly at delivering societal benefits.

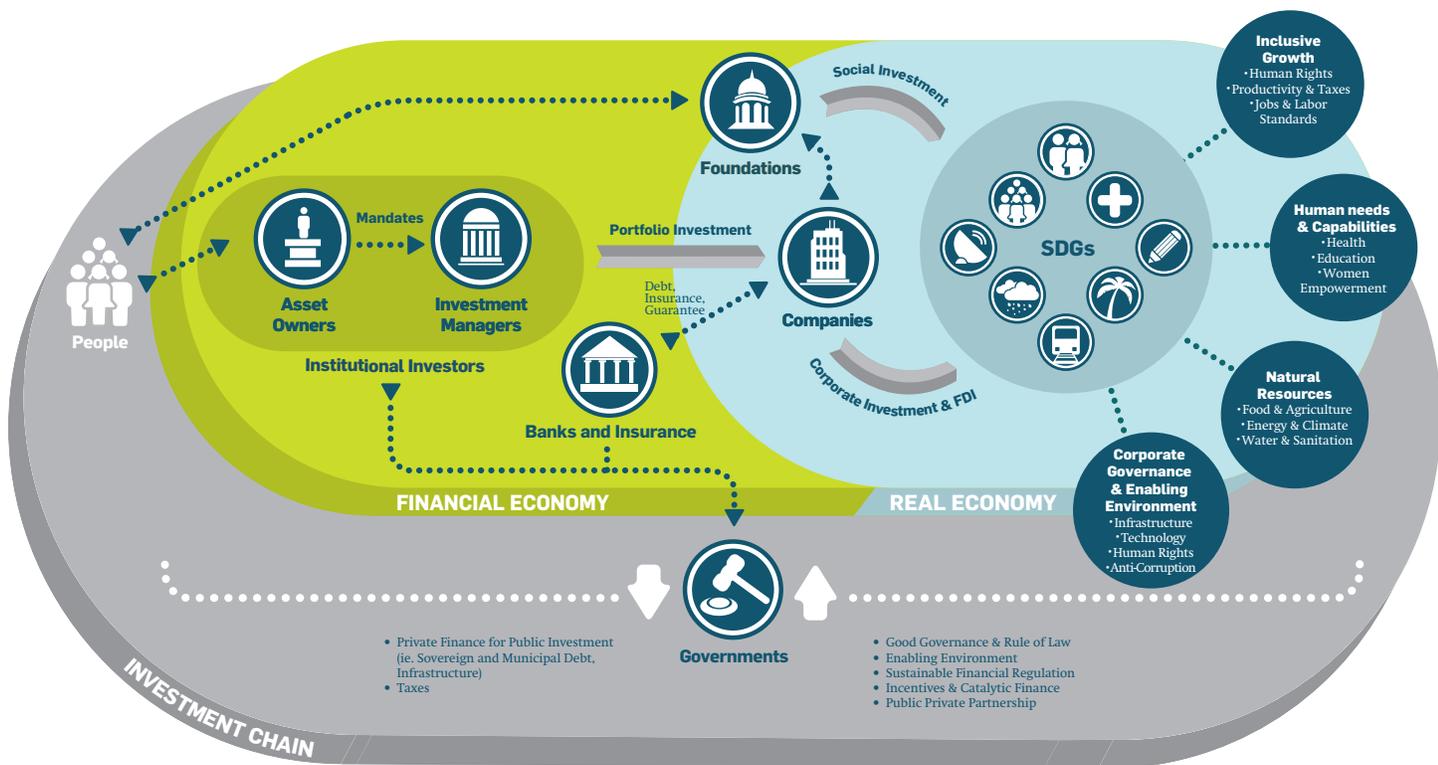


Figure 2. The private investment chain (simplified)

Responsible investment and corporate sustainability is in line with the SDGs, but requires leveraging to achieve stronger sustainable development outcomes. Despite the growth of corporate sustainability, private sector participation in financing sustainability is relatively low, particularly in developing countries. While the volumes of responsible investment with approaches based on exclusion, “best in class” or the

integration of environmental, social and governance (ESG) issues in investment decision-making processes are starting to reach a critical mass, the volumes of responsible investment that can be categorized as “impact investment” or catalytic philanthropy is modest (Figure 3). Enabling companies and investors to scale up investments that embrace sustainability can help in reallocating capital to achieve the SDGs.

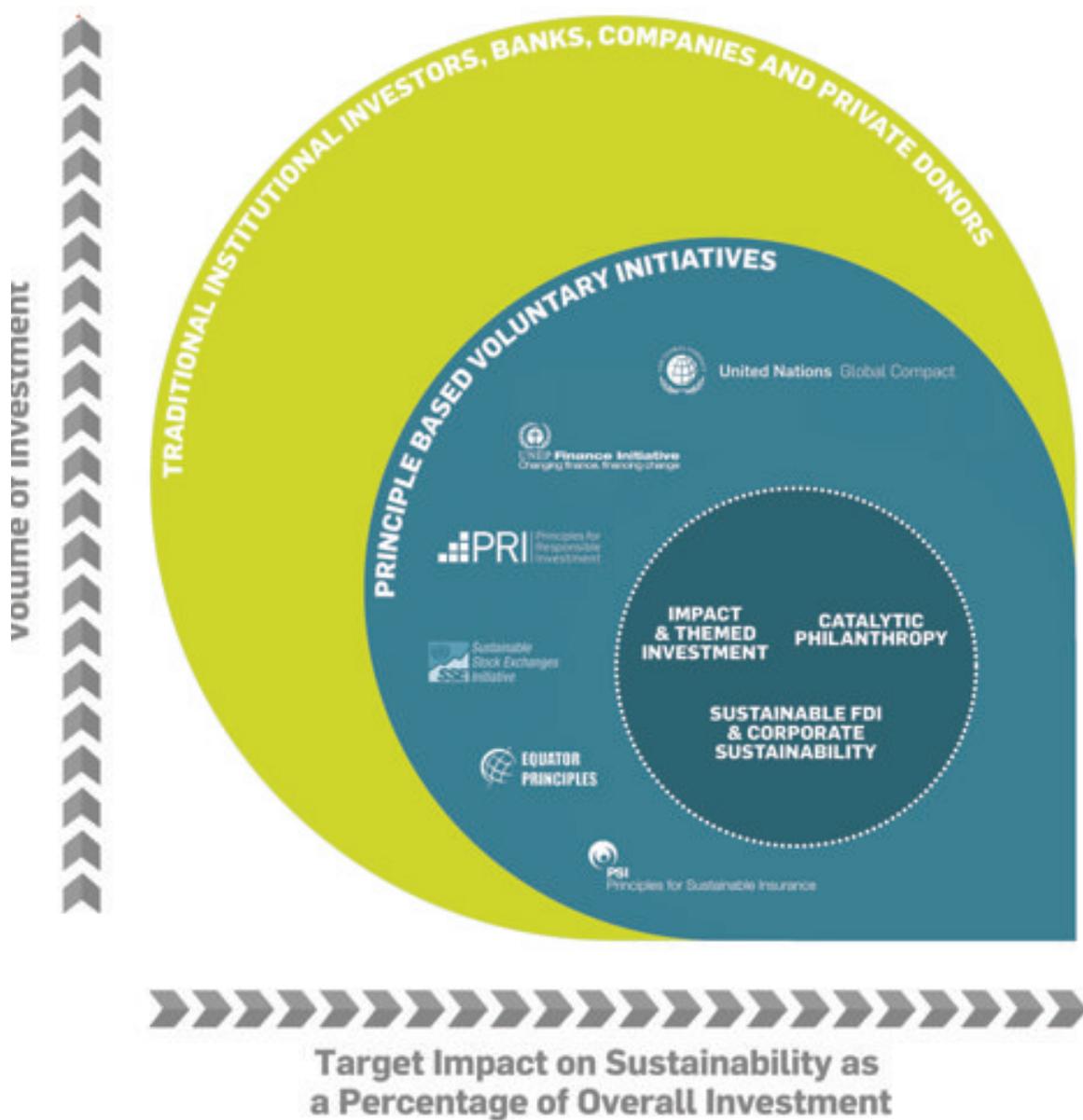


Figure 3. Mobilizing private investment towards sustainability issues

A number of principle-based voluntary initiatives are starting to gain traction throughout the private investment chain and are mobilizing private investment towards sustainability issues.

The UN Global Compact, the world's largest corporate sustainability initiative with over 8,000 companies from more than 150 countries, has developed a Post-2015 Business Engagement Architecture in partnership with the World Business Council for Sustainable Development and the Global Reporting Initiative. The Architecture illustrates the main building blocks necessary to enhance corporate sustainability as an effective contribution to sustainable development: (i) transparency and accountability in order to make private commitments transparent and to ensure that progress is real, (ii) platforms for action and partnership to optimize and scale up private efforts, and (iii) drivers and incentives to strengthen the “business case” for private action on sustainability issues. The Architecture also highlighted the importance of private sustainability finance, broadly understood as finance and investment from private sources that contributes to sustainable development, a new mindset that is gaining global attention throughout the investment chain, as reflected in this paper.

UNCTAD has proposed a Strategic Framework and Action Plan for Private Investment in the SDGs. The framework addresses key policy challenges and options related to (i) guiding principles and global leadership to galvanize action for private investment, (ii) the mobilization of funds for investment in sustainable development, (iii) the channeling of funds into investments in SDG sectors, and (iv) maximizing the sustainable development impact of private investment while minimizing the risks or drawbacks involved. The Action Plan is not an all-encompassing or exhaustive list of solutions; instead, it is a framework for building future ideas. A range of further options may be available or may be developed by stakeholders in governments, international organizations, civil society or corporate networks. By highlighting available options and proposing the development of new ones, this paper will contribute to the implementation of the Action Plan for Private Investment in the SDGs.



United Nations Global Compact



The United Nations Environment Programme Finance Initiative (UNEP FI), a partnership between UNEP and the global financial sector created in the wake of the 1992 Earth Summit, currently consists of more than 230 financial institutions, including banks, insurers, and fund managers. UNEP FI has produced extensive research to reveal and explain the intersection between finance and the environment. It has also produced practical tools to raise awareness and to build capacity among practitioners. UNEP FI's work also includes a strong focus on policy by fomenting country-level dialogues between finance practitioners and their policy-makers and, at the international level, by promoting financial sector involvement in processes such as the global climate negotiations.



The UN-supported Principles for Responsible Investment (PRI) were launched in 2006 and have now reached critical mass with 1,330 signatories worldwide, with combined assets under management of approximately US\$ 45 trillion. These signatories – asset owners, investment managers and service providers – have agreed to six principles that are all consistent with the SDGs. The PRI Initiative supports signatories in implementing the principles by providing guidance documents, case studies, and forums for dialogue and exchange of best practices. Through its Policy and Research Work Stream, it helps to mobilize investors to engage in public policy and brings long-term investors' perspectives into policy decision-making processes at the UN and at the international and regional levels.



Building on these initiatives, the following section highlights ongoing efforts among institutional investors, companies, and foundations to increase the impact of private investments and to align long-term financial success with sustainable development.



Companies

2.1 Companies

Overview

Private companies in the real economy are a major driver of growth. Well-governed and formal companies can invest in providing better and more secure employment opportunities, with health and social security benefits for employees, critical elements in reducing inequality. Companies also often provide basic services such as infrastructure (energy, telecommunications, transport and water), food security, education and health, crucial for attaining the future SDGs.

Companies are a major influence on the environment and society. Using natural resources and energy as productive inputs and generating waste and greenhouse emissions as by-products of their productive cycle, companies can place a strain on their operating environments. Through labor relationships, interaction with workers, suppliers, consumers, and citizens, as well as with public institutions and civil society organizations, companies can have a critical impact on societies.

UNCTAD estimates that transnational corporations (TNCs) worldwide have some \$25 trillion in foreign investment stocks. TNCs offer a significant potential source of financing for investment in SDG sectors in developing countries.

The role of companies in sustainable development

Private sector contributions to sustainable development take two primary forms: financial contributions through new investment or redirection of existing investments, and behavioral contributions through more responsible and sustainable conduct.

Good private sector governance in relation to sustainable development is key. This includes the responsibility to avoid harm and to respect human rights, the commitment of the business sector to sustainable development, specifically to the SDGs; transparency and accountability, and partnership with government to maximize the co-benefits of investment.

Beyond good governance, private sector investment can play a significant role in facilitating a shift in the global economy towards a more sustainable trajectory of long-term growth and development, as envisaged by the SDGs.

Foreign Direct Investment (FDI) deserves particular attention as it represents the largest net flow of capital to developing countries, reaching a new high of US\$778 billion in 2013 (UNCTAD, 2014). It is an important source of relatively stable development capital, partly because investors typically seek a long-term interest in a project, thus making their participation less volatile than that of other sources. In addition, FDI has the advantage of bringing with it a package of technology plus managerial and technical know-how that may be required for the successful set-up and running of SDG investment projects. FDI can therefore provide a unique opportunity to drive inclusive growth in economies where the need is greatest. Nonetheless, FDI to Least-Developed Countries (LDCs) currently stands at a meager 2 per cent of global flows.

Tax revenue generated by TNCs and other companies contributes to domestic resource mobilization that is critical for financing SDG implementation. In many developing countries, TNCs are often the single biggest contributor to government revenues through various forms of taxation. Responsible tax-paying practices on the part of firms and increased collection capabilities on the part of tax authorities in low-income countries are a crucial part of SDG financing.

Emerging trends in corporate investment

Leading companies, through their investments, are increasingly concerned with delivering tangible value for society, but a majority of companies in the world are not meeting current best practices. Trends reflecting a shift towards more responsible and impactful investment among companies include developing products and services that address sustainability needs, investing in local capacity building, improving productivity and sustainability practices in the value chain, communicating the value of ESG and sustainable business practices, adopting sustainability considerations in their FDI and targeting, measuring and reporting their contribution. However, the current level of investment in SDG sectors remains insufficient and sustainable business practices are inconsistent across industries and within industries. While some TNCs demonstrate best practices in the area of sustainable business, many challenges remain for the vast majority of the approximately 80,000 TNCs in the world. What is considered a pioneering sustainable business practice today will need to become mainstream tomorrow. Policy developments in the area of international investment agreements are encouraging this trend. UNCTAD's Investment Policy Framework for Sustainable Development reflects this new policy shift towards the integration of sustainable development factors within international investment agreements.

Developing products and services that address sustainability needs. A clear investment opportunity for companies to deliver social or environmental benefits while advancing long-term business goals is through the development and provision of products and services that respond to market needs, while simultaneously responding to the investment needs for sustainable development. This can be achieved by developing new

technologies and innovative solutions to address global challenges, as well as by facilitating the transfer of technology to developing countries that helps them to meet the SDGs. Companies can also help to address the unmet needs of low-income people by designing new products or by decreasing the costs of existing ones.



Example. Investing in local capacity.

Following the establishment of an assembly plant in Addis Ababa, LG decided to open a technical college focused on information technology, electronics, and television and cell phone maintenance. The technical college will provide local talent for LG's assembly plant, essential job-skills for local youth and a mechanism to facilitate the transfer of technology. As a complement to its capacity building efforts linked to its new assembly plant, and as part of its strategy to invest in Ethiopia, LG partnered with the World Food Program to support community development in rural areas outside Addis Ababa through its Hope Village initiative. LG is helping to build stronger and more resilient communities, and is developing self-supporting farming centers that will serve as technology transfer hubs for rural farmers in the nearby villages.

Investing in local capacity building. Companies have a vested interest in creating local capacity and in engaging in initiatives that support development where they operate. These efforts often go beyond job skill training and contribute more broadly to supporting local communities through other capacity-building initiatives, such as support in the delivery of governance mechanisms, health services, primary and secondary education.

Improving productivity and sustainability practices in the value chain. Companies can also benefit from assisting suppliers to improve their productivity and sustainability practices, particularly in the case of small and medium-size enterprises (SMEs). SMEs often face challenges in embedding sustainability practices within their operations and in financing investments in sustainability and growth (UNCTAD, 2012). The involvement of large companies with their suppliers will result in better quality services, and will help to ensure the sustainability of the human and natural resources needed in the value chain.



Example. Nestle: Creating Shared Value.

Nestle adopted the *Creating Shared Value* approach in order to deliver shareholder value and benefits for society. Given the critical importance to their business, as well as to employees, suppliers, distributors and to the communities in which they operate, Nestle focused its shared value efforts on improving nutrition and health, as well as water and rural development. As part of its shared value efforts, Nestle has provided assistance to 300,000 farmers in their supply chain, ranging from technologies that make agricultural processes less water intensive, to drought-resistant plantlets. As a result, Nestle will maintain a secure, long-term supply of ingredients for its food and beverage products, the majority of which are grown in rural areas, and its suppliers will increase their productivity and opportunities for income growth and societal advancement.

Communicating the value of ESG to investors and other stakeholders. Whereas companies once saw sustainability issues as risks to be managed, many now also see sustainability as a source of innovation that drives growth, productivity and profitability, and they are increasingly incorporating sustainability into their reporting cycle to enhance accountability. Governments are also supporting the mainstreaming of sustainability reporting and non-financial disclosure through regulatory initiatives such as the EU Directive on disclosure of non-financial and diversity information, and the Securities and Exchange Board of India's requirement that the top 100 companies must produce sustainability reports. Companies are also increasingly working towards an integrated thinking and reporting approach to communicate to investors how their ESG strategies and performance translate into long-term financial value.

Example. Value Driver Model.

The *Value Driver Model*, put forth by the UN Global Compact and the *Principles for Responsible Investment*, provides a simple and direct approach that companies can use to assess and communicate the financial impact of their sustainable business strategies. The intent of the *Value Drive Model* is to determine the financial impacts of sustainability by measuring three key factors:

- *Sustainability-advantaged growth: measuring a company's revenue volume and growth rate from products they define as sustainability-advantaged.*
- *Sustainability-driven productivity: measuring the aggregate financial impact on a company's cost structure as reported by the company from all sustainability-related initiatives.*
- *Sustainability-related risk management: measuring performance over time on the critical metrics that can pose meaningful risks to revenue and reputation. Companies use the Value Driver Model in their official reports, as well as in Analyst Calls and Road Shows.*

Many TNCs from developed and developing countries are aware of the importance of adopting sustainability considerations in their FDI. FDI in developing countries face unique sustainability challenges, ranging from the availability of skilled labor to weaker institutional arrangements and environmental management practices. Adopting ESG best practices can help companies to mitigate

risks and to shape investments in a way that combines business success with contributions to sustainable development in the societies where they invest.

Companies with a long-term perspective are targeting, measuring and reporting the contribution of their FDI to creating lasting jobs, generating income and taxes, spreading best practices in social and environmental issues, diffusing knowledge and technology, and building local capacity.



Example. Measuring and reporting the contribution of FDI to Sustainable Development. Maersk has invested in the construction of a series of container vessels, new container terminals, hinterland logistics and training and education in Brazil. In 2012, Maersk used the opportunity to deepen their understanding of their impact on trade, infrastructure and energy by establishing and monitoring a series of sustainability indicators associated with their investments. As an example, Maersk was able to establish that a US\$1 billion investment in a new container terminal generated US\$100 million in annual tax income, 3,000 jobs during the construction phase, 1,500 jobs during the operational phase and 9,000 indirect jobs when the terminal was fully up and running, in addition to unlocking new trade opportunities for the local community and the business environment. The use of sustainability indicators helped Maersk to maximize and communicate the value generated through its investments.

SUSTAINABLE STOCK EXCHANGES

Stock exchanges provide transparent and regulated securities markets, and are important institutions to promote economic stability and to channel domestic and foreign capital towards productive enterprises. Through listing rules, indices and a range of voluntary and mandatory mechanisms, stock exchanges can play an important role in promoting improved sustainability reporting and performance among listed companies.

In addition to promoting sustainability reporting, stock exchanges can help to mobilize private sustainability finance by supporting the development of indices based on the sustainability performance of companies, as well as other financial products that direct investment to companies that are contributing to sustainable development.

The United Nations Sustainable Stock Exchanges (SSE) initiative is a peer-to-peer learning platform for exploring how exchanges can work together with investors, regulators and companies to enhance corporate transparency and, ultimately, performance in terms of environmental, social and corporate governance issues, and to encourage responsible, long-term approaches to investment. An increasing number of stock exchanges and regulators are introducing initiatives to help companies meet the evolving information needs of investors, to navigate the increasingly complex disclosure requirements and expectations, to manage sustainability performance, and to understand and address social and environmental risks and opportunities.



2.2 Institutional Investors

Overview

Institutional investors include asset owners and investment managers. Asset owners include pension funds, insurance companies, foundations and endowments, development finance institutions and sovereign wealth funds (SWFs). Asset owners may manage their funds internally, or may hire external investment managers.

Institutional investment funds are growing. For example, in OECD countries, pension funds, insurance companies and mutual funds held over US\$70 trillion in assets by December 2011. The majority of institutional investors are based in high-income countries and have a bias toward investing domestically, typically in listed equity and fixed income.

The role of institutional investors in sustainable development

Institutional investors, together with banks, constitute the financial system upon which consumers, savers, pension and insurance holders depend for financial services and products. Institutional investors drive growth in the private sector by investing the assets that they manage on behalf of their beneficiaries. Institutional investors own and finance companies, infrastructure and property, which in turn generate economic growth and development, jobs, products and services. Institutional investors also provide financing for governments, for example through investing in sovereign bonds.

Investors are increasingly incorporating ESG issues into their investment decision-making processes as a way of identifying risks and opportunities. As an indication of this trend, more than 1,330 investors, representing approximately US\$ 45

trillion in assets under management, have signed the six United Nations-supported Principles for Responsible Investment. These principles cover different approaches for incorporating ESG issues and stewardship practices, and are consistent with the SDGs. The Principles are accompanied by a reporting framework through which each signatory reports annually on its progress in implementing the principles.

Pension funds, insurance companies and similar institutional investors are driving this trend because they often have a long-term perspective. They are more inclined than other categories of investors to think about the long-term sustainability of financial markets and the economy, as they are contracted to deliver long-term returns for their beneficiaries. Therefore, it is in their interest to consider global social and environmental factors, such as climate change, income disparity, unemployment, water crises, energy risks and natural catastrophes in the investment decision-making process. Investors also have an interest in driving governance best practice as an enabler for sustainable development.

Many institutional investors are bound by fiduciary obligations. Institutional investors are typically more cautious than other groups of investors, while they also have a duty to maximize risk-adjusted returns, which can restrict their investment decisions. These risk/return requirements are related to institutional investors' fiduciary obligations, which are in place to ensure that they act responsibly in the interests of beneficiaries, rather than serving their own interests. Lack of definitive legal guidance on fiduciary duty can deter investors from integrating ESG into investment decisions.

Emerging trends in institutional investment

Contribution to more sustainable financial markets. Investors have a role to play in ensuring markets adequately reward the sustainable conduct of companies. Academic research shows that companies with strong sustainability ratings deliver improved long-term returns. However, the financial industry is largely driven by short-term

performance, reporting and incentive structures. In addition to including ESG their financial analysis, investors can introduce long-term mandates to take the pressure off companies to make short-term returns, thereby rewarding them to act more sustainably. See PRI's discussion paper on long-term mandates and UN Global Compact's recent work on long termism (UN Global Compact, PRI, 2014).

Engaging with companies. A recent study by PRI and Nasdaq of 379 listed companies with a market capitalization of US\$19 trillion found that PRI signatories hold almost half of all the shares in those companies. As owners of equity in listed companies, they have the power to exercise shareholder rights to influence companies' business, management and strategy. While an individual investor may not own a controlling stake of a given company, investors can engage collaboratively with companies to make their voices heard, for example via the PRI's Investor Engagement platform. Of the 578 investors with investments in listed equity who reported through PRI's Reporting Framework in 2013, 70% engaged with companies, and 73% of these engaged collaboratively.

Example: Engaging with companies on conflict minerals.

From October 2009 through September 2012, a group of 16 PRI signatories representing US\$635 billion in assets under management engaged with 16 consumer electronics companies on sourcing conflict minerals. The companies, based in the United States, Europe and Japan, were requested to publicly disclose their policies regarding the sourcing of minerals from the Eastern Congo, and to implement external verification systems and monitoring procedures on suppliers' stated practices. The results of the engagement were positive, with improvements seen in the areas of public disclosure and implementation, including greater measures to monitor the activities of suppliers, taking steps to meet targets, and participating in sectorial initiatives related to external verification.

Several investors also participated in the development and adoption of the SEC's Conflict Minerals Provision rule (Section 1502) of the Dodd-Frank Act passed by the US Congress in 2012. The expectation of potential regulatory requirements created a strong business case for companies to take the issue seriously and to engage with investors on this topic.

Allocating capital to environmentally and socially themed investments. Environmentally and socially themed investing, as well as certain types of impact investing, are investments in assets or sectors that contribute to solving sustainability challenges while generating attractive financial returns. Investments can include renewable energy infrastructure, energy efficiency solutions, green buildings, affordable housing, microfinance, sustainable agriculture and forestry, investments in the empowerment of women and girls, and global health solutions.

Figure 6 illustrates the terminology used when speaking about different investment approaches, and clarifies the subtleties and differences between them. The 'Responsible Investing' bar at the top indicates the range of different approaches that institutional investors may take to incorporate ESG issues, to an increasing degree from left to right, but stopping just before 'impact first' impact investing, as consistent with their fiduciary duty to maximize risk-adjusted returns for their beneficiaries. Of the 814 investors who reported through PRI's Reporting Framework in 2014, 33% had made investments in one or more of these areas.

However, there are capacity limitations to how much capital institutional investors can allocate to environmental and social-themed investments, particularly in emerging markets. These investments are typically made via private markets, in new sectors and regions, and with managers that lack long track records. The financial risks, both real and perceived, are therefore high, with sometimes uncertain returns. There is a need for commonly accepted definitions of impact that would allow the alignment of efforts at the industry level. As highlighted in UNCTAD's Action Plan, there is also a need for innovative financing mechanisms and public-private partnerships to address some of these barriers, in order to allow institutional investor capital to be increased.

Focus	Responsible Investing		Impact Investing			
	Traditional	Screening	ESG Integration	Themed	Impact First	Philanthropy
	Competitive Returns			Targeted Social and/or Environmental Impact		
Limited or no focus on ESG factors of underlying investments.	Negative or exclusionary screening and positive or best-in-class screening, based on criteria defined in a variety of ways (i.e. by product, activity, sector, international norms).	The use of qualitative and quantitative ESG information in investment processes, at the portfolio level, by taking into account ESG-related trends, or at the stock, issuer or investee level.	The selection of assets that contribute to addressing sustainability challenges such as climate change or water security.	Environmental or social issues which create investment opportunities with below market return rates.	Focus on one or a cluster of issues where social and environmental need requires zero return and loss of invested capital.	

Figure 4: The investment spectrum. Adapted from Bridges Ventures (2012)

Example: Local Government Superannuation Fund.

As a universal owner with a long-term investment horizon and investments spread across many asset classes and regions, Local Government Superannuation Fund (LGS) recognizes that it is exposed to many ‘macro’ or systemic ESG risks, such as climate change and resource scarcity. The fund believes that measuring, managing and hedging these risks is a fundamental aspect of its fiduciary duty. LGS has done so by investing in environmentally themed funds across different asset classes. Up to 15% of its US\$1.7 billion fixed income and cash portfolio is invested in green bonds. Of its US\$1.4 billion listed equity portfolio, 5% is invested in companies in environmental sectors, such as renewable energy. Around 10% of its US\$245 million in private equity investments is invested in the clean tech sector. These investments must meet all standard return and diligence thresholds – there is no question of trading off environmental or social return against financial return. Overall, LGS’s environmentally themed investments are fulfilling their investment objectives and have performed satisfactorily but, as with all active strategies, some have performed better than others.

Example: TIAA CREF. TIAA’s General Account Social Investment Program portfolio totals US\$664 million, including US\$50 million in the inclusive-finance sector.

TIAA’s General Account is the investment portfolio that supports its guaranteed fixed-annuity products; that is, the pool of capital that enables TIAA CREF to pay out claims. Investments therefore need to be of high quality. TIAA CREF has identified investments contributing to measurable social outcomes while also meeting the required risk/return requirements. It does this by identifying sectors overlooked or underpopulated by mainstream investors and facing “capital gaps.” For example, in 2012 it invested US\$32 million in two global private equity funds focusing on inclusive finance. These funds in turn invest in financial institutions in developing countries that provide financial services and products to underserved consumers, micro-entrepreneurs and SMEs. TIAA CREF also made a US\$5 million investment in a group of development-oriented banks operating in Latin America, Africa and Eastern Europe.

In 2012, according to the Climate Policy Initiative, climate finance plateaued at US\$359 billion, with US\$224 billion coming from a variety of private actors, predominantly institutional investors, utilities and energy producers, as well as corporate and domestic end-users. However, according to a 2014 Ceres report, estimated annual investment needs for climate change mitigation to reach a stabilization path below two degrees are significantly higher than are current investment levels.

Climate finance is a clear case of private flows only being able to be mobilized when the right incentives and policies are in place. Private climate finance requires public incentives in various forms, from comprehensive legislative and fiscal frameworks that make markets work at an international level, such as a stable and predictable price of carbon, to catalytic investments required to address the risk of initiatives that would otherwise not meet the private sector's risk/return expectations. Climate finance is an area with clear impact indicators, and in which the practice of setting sustainability targets beyond financial returns is at the heart of investment decision-making.

Example. A Business Partnership Driving Sustainability: how to save energy and increase profit while investing in renewable energy.

In 2007, a climate partnership was signed between Danish healthcare company Novo Nordisk and energy provider DONG Energy to combine energy savings and the promotion of renewable energy. DONG Energy provides Novo Nordisk with energy consulting services and energy efficiency improvements. In exchange, Novo Nordisk's resulting financial savings are earmarked for the purchase of renewable energy certificates from DONG Energy's wind farm in the North Sea. The model enabled both companies to achieve their long-term goals, and has generated results that exceed the initial expectations. By 2010, all electricity supplied to Novo Nordisk's Danish production sites was covered by certificates from DONG Energy. For Novo Nordisk, this meant annual energy savings of US\$7.8 million, corresponding to a 20% reduction of its energy consumption in Denmark, and a reduction of approximately 24,000 tons of CO₂ emissions annually. This enabled the company to live up to its commitment to cut CO₂ emissions from global production sites by an absolute 10% from 2004 to 2014.

Innovative finance. Many "innovative financing" initiatives have sprung up, many of which are collaborative efforts between the public and private sectors. Companies are increasingly using innovative financing mechanisms to finance their investments in sustainability. These initiatives are particularly relevant for climate and infrastructure investments, as well as for investments in social issues that often show higher risk profiles and require patient capital.

Example. Green Bonds – The investor perspective.

Green bonds are an accessible and relatively low-risk way that investors can invest in environmental themes. An increasing amount of these have been issued in recent years.

A total of US\$36 billion labelled green bonds were issued in 2014. Most of the issuers to date have been multinational banks, but around half of the growth in 2014 has come from corporate issuers who have recently entered the market. These investments are attractive to institutional investors, because they have similar characteristics to other bonds while guaranteeing that the use of proceeds contributes to environmental projects. For example, Zurich insurance group plans to invest US\$2 billion in green bonds, which will allow them to have a positive impact at a return that fully compensates for the risk. The bonds they are targeting have a top credit rating and a prudent allocation for one of their largest portfolios; about 30% of the group's investment is in government or supranational bonds. With this allocation, they also hope to help the market to grow and become more liquid.

Example. Green Bonds – The corporate perspective.

In March 2014, Unilever issued a green sustainability bond to support its efforts to reduce waste, improve water use and to reduce greenhouse-gas emissions. Unilever developed a Green Sustainability Bond framework, providing clarity and transparency regarding the use of proceeds with clearly defined criteria on greenhouse-gas emissions, water use and waste disposal for the projects selected, and a yearly reporting structure. By providing a transparent framework and full traceability of the funds, Unilever was able to generate growing demand for sustainability investment options and finance projects that deliver a positive environmental benefit while advancing the group's long-term business goals.



2.3 Banks and Insurance

The role of banks in sustainable development

A well-regulated and transparent banking system can provide the debt finance that is a critical element to implementing the SDGs. Banks can provide “green” or “sustainable” lending – not just in the context of large infrastructure projects, but across the spectrum of economic activity, which is instrumental in the pursuit of energy efficiency goals, for instance. An increasing number of banks are seeking to get a better understanding of how to increase their net positive impact on society and the environment, precisely by providing financing solutions for “greening” activities and processes across all sectors of the economy. More work needs to be done to mainstream best practices in this sector.

The adoption of sector-specific sustainability standards (e.g. the Equator Principles) can help banks to better assess and manage the environmental and social risk of projects they finance, and encourage banks to avoid financing projects that have significant detrimental social and environmental impacts. In an increasing number of emerging markets, banks are working collaboratively to establish guidelines and minimum standards of environmental risk management at the national level. While these efforts are often voluntary, in a growing number of countries banking supervisors and regulators have started to engage directly, and some have started to issue clear requirements to assess systemic environmental risks and adopt practices to mitigate the banking sector’s exposure and contribution to environmentally unsustainable activity.

Banks and similar financial institutions can also play an important role in promoting access to finance by providing financial services to micro entrepreneurs and small enterprises, who often find access to finance as a major barrier for growth. The development of the microfinance industry as well as initiatives such the Global Alliance for Banking on Values seek to develop the market of financial services for unserved people, communities and the environment. Banks also play a crucial in providing financial services to ‘the missing middle’ i.e. SMEs graduating from microfinance but currently often unable to access next stage formal financing.

The role of insurance companies in sustainable development

Insurance companies can provide risk transfer services and insurance solutions at the macro, meso and micro level, protecting governments, companies, and individuals from unforeseen adverse events. In addition to providing protection, pricing risk also allows for more effective investment. And by reaching to micro entrepreneurs and small companies through micro insurance products, the sector can also help drive growth and resilience for vulnerable populations.

The UNEP FI Principles for Sustainable Insurance serve as a global framework for the insurance industry to address ESG risks and opportunities. Insurance companies are increasingly incorporating ESG considerations alongside traditional risk factors in response to the changing landscape and the complex, changing and interconnected challenges facing the world.

Example. Environmental Risk in Banking Regulation.

In 2014, the Central Bank of Brazil implemented a regulation which establishes guidelines for financial institutions in connection with the Pillar 2 Supervisory Review and Evaluation Process (SREP) to consider the bank’s “degree of exposure to the social and environmental risk of the activities and transactions of the institution”. This regulation also requires the bank to publicly disclose its environmental and social risks (with penalties if disregarded) as part of the market discipline disclosure rules of Pillar 3 of Basel III.



Example: Recognizing the particular financial needs of women, Green Delta Insurance Company in Bangladesh launched a comprehensive insurance policy specifically for women.

The policy, the first of its kind in Bangladesh, has separate clauses to cover critical life events or tragedies that specifically impact women (i.e. childbirth, rape, violence against women, divorce, etc.). The policy is offered at a lower cost, making it affordable for women of all income levels.



Foundations

2.4 Foundations and Philanthropy

Overview

There are many types of philanthropic institutions and foundations, depending on specific countries' regulations. The three main categories are independent foundations, corporate philanthropy, and community foundations. Independent foundations are entities that typically make grants based on an endowment, and which have an independent governance based on a mandate associated with the endowment. Corporate philanthropy entails direct giving on the part of companies, as well as giving through dedicated corporate foundations that finance their activities with financial contributions from a company. Community foundations are institutions established by specific communities, and are aimed at addressing issues relevant to those communities through making grants. The funding to support the activity of community foundations comes from multiple sources, from individual to corporate donors, as opposed to corporate and independent foundations, which tend to have one or only a few major donors.

Private philanthropic giving represents an important amount of overall development finance. According to the Center for Global Prosperity, charitable giving to developing countries reached almost US\$60 billion in 2011, versus almost US\$140 billion Official Development Assistance (ODA).

Internal philanthropy in developing countries is also reaching significant volumes, with charitable giving in Brazil at over US\$1.2 billion and at over US\$13 billion in China, according to the Foundation Center. Foundations in developed countries are also giving significant resources domestically towards global issues, such as climate change mitigation and adaptation. According to the Foundation Center, the US was home to 86,192 foundations with US\$715 billion in assets and US\$52 billion in giving, 63% of which was in support of domestic activities.

The role of foundations in sustainable development

The contribution of foundations to sustainable development takes several forms, such as development partners, as providers of sustainable development finance, and as institutional investors. Foundations bring a unique set of competitive advantages that can complement the role of governments, companies, and institutional investors, and which provide a valuable contribution to sustainable development.

Foundations combine dynamism and flexibility with a long-term commitment. Foundations are created for a purpose. Their choice of areas of intervention and modes of operation are guided by how they contribute to the institutional purpose over the long term. This often results in foundations becoming involved in the early stages in emerging issues related to the institutional purpose. Given the sheer number of foundations working to promote sustainable development, this combination of long-term commitment with early-stage involvement allows philanthropy to play a variety of roles and to fill essential gaps in ways that are not viable for the public or private sectors, nor for multilateral organizations.

Foundations have a natural inclination to convene and engage in partnerships. The mission-driven approach of foundations often gives them the legitimacy to act as trusted conveners and connectors of different stakeholders with complementary roles to develop collaborative solutions. In addition, in environments where institutions are weak, foundations may generate greater trust than public institutions, and thus have greater access to communities. This proximity to the ground also gives foundations a greater sensitivity towards bottom-up local approaches, rooted in local needs, and developed via dialogue

with the communities. Dialogue and partnerships are at the heart of foundations' work. Foundations partner first and foremost with their grantees, building capacity and helping them to achieve their objectives. Foundations also seek to partner with a broad range of public, private and civil society actors in order to provide solutions to complex, large-scale problems.

Example. The Guidelines for Effective Philanthropic Engagement (GEPEs), developed by the OECD Global Network of Foundations Working for Development (netFWD) with philanthropic actors, are an emerging initiative that addresses the potential for better collaboration between the philanthropic sector, governments and other stakeholders.

This non-binding tool aims to enhance collaboration on the ground by encouraging dialogue between the philanthropic sector and governments regarding specific themes (e.g. youth empowerment or education) on the basis of their comparative advantages, as well as by encouraging data sharing, accountability and by identifying the contours of how best to work together at the country level. The GEPEs rest on the premise that more systematic collaboration and partnering between the philanthropic sector and governments are crucial to facilitate the scaling up of promising or innovative initiatives, as well as to foster ownership by local governments to ensure their sustainability. The Guidelines will be piloted on the ground in 2014 and 2015 across the globe, starting with Mexico, Colombia and Haiti, in order to test their applicability and to measure their potential contribution to a more effective philanthropic collaboration.

Foundations rely on regional and national networks. A number of thematic, national and regional networks are helping to develop and advance the voice of foundations, such as the Council on Foundations, the European

Foundation Centre, and the OECD's netFWD. These networks play an important role in promoting knowledge exchange and best practices, and can help to create affinity and assist thematic groups to coordinate efforts regarding regional or national challenges. Other initiatives, such as the US-based Foundation Center, are providing valuable global data, analysis and training related to philanthropy with the objective of strengthening the sector worldwide.

Corporate foundations deserve particular attention. While some companies embed their social investment activities at the firm level, others set up corporate foundations for this purpose. Companies are increasingly blending financial philanthropy with their skills and other resources, which comprises a significant additional source of private sector financing for sustainable development. Many companies and corporate foundations are evolving towards a model in which their philanthropic efforts are increasingly aligned with the sustainability agenda of the company. However, a number of corporate philanthropy initiatives remain at arms' length of the corporate strategy for various reasons.

Emerging trends in philanthropic giving and investment

Foundations and philanthropy are essential partners and providers of finance for sustainable development. Trends reflecting a shift towards maximizing the impact of foundations' giving include addressing market failures and creating new markets, catalytic philanthropy, new financial tools and approaches to social investment, issue-based funding, and a focus on development effectiveness.

Addressing market failures and creating new markets. In order to find solutions to persistent challenges, as well as emerging and changing ones, foundations are increasingly playing a pioneering role, focusing their grants on neglected areas, entering new markets and developing innovative solutions that serve as proof of concept and that can attract other actors. There is an important complementarity between the work of foundations and that of businesses and institutional investors. Foundations can be a critical actor by providing solutions to address market failures and to mobilize support towards areas in which neither the private nor public sector are willing or capable of investing. Once the market failure is addressed, foundations can rely on businesses to ensure the continuity and sustainability of the initial effort, and bring solutions to scale through market mechanisms.



Example. Sustania is an innovation platform where companies, NGOs, foundations, and thought leaders come together to support and work with a tangible approach to sustainability.

Sustania works to mature markets and sectors for sustainable products and services based on readily available solutions in the fields of education, energy, health, cities, natural resources, information technologies, transportation, fashion, food and buildings. Every year, Sustania introduces 100 readily available, innovative sustainability solutions from around the world. Focusing on vetted, investable projects with a proven track record gives foundations, investors and business leaders insights into investment opportunities.

Catalytic philanthropy for systemic change. Foundations are increasingly taking a systemic approach to sustainability challenges. This focus seeks to generate greater impact that is beyond the direct effects of individual grants. It requires a proactive approach towards identifying and supporting potential grantees and partners, and a greater level of engagement with grantees. Individual projects are used to test and develop new solutions, but working with complementary partners and sharing knowledge to influence behaviors is considered as important as the projects themselves.



Example: The Catalytic Philanthropy approach at the Ford Foundation.

Based on initial evidence that extra contact hours lead to better student outcomes, the Ford Foundation embarked on a transformative movement, experimenting with the concept in a number of public schools in order to evaluate its impact on a larger scale. The Ford Foundation financed expanded learning hours in approximately 1,000 schools encompassing around 460,000 students, and supplemented its financial contribution with an alliance of over 100 of the country's leading experts and stakeholders in the education sector, called the "Time to Succeed Coalition". On the basis of the positive results achieved, the Ford Foundation launched a massive communication campaign targeted at the public and particularly at politicians to inform them of the benefits of expanded learning hours. The project has attracted a great deal of attention among national authorities, and the concept has been incorporated into local budgets, with US\$4.5 billion earmarked for a broader implementation of the "Expanded Learning Time" model.

New financial tools and approaches to social investment. Financing from foundations and philanthropy can play a critical role in pioneering new funding approaches and mobilizing resources from other actors, both public and private. Foundations are diversifying the types of financing they provide, from grants to impact investments and blended finance, with the goal of de-risking relevant initiatives, creating new markets and mobilizing significant amounts of additional investment.

Issue-based funding. Recent years have witnessed the growth of global platforms and initiatives that focus on a particular sustainability challenge. These platforms allow the creation of new markets through standards and norms, best practices, and learning and knowledge sharing. In addition, they spur innovation and facilitate matchmaking for partnerships among like-minded businesses, investors, foundations, and other stakeholders. Finally, they can help to organize the business and investment community around an issue in order to mobilize the resources required for systemic changes. Foundations can play an important role in launching these kinds of issue-based funding platforms and in convening the right partners.



Example: Issue-based funding.

EMBARQ is a program focusing on the role of transport in making cities around the world better places in which to live. EMBARQ was set up by the World Resources Institute with initial financial support from the Shell Foundation, and the network now includes governments, foundations, the private sector and civil societies around the world. EMBARQ seeks to influence government and decision-makers at the national and city levels, as well as development banks, private developers and NGOs in order to reach scale. As a means of achieving this, they have been delivering flagship projects in a number of cities. Through strategic communications, these flagship projects serve as a demonstration effect to shift international policy and have been replicated in an increasing number of cities. Since 2005, the initiative has avoided 3.3 million tons of CO2 emissions, has saved 1.2 billion hours of commuting time, and has leveraged US\$4.8 billion in project investments.

Focus on development effectiveness. With the emergence of new philanthropic actors and new approaches to philanthropy, and with the general growth and development of the field, foundations are improving their efficiency and effectiveness. While many foundations are naturally inclined to measure results, as this is the main metric of their progress, the focus on measuring and reporting results, increasing transparency and using data to make informed decisions about programming is gaining global attention among foundations.

As discussed above, foundations have a dual role as providers of social investment towards sustainable development challenges through their grants and program-related investments, and as institutional investors in the capital markets. As institutional investors, foundations play an important role by acting as role models for other institutional investors. Trends reflecting a shift towards maximizing the impact of foundations' investments include adopting a responsible investment approach and aligning investments with their programmatic work.

Adopting a responsible investment approach. Following the overall evolution of the institutional investor community, foundations are increasingly incorporating ESG issues in their investment decision-making and practices associated with the management of their trusts/endowments.

Increasing the impact of investments and aligning them with the programmatic work. A number of foundations are exploring ways to increase the link between their programmatic work and their portfolio investments that finance such work. Some foundations are devoting a fraction of their portfolio to impact investments as a way of producing measurable social or environmental returns from their investment portfolio.



Example: Responsible and impactful investment of foundation assets.

Fondazione Cariplo, one of Europe's largest foundations with over US\$10 billion in assets, has established a goal to invest 7% of its total assets in impact investments. Such investments span microfinance, social housing / urban regeneration, infrastructure, public-private partnerships, technological innovation, SME private equity and agriculture. Currently, impact investments account for more than 6% of the foundation's portfolio. The remaining 94% of the foundation's assets are managed according to a responsible approach. Together with other foundations, Fondazione Cariplo created an independent fiduciary asset manager platform serving the specific needs of the non-profit sector. Impact investments have been explicitly included in the benchmark used for measuring the foundation's investment performance.

3. Conclusion: Leveraging the Private Sector for Sustainable Development

Responsible investment and corporate sustainability are in line with the SDGs, but need leveraging to achieve stronger sustainable development outcomes. As evidenced in the previous sections, the actors in the private sector are embracing the concept of sustainability in their operations. Private sector practices are evolving from a risk management approach of avoiding harm, to driving innovation and new investment opportunities that create long-term value for businesses and for society.

There are great synergies between different public and private actors. Companies, investors, and

philanthropic initiatives are increasingly working together to address sustainability challenges and are adopting similar approaches to social investment. The interplay and complementarity of different private actors will also be critical to address the financing of a sustainable future. In particular, the combination of the pioneering role of foundations in addressing market failures and creating new markets with companies' ability to develop market solutions to sustainability challenges, and investors' role in supporting company growth and taking sustainability solutions to scale, could generate a virtuous cycle of innovation to achieve the SDGs (Figure 5).

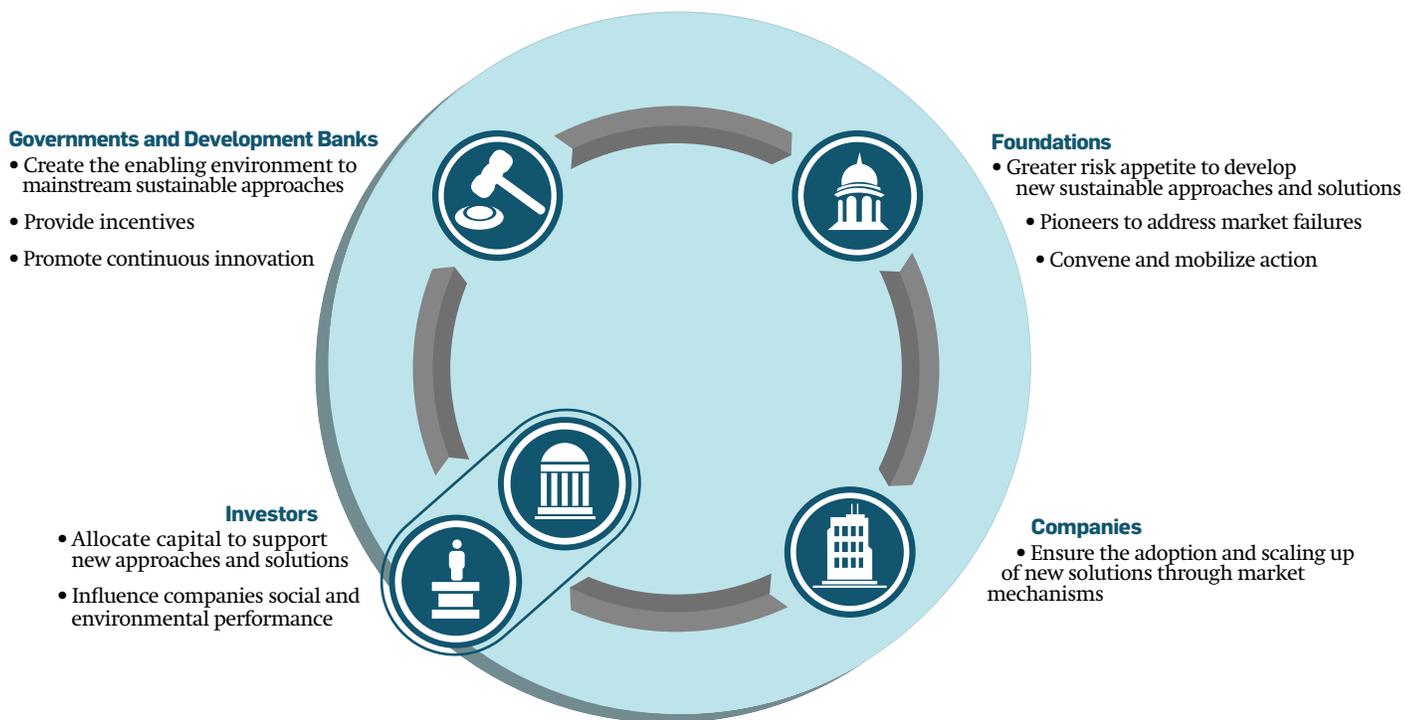


Figure 5. A virtuous circle of innovation to achieve the SDGs

Governments play an important role in mobilizing private investment into sustainable development. The Strategic Framework and Action Plan for Private Investment in the SDGs proposed by UNCTAD addresses key policy challenges and options. A prerequisite for successful promotion of investment that is consistent with the SDGs is a sound overall policy environment, conducive to attracting long-term investment while safeguarding public interests. With the right incentives and enabling policies, private flows could be redirected to sustainability issues and geographies in need, and away from areas with negative externalities. It is critical for governments to include investors, companies and foundations in the policy dialogue and in the design of a global strategy to finance the SDGs. Governments can also promote stewardship codes to stimulate active ownership, enabling investors to exercise their rights as shareholders. Government-sponsored funds can be invested in long-term sustainability projects, such as infrastructure, hand-in-hand with private investors. ODA remains a critical financing source for extreme poverty eradication, especially in the least developed countries and in countries with special situations.

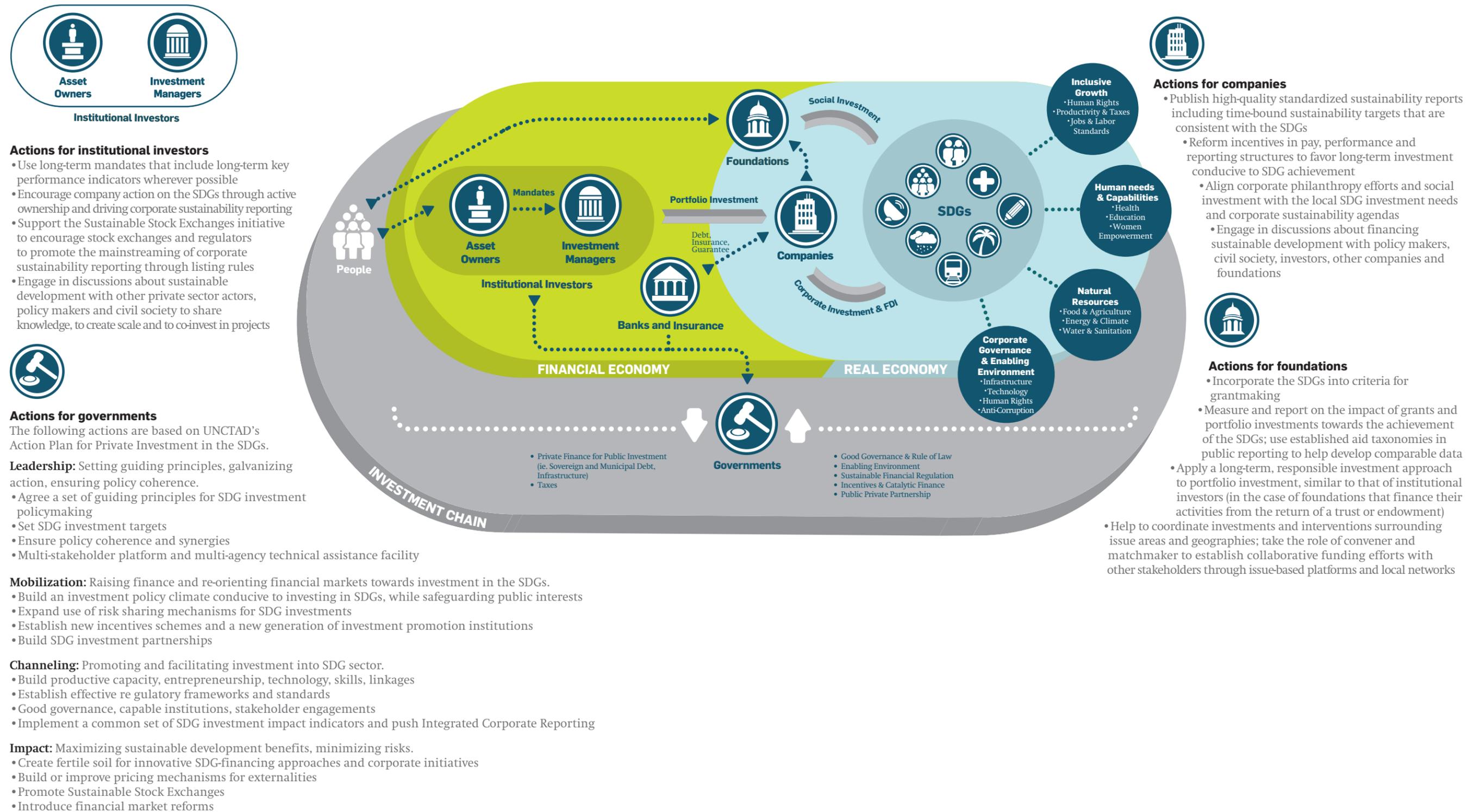
Policies that encourage private sector transparency and accountability, including sustainability reporting, can help to inform private investment and align it with sustainable development. Requiring companies to disclose information on policies, risks and results with regard to environmental matters, human rights, labor, and anti-corruption and bribery issues helps

to highlight why unsustainable practices by companies are damaging to the financial system, the economy, the environment and to society at large. It can also help investors to make more informed investment decisions and to improve their dialogue with companies.

Multilateral and National Development Banks are effective vehicles to mobilize investment from the private sector. Through their work with the public sector, they help to create an enabling environment conducive to corporate sustainability practices and, through their direct work with the private sector, they provide catalytic finance, testing and mainstreaming innovative approaches to align private investment with sustainable development. Development banks should ensure their investments do not compete with or crowd out other private actors, and should instead be selective in positioning their resources in such a way that creates markets and mobilizes additional private investment towards a systemic change in the areas of greatest need.

There are a range of options available now for private and public sector actors to scale up private sector investment in sustainable development. Figure 6 sets out an initial set of possible options for private and public sector action to increase the impact of private investment on sustainable development. A multi-stakeholder dialogue between governments, investors, companies, and foundations concerning these ideas could be a beneficial way to scale up private action.

Figure 6. Actions for Private Actors to Scale Up Private Sector Involvement in Sustainable Development



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PRIVATE SECTOR INVESTMENT AND SUSTAINABLE DEVELOPMENT

The current and potential
role of institutional investors,
companies, banks and foundations
in sustainable development



United Nations Global Compact



UNITED NATIONS
UNCTAD



UNEP Finance Initiative
Changing finance, financing change

 **PRI** Principles for
Responsible
Investment