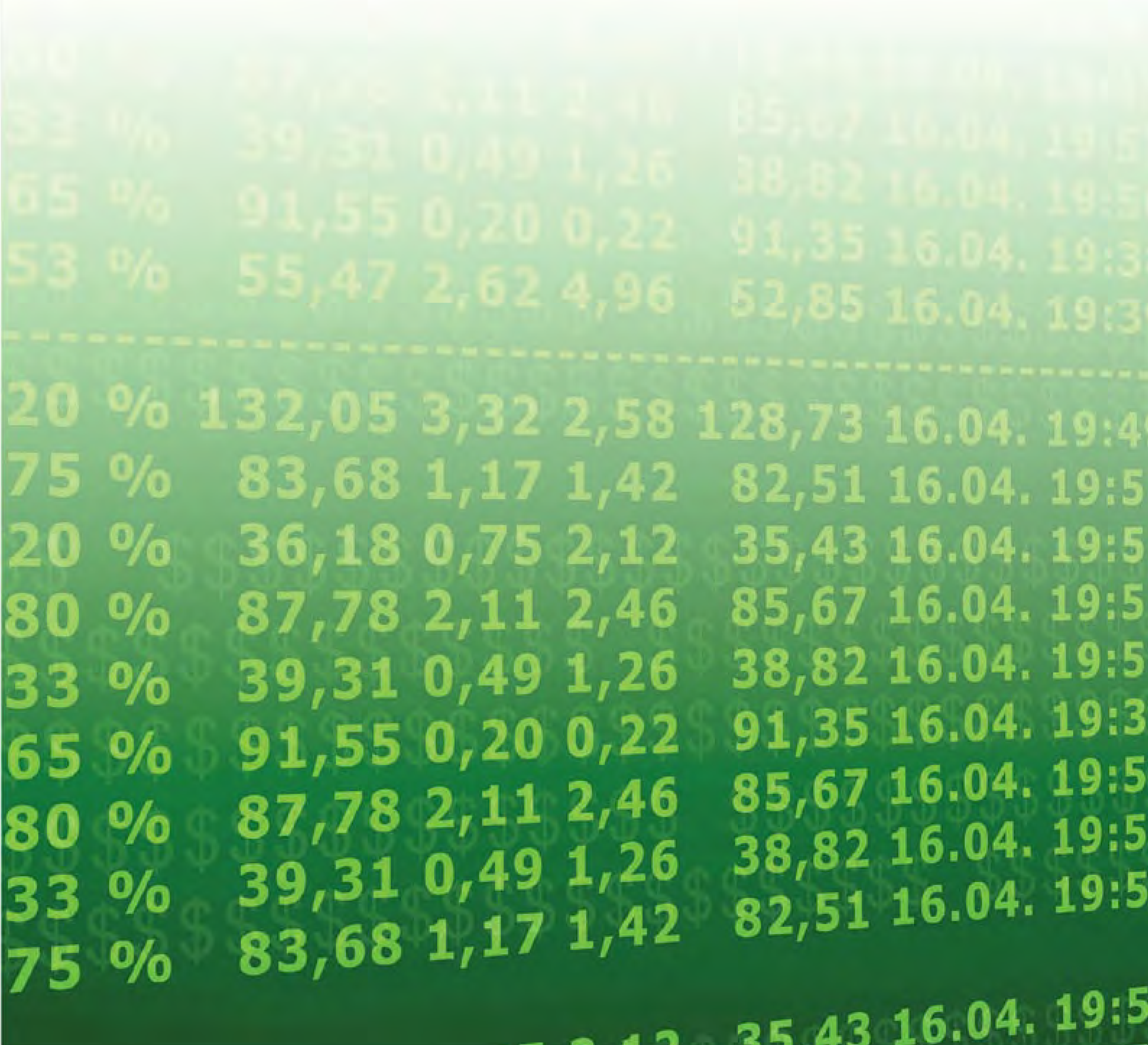
SUSTAINABLE STOCK EXCHANGES

Real Obstacles, Real Opportunities

Discussion paper prepared for the Sustainable Stock Exchanges 2010 Global Dialogue

WORLD INVESTMENT FORUM 2010
INVESTING IN SUSTAINABLE DEVELOPMENT
6-9 SEPTEMBER 2010 - XIAMEN, CHINA

UNITED NATIONS
UNCTAD



Sustainable Stock Exchanges
Real Obstacles, Real Opportunities

Authors | Rumi Morales & Edouard van Tichelen
Editor | Lucy Carmody

Acknowledgements

This report was prepared by Responsible Research with the financial support of Aviva Investors. The report benefited from the advice of: Anthony Miller, Economic Affairs Officer, UNCTAD; Steve Waygood, Head of Sustainability Research and Engagement, Aviva Investors; and Christina Zimmerman, Manager, Public Policy and UN Engagements, Principles for Responsible Investment.

Note

The opinions expressed in the report, intended as a basis for discussion for delegates of the Sustainable Stock Exchanges 2010 Global Dialogue, are those of Responsible Research and are their sole responsibility. The opinions are not to be taken as the official views of Aviva Investors, UNCTAD Secretariat or its Member States. The designations and terminology employed are also those of the authors.

Comments on this paper are invited and may be addressed to the authors at info@responsibleresearch.com.

FOREWORD

In November 2009, along with the United Nations Global Compact and the Principles for Responsible Investment (PRI), the United Nations Conference on Trade and Development (UNCTAD) co-hosted a meeting of institutional investors and CEOs from stock exchanges to explore how the world's exchanges could work together with investors, regulators and business to encourage responsible long-term approaches to investment.

The meeting produced a number of key insights and examinations into the various ways in which stock exchanges could promote sustainable business practices. Those included existing best practices such as enhanced sustainability reporting requirements for listed companies and the establishment of sustainability indices.

We knew that the discussion was only the start of a concerted, collaborative and continued effort to help stock exchanges improve corporate responsibility practices. From more international forums exploring issues such as international integrated financial reporting to studies that provide key policy recommendations for exchanges, it is important to keep the dialogue on sustainable stock exchange ongoing.

In September 8, 2010 in Xiamen, China, UNCTAD will again bring together stock exchange leaders, investors and regulators along with the UN Global Compact and PRI to assess the achievements of the past year and the progress still to be made.

We hope that the results of those discussions, as well as the ideas presented in this report, will continue to inspire and inform the decisions of all stakeholders of corporate sustainability and socially responsible investing. Together, we can work to ensure that improved environmental, social and governance practices by public companies become a public reality.

- Paul Abberley, Chief Executive, Aviva Investors, London

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Sustainability, as practiced by institutions, generally refers to the adoption and application of environmentally responsible practices, sound social policies and exceptional governance structures in order to minimize risk and volatility and to enhance the long-term development impact of corporate activities.

In recent years corporations and other entities requiring capital have proactively or, in response to investors, government and civil society, begun to emphasize sustainability issues in their operations, supply chains and investment approaches. The deliberations of the international community, at the United Nations, the OECD and G20, reveal a strengthening international consensus that long-term financial stability and economic development requires rapid improvements in corporate environmental, social and governance (ESG) practices in light of looming challenges such as climate change, demographic shifts and natural resource depletion.

Few firms currently provide data in a way that facilitates comprehensive analysis. Even companies that do provide insightful sustainability reporting sometimes do so months after a firm's annual financial report indicating to market participants that ESG risks are somehow less important in forward-looking investment analysis. Moreover, company reporting is not easily comparable across countries, raising the issue of difficulty in assessing the results of a global firm's long-term sustainability efforts. Efforts are now being made towards internationally integrated reporting, which aims to offer investors and regulators a single report addressing a company's overall performance on ESG as well as economic factors.

Global stock exchanges have a complicated role to play in this regard. As the central marketplaces between buyers and sellers of equity securities, members of the World Federation of Exchanges (WFE) transacted over US$80 trillion in 2008, connecting millions of buyers and sellers.[1] Through their listing requirements, stock exchanges can affect some of the business operations and practices of the companies that seek to use the exchange as a forum to access capital from global retail and institutional investors.

Stock exchanges are in a position to promote improved ESG practices and reporting among the companies on their exchanges. Seven out of ten respondents in our exchange survey agreed that exchanges do have a responsibility to encourage greater corporate responsibility on sustainability issues and many have already begun to implement initiatives. These range from the introduction of sustainable investment indices to listing requirements requiring sustainability reporting. Whilst understanding the limitations of mandate and scope of the exchanges to assess materiality of ESG risk for its listed entities, there is still potential for exchanges to do more, including strengthening requirements for general ESG reporting and, potentially, introducing requirements for a forward-looking non-binding shareholder resolution on sustainability strategy at the Annual General Meeting (AGM).

This report provides an assessment of the current sustainability structures and practices at 30 of the world's largest stock exchanges by market capitalization. To enhance this overview, a survey was conducted of these exchanges concerning their existing and planned sustainability initiatives and their views of the importance of ESG practices. Although the sample size was small (30 exchanges), the survey responses (16 exchanges) illustrate how far some exchanges have come in implementing and contemplating sustainable initiatives, as well as the efforts towards changes yet to be made.

Following this there is a discussion of the obstacles and opportunities that stock exchanges face in the promotion of sustainability practices among publicly listed companies. Finally, suggestions on policy and ideas on how to manage the practical sustainability integration are detailed for stock exchange leaders to consider. These are intended as starting points for discussion only as each exchange will have its own set of challenges ahead in terms of implementing required sustainability disclosure and other measures to enhance good ESG initiatives by companies.

Such initiatives face a number of real challenges. The definition of ESG itself remains open to interpretation and measurements are hard to quantify. Sustainability programs tend to produce results over the long-term while most investors still focus on short-term results, despite the recent global financial crisis. Businesses continue to seek to lower their cost of capital and implementing ESG initiatives often involves high upfront investments that are not immediately rewarded by the market. Many exchanges themselves are for-profit institutions that strive to provide a forum for public offerings of stock without the imposition of seemingly onerous listing and reporting requirements. And with differing global standards, accounting practices, regulatory regimes and legal frameworks, stock exchanges should not be singled out as the sole means for improved corporate sustainability practices through their influence and operations alone.

"This report discusses the obstacles and opportunities that stock exchanges face in the promotion of sustainability practices among publicly listed companies"

Despite these significant challenges, many entities are taking thoughtful steps to expand the reach and influence of the global exchanges in the effort to create a sustainable future. The recently established International Integrated Reporting Committee (IIRC), which includes exchanges, listed companies, investors, and policymakers, is seeking to introduce a global integrated reporting model that will include sustainability issues and make annual reports comparable across borders. Collaborative forums for global business leaders, investors and policymakers are leading the call to urge exchanges to adopt effective ESG requirements. Exchanges are also implementing a greater number of relevant ESG initiatives, including separate listing boards for companies that meet higher ESG thresholds or by supporting social trading platforms that offer new forms of access to capital markets for social enterprises.

It is hoped that this report will illuminate and define the landscape that sustainability advocates must work within to promote structural change at stock exchanges. Moreover, initiatives that require listed companies to provide improved sustainability reporting need consistent dialogue and engagement from all stakeholders to achieve their aims. This research should be part of a multi-lateral effort to outline a robust call to action that aims to make outstanding corporate sustainability practices commonplace.

KEY FINDINGS

1. Current ownership structures and fiduciary duties of stock exchange boards are generally designed to maximize returns to their own shareholders with no explicit mandates to improve sustainability. Only one in ten exchanges in our respondent universe are considering altering listing requirements and almost all say they prefer voluntary initiatives to mandatory requirements. If stock exchanges are to consider requiring a real commitment toward sustainability from listed companies, **issuing guidelines for voluntary adoption of ESG practices and reporting is recommended as a first step, focusing on the goals of promoting sustainable development and financial stability**. This should be an additional and separate step to exchanges setting up internal sustainability committees to report on their own corporate ESG practices, in order to lead by example.

2. Our research suggests that several companies which were early leaders in sustainability reporting, complain that it is frequently overlooked by investors in favor of forward-looking financial models. Investors, regulators and exchanges can together **support the movement for integrated financial and non-financial reporting** which reflects a company's performance within a comprehensive business strategy and should result in sustainability practices being embedded throughout the organization.

3. Investors with an active focus on sustainable and responsible investment asset classes are growing, but still represent only a small fraction of all global assets under management. Stock exchanges can encourage asset owners and managers to become responsible investors by **supporting the development of products such as sustainable investment indexes**. Almost all exchange respondents already offer, or are planning to launch, sustainability-related investment indices. These are an obvious revenue source for exchanges and will help to raise the profile of sustainable and responsible investment issues but, of course, altering listing requirements would be a stronger way to encourage sustainable business practices over time.

4. Short-termism among many investors and demutualized, for-profit exchanges, primarily dependent on trading volumes for revenue, create barriers to a long-term sustainable approach. **Appeals to policy makers, greater education and consistent outreach to sovereign, retail and institutional investors will be required to eradicate the worst of the market's short-term mentality.**

5. Exchanges have a come a long way in a relatively short time, with some instances of excellent practices and clear commitments to continue to move further towards sustainability. However, lack of disclosure by companies around the world, the scale of the underlying sustainability problem and the potential for it to impact on both systemic risk and financial stability, should cause regulators and market participants to question whether they are going far or fast enough. With only one in five exchange respondents saying their regulator stipulates mandatory ESG reporting requirements for listing, it seems that regulators need to step in so that corporate leaders in this space have a level playing field on which to perform. As part of the move to require companies to improve their sustainability practices, **exchanges are urged to enhance the dialogue and partnership with regulators on these issues.** With a united approach, they can more forcefully impress upon businesses and investors the importance of effective ESG policies.

Stock Exchanges	Country	Number of listed companies (2009)	Market capitalisation 2009 (USD bn)	Type of company	Government Role	CSR/Sustainability Report	PRI signatories	Sustainability Indices	Sustainability guidance for listing companies	Support the trading or development of carbon markets	Involvment in public/private mechanisms for development aid
Australian Stock Exchange	Australia	1,966	1,261.9	Listed company for profit	-	○	○	○	●	●	—
BM&FBOVESPA	Brazil	386	1,337.2	Listed company for profit	Public company with two members of the board have background in the government	GRI	●	●	○	●	○
BME Spanish Exchanges	Spain	3,472	1,434.5	Listed company for profit	-	●	○	●	●	—	—
Bolsa de Comercio de Santiago - Santiago Stock Exchange	Chile	236	230.7	Listed company for profit	-	○	○	○1	—	—	—
Bolsa Mexicana de Valores	Mexico	406	352.0	Listed company for profit	-	○	○	PLANNING	○	○	○
Bombay Stock Exchange	India	4,955	1,306.5	Demutualized	Private company + members of the board of directors from the government	○	○	PLANNING	○	●	○
Borsa Italiana	Italy	364	656.0	Listed company for profit	-	○	○	○1	—	●	●
Bursa Malaysia	Malaysia	959	286.2	Listed company for profit	The company has more than 50 percent public shareholding. The chairman + three other members of the board are appointed by the Minister of Finance	○	○	PLANNING	●	●	○
Deutsche Börse AG	Germany	783	1,292.4	Listed company for profit	-	GRI	○	●	○	●	●
Hong Kong Exchanges and Clearing	Hong-Kong	1,319	2,305.1	Listed company for profit	Public company with approval and appointment of the chief excecutive by the government	●	○	PLANNING	○	○	○
Indonesia Stock Exchange	Indonesia	398	214.9	Private company for profit	Government support + president commissioner - former position at the Office of the State Minister of Investment and SoE	○	○	●	—	—	—
Istanbul Stock Exchange	Turkey	315	233.9	Governmental not for profit	The Turkish Republic Ministry of Finance is the main shareholder	○	●	●	○	○	●
Johannesburg Stock Exchange	South-Africa	396	799.0	Listed company for profit	-	○	●	●	●	●	—
Korea Exchange	Korea	1,788	834.5	Demutualized for profit	Quasi-governmental institution	○	○	●	○	PLANNING	●
London Stock Exchange	UK	2,792	2,796.4	Listed company for profit	-	○	○	●	●	●	●
Moscow Interbank Currency Exchange	Russia	234	736.3	Private company for profit	-	○	○	○1	—	—	—
Nasdaq OMX	US	2,852	3,239.5	Public company for profit	-	○	○	●	●	●	●
NASDAQ OMX Nordic Exchange - Stockholm, Helsinki, Iceland and Copenhagen	Denmark, Finland, Sweden and Iceland	797	733.4	Listed company for profit	-	○	○	●	○	●	●
National Stock Exchange of India	India	1,453	1,224.8	Demutualized for profit	Private company, owned by the leading institutional investors in the country + chairman is a former Union Finance Secretary and Advisor to the Finance Minister	○	○	●	○	○	○
NYSE Euronext	France	1,160	2,869.4	Listed company for profit	-	○	○	●	●	●	○
Philippine Stock Exchange	Philippines	248	86.3	Association not for profit	Partner with government and other stakeholders	○	○	○1	—	—	—
Saudi Stock Market - Tadawul	Saudi Arabia	135	318.7	Governmental not for profit	The board includes representatives of the Ministry of Finance, and Ministry of Commerce and Industry	○	○	○1	—	—	—
Shanghai Stock Exchange	China	870	2,704.7	Association not for profit	Semigovernmental status - directly administered by the China Securities Regulatory Commission	●	○	●	●	—	—
Shenzhen Stock Exchange	China	830	868.3	Association not for profit	Semigovernmental status - directly administered by the China Securities Regulatory Commission	○	○	●	●	—	—
Singapore Exchange	Singapore	773	481.2	Listed company for profit	Public company + background in the government for the chairman	○	○	PLANNING	●	○	○
SIX Swiss Exchange	Switzerland	339	1,064.6	Private company not for profit	-	○	○	○1	●	—	—
Taiwan Stock Exchange	Taiwan, province of China	755	657.6	Demutualized for profit	Quasi-governmental institution : Private shareholders + chairman + some of the board directors are appointed by the government	○	○		●	○	
The Stock Exchange of Thailand	Thailand	535	176.9	Governmental not for profit	The SET Chairman is a Permanent Secretary, Ministry of Commerce + three others members of the board are in the government	○	○	○	●	●	
Tokyo Stock Exchange	Japan	2,335	3,306.0	Demutualized for profit	-	○	○	PLANNING	○	●	
Toronto Stock Exchange	Canada	3,700	1,676.8	Listed company for profit	-	○	○	●	○	●	●

SUMMARY OF SUSTAINABILITY PRACTICES AT THE LEADING 30 EXCHANGES

KEY OF TABLE

● YES

○ NO

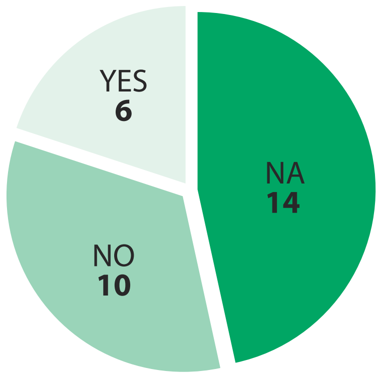
○1 NO (2009 data)

* This study was completed using publicly available information and Responsible Research findings at the time of research, 27th August 2010. Whilst we aim for comprehensive coverage, the table may not reflect all governance structures and sustainability initiatives that exchanges have been internally pursuing or contemplating.

SURVEY OF SUSTAINABILITY AT GLOBAL EXCHANGES

A brief ten-question survey was sent to the world's 30 leading stock exchanges to better understand the ESG-related requirements and initiatives they practice with regard to listed companies. The survey yielded 16 responses and questioned the exchanges' sustainable investment initiatives, existing policy environments, regulatory functions, listing and disclosure requirements, and other regulatory or policy initiatives. Although the sample size was small, the response rate was encouraging at 53.3% and answers highlight the progress that a number of exchanges have made towards enhancing ESG practices at listed companies. A summary of those responses, including selected commentary directly provided by the exchanges from their surveys or disclosed in public information, is provided below.

Question 1: Does your stock exchange provide sustainability guidance for listing companies?



Source: Responsible Research 2010

Some stock exchanges promulgated CSR guidelines, principles of good corporate governance or best practice recommendations. For example:

- **Bursa Malaysia** introduced a CSR Framework in 2006, evaluated the quality of CSR reporting in Malaysia and published a detailed report on companies' progress in 2008.

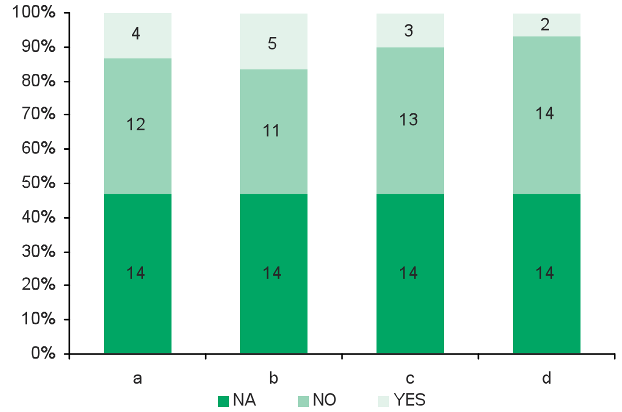
- The **Stock Exchange of Thailand** (SET) established the 'Principles of Good Corporate Governance for Listed Companies' which are in line with those recommended by OECD.

Question 2: Would your exchange consider altering listing requirements to oblige companies to:

a. Assess how responsible/sustainable their business model is
b. Report on their ESG impacts and risks
c. Align incentives with long-term sustainable growth
d. Put a proposal addressing ESG risks and opportunities to a non-binding shareholder vote at the AGM

Only few stock exchanges would consider altering listing requirements for listed companies. They mainly, such as the **HKEx**, prefer a recommended best practice guideline rather than a listing requirement.

In **Taiwan, Province of China**, for example, the regulator has asked all public companies to disclose the state of the company's CSR performance in the annual report and prospectus, including systems and measures that the company has adopted with respect to environmental protection, community participation, contribution to society, service to society, social and public interests, consumer rights and interests, human rights, safety and health and other corporate social responsibilities and activities, as well as the level of implementation. Although this is not articulated in the stock exchange's listing criteria, companies are still obliged to do so in order to be listed on their exchange.



Source: Responsible Research 2010

In **Thailand**, the SET provides guidelines on corporate governance that are the best practices for listed companies. In addition, SET has been working with the SEC, the country's regulator, to urge listed companies to disclose such information in accordance with GRI standards.

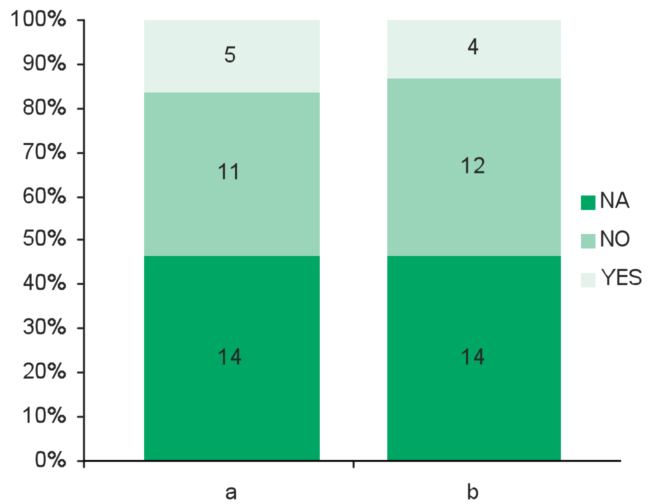
The **Johannesburg Stock Exchange** has, for a number of years, encouraged disclosure through the requirement for listed companies to comply with the King Codes on Corporate Governance that has, since King II in 2002, required integrated sustainability reporting. As a result, from 2010, the JSE became the first exchange in the world to require listed companies to move towards integrated reporting as required in King III. Since the SRI Index covers sustainability reporting in depth, many listed companies already make significant efforts to meet these requirements. They foresee that over time some of the requirements may become more specific as listing requirements.

Question 3: Would your exchange consider enacting policies to allow shareholders to:

a. Comment on the quality of the sustainability (ESG) reporting
b. Approve the sustainability strategy proposal of the board of directors

For the **Bombay Stock Exchange**, "enacting policies might be possible with the consultation of the different regulators and government authorities."

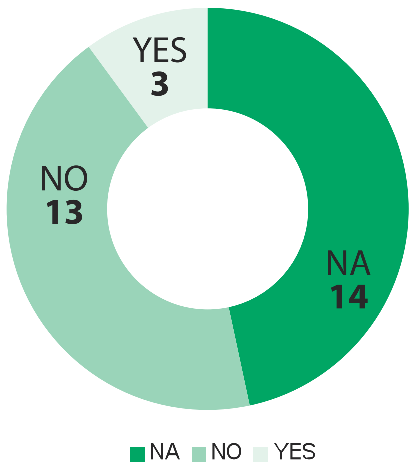
The **Taiwan Stock Exchange** promulgated the CSR best practice principles in February 2010 and began promoting them in the third quarter. It is considering revising these principles to recommend listed companies allow shareholders to comment and approve CSR reporting and proposal.



Source: Responsible Research 2010

* Survey Respondents: Tokyo Stock Exchange; Hong-Kong Stock Exchange; Bombay Stock Exchange; NYSE Euronext; The National Stock Exchange of India; Korea Exchange; Bursa Malaysia; Singapore Stock Exchange; Taiwan Stock Exchange; the Stock Exchange of Thailand; Toronto Stock Exchange; BM&FBOVESPA; Bolsa Mexicana de Valores; Deutsche Börse AG; Johannesburg Stock Exchange; Istanbul Stock Exchange.

Question 4: Does your exchange require that all listing companies meet ESG criteria?



Source: Responsible Research 2010

Most of the stock exchanges (13 respondents) prefer voluntary initiatives over mandatory requirements.

For example, the **BM&FBOVESPA** does not require ESG criteria for all listed companies. Instead it has three listing segments that companies can voluntarily adhere to with different standards of corporate governance. Though the adhesion is voluntary, once listed in a particular segment, adopting the standards is mandatory and enforced by the Exchange.

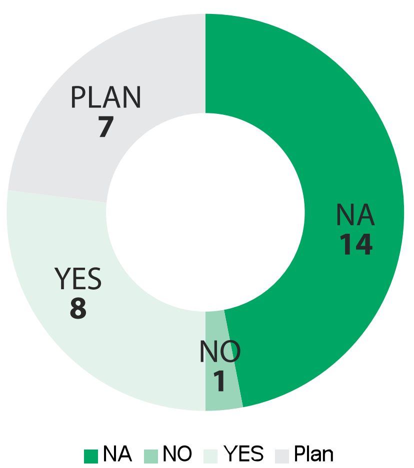
Some of the exchanges, such as **JSE**, have both voluntary and mandatory approaches.

The **JSE** has specific governance principles as part of its listings requirements such as the separation of CEO and Chairman and appointment of an audit committee. In addition, the listing requirements require compliance with the internationally recognised King Codes on Corporate Governance on a "comply or explain" basis. King III has extensive coverage of sustainability matters, recommending integrated reporting on and management of such issues, and endorses the GRI guidelines for reporting. The SRI Index, which is JSE's most extensive tool for setting its expectations regarding the ESG policies and practices of listed companies, is not required by the country's regulator, but has proved to be very effective in influencing companies to prioritise ESG considerations.

In **Taiwan, Province of China**, the CSR Best Practice Principles contain ESG criteria, and all listing companies are recommended to meet them. However, all listing companies are required by the regulator to disclose CSR information in the annual report and prospectus.

Question 5: Does your stock exchange offer any sustainability-related investment indices?

The majority of survey respondents already offer or are planning to launch sustainability-related investment indices. Please, see the following page for the current list of indices.



Source: Responsible Research 2010

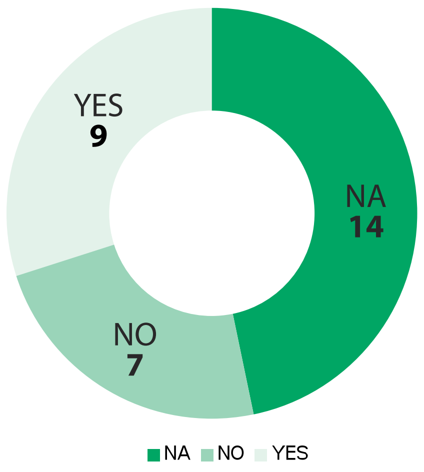
Table 2: Summary of Sustainability Indices listed by Exchange

Exchange	Index	Launch year
BME	FTSE4Good IBEX Index	2008
BM&FBOVESPA	Corporate Sustainability Index (ISE)	2005
Deutsche Börse	DAXglobal® Alternative Energy Index	2006
	DAXglobal® Sarasin Sustainability Germany Index	2007
	DAXglobal® Sarasin Sustainability Switzerland Index	2007
Hong-Kong Stock Exchange	ESG index in development with Heng Seng	2010
Indonesia Stock Exchange	SRI-KEHATI Index	2009
Johannesburg Stock Exchange	JSE Socially Responsible Investment (SRI) Index	2004
Korea Exchange	KRX SRI Index	2009
London Stock Exchange Group	FTSE4Good Global Index	2001
	FTSE4Good US Index	2001
	FTSE4Good Europe Index	2001
	FTSE4Good UK Index	2001
	FTSE4Good Global Index 100	2001
	FTSE4Good US 100 Index	2001
	FTSE4Good Europe 50 Index	2001
	FTSE4 Good UK 50 Index	2001
	FTSE4Good Japan Index	2004
	FTSE4Good Environmental Leaders Europe 40 Index	2007
	FTSE4Good Australia 30 Index	2008
	FTSE4Good IBEX Index	2008
	FTSE KLD Global Sustainability (GSI) Index Series	2008
	FTSE KLD Global Climate 100 Index	2008
	FTSE Environmental Technology Index Series	2008
	The FTSE Environmental Opportunities Index Series	2008
NASDAQ OMX	NASDAQ Clean Edge US Index	2006
	NASDAQ OMX Clean Edge Global Wind Energy Index	2008
	Wilder NASDAQ OMX Global Energy Efficient	
	Transport Index	2008
	OMX GES Sustainability Nordic Index	2008
	OMX GES Ethical Nordic Index	2008
	OMX GES Ethical Denmark Index	2008
	OMX GES Ethical Finland Index	2008
	OMX GES Ethical Norway Index	2008
	OMX GES Ethical Sweden Index	2008
	OMX GES OMXS30 Ethical Index	2008
	OMX GES Sustainability Sweden Ethical Index	2008
	OMX GES Sustainability Sweden Index	2008
National Stock Exchange of India	S&P ESG India Index	2008
NYSE Euronext	NYSE Arca Cleantech Index	1999
	NYSE Arca Environmental Services Index	2003
	NYSE Arca WilderHill Clean Energy Index	2004
	NYSE Arca WilderHill Progressive Energy Index	2006
	Euronext FAS IAS Index	2006
	Low Carbon 100 Europe Index	2008
Shanghai Stock Exchange	SSE Social Responsibility Index	2009
	SSE Corporate Governance Index	2008
	SSE 180 Corporate Governance Index	2008
Shenzhen Stock Exchange	ESG indexes plans for 2010 with hang Seng	
Tokyo Stock Exchange	The first environmental index ETF "Listed Index Fund FTSE	
	Japan Green Chip 35 (1347)"	2009
	TOPIX 1000 CSR Index	2006

Source: World Federation of Exchanges, Responsible Research, 2010

Emerging market exchanges are following suit; In August 2010 the Istanbul Stock Exchange (ISE) and Turkey Business Council for Sustainable Development (TBCSD) launched the Istanbul Stock Exchange Sustainability Index (ISE SI) to review listed companies based on their management of sustainability issues and to create an index that will demonstrate the leadership of listed Turkish companies.[2]

Question 6: Does your exchange support the trading or development of carbon markets?



Source: Responsible Research 2010

A majority of the respondents currently support the trading or development of carbon markets.

The **Tokyo Stock Exchange** and Tokyo Commodity Exchange have created a joint venture in order to prepare for the establishment of an emissions trading exchange.

In Hong Kong, **HKEx** conducted a public consultation on carbon emissions trading in December 2009. Respondents considered demand for a market for Certified Emission Reductions in Hong Kong to be limited at this time (in line with the results of HKEx's informal consultation with market participants). Moreover, the general knowledge level of the Hong Kong investment community regarding carbon emission trading is still very low.

In Europe and the Americas, this market is already well developed with some major actors:

The **NYSE** launched Bluenext jointly with the Caisse des Depots et Consignation in December 2007. This Exchange aims to be the world's largest exchange for carbon and environment-related products.

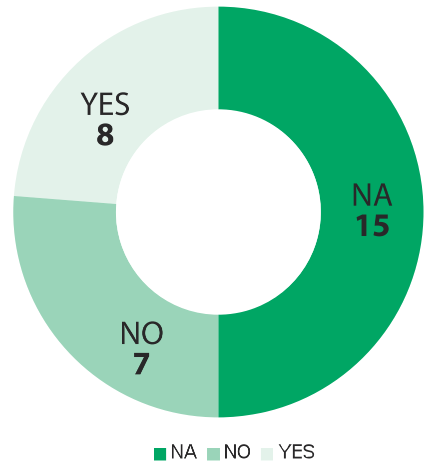
Deutsche Börse Group, through its cooperation between European Energy Exchange and Eurex, is already active in offering a trading platform to utilities and financial markets for trading of European Emission Allowances under the European Emissions Trading Scheme as well as international CER under the Kyoto Protocol.

In North America, the MCeX, a voluntary legally binding rules-based greenhouse gas emissions allowance trading system was created in 2006 and officially began trading in 2008. The MCeX is a joint venture between the Montreal Exchange, part of the **TMX Group** and the Chicago Climate Exchange.

In Brazil, **BM&FBOVESPA** also operates a carbon market launched in 2005.

In Africa, the **JSE** has a carbon-related instrument known as the carbon credit note, and was the first listed carbon derivative instrument in the world at the time in 2005. It has researched the opportunity for a local market for spot trading as well, but there is limited supply and not much 'natural' local demand as a result of the absence of regulation limiting greenhouse gas emissions.

Question 7: Is your stock exchange involved in public/private mechanisms for development aid or community assistance?



Source: Responsible Research 2010

Stock exchanges developed a wide range of public/private mechanisms for development aid and community assistance, including conferences, staff training, community programs, support of charitable causes, support of education and research.

The **Tokyo Stock Exchange** provides staff training programs for stock exchanges in developing countries through the Japan International Cooperation Agency.

The **National Stock Exchange of India** conducted a Capital Markets Forum on Responsible Investment in India in September 2009.

The **Deutsche Börse** Group's corporate citizenship activities focus on community relations and social issues. It is aiming to become a good corporate citizen by concentrating on education and research (targeted support to projects from primary school through to university and advanced studies), culture (supporting various institutions and projects that deal with or present fine arts and music), as well as social projects, through the personal involvement of their employees at their locations, or financially through donations.

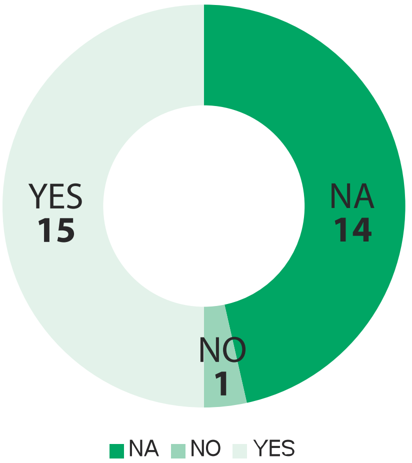
The **Istanbul Stock Exchange** adopted an eight-year compulsory primary education project, which started in Turkey back in 1997, which it continues to finance through the ISE Education Fund. As of September 2009, the program constructed 376 schools serving approximately 200,000 students.

The **Taiwan Stock Exchange** has cooperated with Taiwan Business Council for Sustainable Development (BCSD-Taiwan) and the Taiwan CSR Institute to draft CSR best practice principles for listed companies. After promulgation of the CSR principles in February 2010, it worked with BCSD-Taiwan and the Securities and Futures Institute, and launched promotions in the third quarter. TWSE has been emphasizing on promoting corporate governance for a decade, and are going to help listing companies to raise ESG awareness.

The **Korea Exchange** contributes to the Korea Corporate Governance Service.

The **Stock Exchange of Thailand** established the Corporate Social Responsibility Institute (CSRI) to encourage the business sector to be more involved with society and support sustained business growth.

Question 8: Is your stock exchange currently considering more initiatives on sustainability issues?



Source: Responsible Research 2010

Stock exchanges are constantly monitoring developments in the sustainability space locally and globally and exploring new opportunities. Nearly all of the respondents (15 out of 16) are considering new initiatives on sustainability issues. Some of them are in discussion with local regulators.

The **HKEx** plans to introduce an ESG Code for listed issuers, while the **Korea Exchange** is planning to provide CSR guidelines for listed companies and the **National Stock Exchange of India** proposes to initiate awareness programmes for listed companies on ESG reporting.

Currently, listed companies on the **Bolsa Mexicana de Valores** fill in the 'Best Corporate Practices' questionnaire; a new section on sustainability will be added to this questionnaire.

TSX is compiling an educational program for issuers on understanding ESG and enhanced disclosure.

The **BM&FBOVESPA** plans to launch the new 'Carbon Efficient Index' next November, develop a relationship program with listed companies as well as traders based on sustainability issues, include ESG rules in PQO – Operational Procedure Manual ("Requirements for Traders and Participants") and create listing requirements regarding the sustainability report.

The **Deutsche Börse Group** plans to develop further sustainable indices to encourage best practices amongst companies, incorporate environmental, social and governance performance disclosure requirements into reporting tools, and increase transparency in the non-profit sector in Germany through the establishment of a "social market place" where social projects that have been positively evaluated are listed.

The **Taiwan Stock Exchange** has proposed to the regulator a draft of the anti-bribery/anti-corruption guideline, which is currently under discussion.

The **Singapore Stock Exchange** issued, in August 2010, a "Policy Statement on Sustainability Reporting" and proposed a Guide for its listed companies to use for their sustainability reporting. Some of the stated principles include;

- that the guidelines will be voluntary
- there is a view to future regulation
- company boards are responsible for matters of sustainability
- ESG issues are important for the long-term performance of a company
- global industry standards driving sector materiality of reporting is key

The **Bursa Malaysia** plans to introduce a sustainability guide for directors on embedding sustainability within their organisation and improve sustainability reporting as well as possible enhancement of sustainability disclosures. It wants to create a sustainability portal for Malaysian public listed companies on sustainability related matters. It is working with strategic partners such as CSR Asia and Conservation International to create some sustainability standards for Bursa Malaysia and companies. These will include looking into ecological footprints, resource management, measures and targets (energy, water, waste, etc.) It wants to improve triple bottom line reporting standards and to encourage independent stand-alone sustainability reports for Bursa Malaysia and companies. In order to qualify to become constituents of international sustainability indices such as the Dow Jones Sustainability Indices, it seeks to improve sustainability practices at Bursa Malaysia and companies.

Question 9: Does your country's financial markets regulator have mandatory requirements for listing companies to disclose sustainability practices?

Only three stock exchanges chose to respond to this question:

In **Taiwan, Province of China**, the regulator has required all public companies, including listing companies, to disclose the state of the company's performance of CSR in the annual report and prospectus, including systems and measures that the company has adopted with respect to environmental protection, community participation, contribution to society, service to society, social and public interests, consumer rights and interests, human rights, safety and health, and other corporate social responsibilities and activities, and the state of implementation. Moreover, all public companies, including listing companies, are required to disclose disbursements for environmental protection and labour relations in the prospectus.

In **Malaysia**, with effect from 31 December 2007, listed issuers are required to disclose their CSR activities or practices (and of their subsidiaries) and if there are none, a statement to that effect under the Listing Requirements.

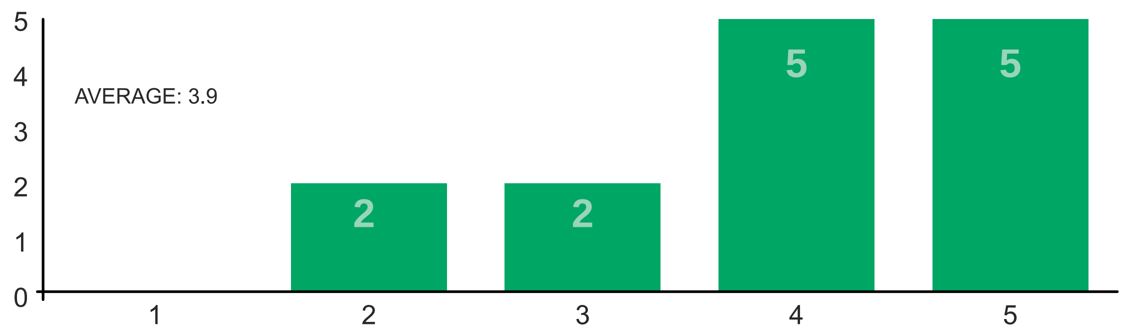
In **Thailand**, listed companies on the SET are required to demonstrate, in their annual registration statement (Form 56-1) and annual reports, how they comply with the exchange's corporate governance principles.

Question 10: Have any companies chosen not to list on your exchange because of the sustainability requirements?

No responses were provided on this issue.

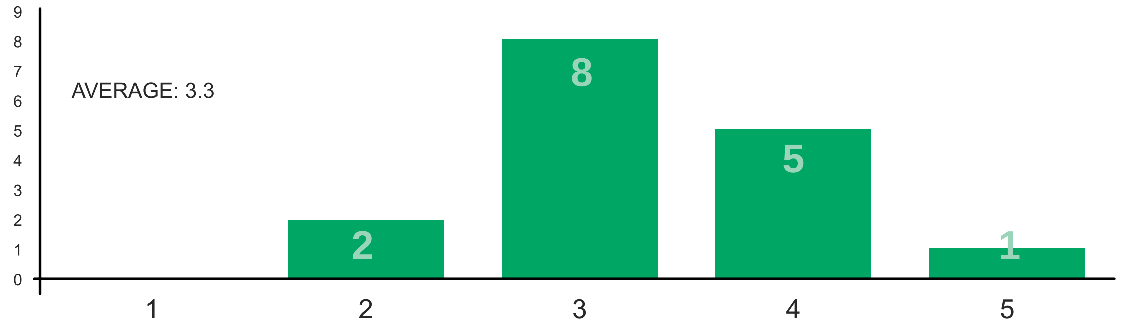
Question 11: On a scale of 1-5, how much do you agree with the following statements?

A. Stock exchanges have a responsibility to encourage greater corporate responsibility on sustainability issues. (1=strongly disagree; 2=disagree; 3=neutral; 4=agree; 5=strongly agree)



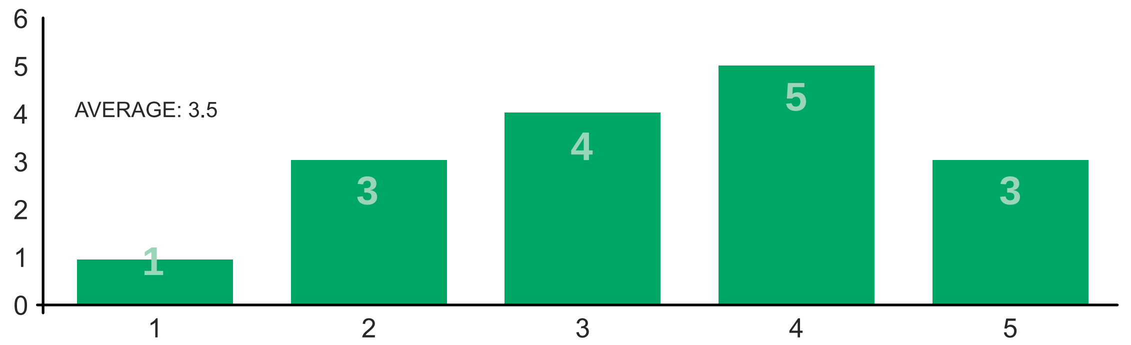
Source: Responsible Research 2010

B. Having very strong sustainability requirements of listed companies makes good business sense for a stock exchange (1=strongly disagree; 2=disagree; 3=neutral; 4=agree; 5=strongly agree)



Source: Responsible Research 2010

C. Regulators should not compel stock exchanges to make listed companies disclose their sustainability practices (i.e. voluntary initiatives are adequate). (1=strongly disagree; 2=disagree; 3=neutral; 4=agree; 5=strongly agree)



Source: Responsible Research 2010

ESG AND STOCK EXCHANGES: THE WAY FORWARD

Taking into account the landscape of current and proposed stock exchange initiatives, the next task is to assess the obstacles and opportunities facing global stock exchanges in promoting sustainability among listed enterprises. This discussion is underpinned by the following four key considerations:

- How can stock exchanges be part of the solution for global sustainability?
- Considering the exchanges' existing scope as influential, regulated platforms for buyers and sellers to meet, could they also adopt a role as drivers of more sustainable business practices?
- What barriers limit the ability of financial markets to adopt the sustainability agenda?
- What are the entrenched stakeholder interests that affect the trade-off between sustainability and business-as-usual?

To understand the challenges, stock exchange executives, exchange listing committee members, fund and investment managers, equity research analysts, securities regulators and corporate governance experts were interviewed for this report, in addition to researching publicly available information. Further, additional stakeholders were identified and engaged, such as large global accounting firms, sovereign wealth funds, investor groups, broker/dealers, legislators, and the public.

Categorizing ESG

With its three pillars of environment, social and governance, corporate sustainability practices are relatively straightforward to categorize. Quantitative measurement is proving trickier but, as shown in Figure 1, indicators can be isolated to provide more information on management's leadership in sustainability issues.

Figure 1. Selection of possible quantifiable indicators of corporate ESG practices

ENVIRONMENT	SOCIAL	GOVERNANCE
Energy efficiency	Employee compensation	Board independence
Carbon emissions	Benefits	Board attendance
GHG emissions	Staff turnover	Directors and management compensation
Biodiversity targets	Employee health	Shareholder voting
Water usage	Safety practices and targets	Litigation risks
Natural resource use	Training spend and coverage	
Recycling practices	Diversity and targets	
Waste to incineration		

Over the past decade, companies have been disclosing more and more information about their ESG practices. While some companies are providing additional detail on their ecological and social practices and impacts, there has been a faster acceptance of the need for disclosure on corporate governance indicators. This is partially rooted in public outcries to financial shocks, such as the Enron and Worldcom accounting scandals and details of ballooning executive compensation following the bailout of financial and insurance institutions in 2008-2009. Additionally, as a result of regulatory requirements and jurisdictional oversight, corporate management has been detailing good governance initiatives for a longer period than environmental or social activities.

It is important to note that this report addresses ESG practices by all companies. Just because a firm is in the sustainable space (e.g. solar panel manufacture or water membrane technology), does not automatically make it 'sustainable'. Rather, the quality of management's understanding and leadership on sustainability issues should be the center of discussion on how stock exchanges can improve corporate ESG practices.

Stock Exchanges and Sustainable Reporting 'Redundancy'

Stock exchanges globally have been implementing initiatives related to sustainability, and such efforts are increasing yearly. Of the world's largest stock exchanges by market capitalization, all have some type of sustainability related initiative, including providing sustainability guidelines for listing companies or launching sustainability indices. These initiatives are discussed in greater detail in the next section.

> **"Investors and companies will need to help determine the quality and materiality the quality and the materiality of the ESG reporting required…**
>
> **Stock exchanges should be able to determine ESG measurements by industry across different industries."**

Because of a heightened emphasis on sustainability disclosure, companies that seek to list on exchanges often provide several hundreds of pages of information on their ESG practices within their listing documents for the exchange and potential investors. Several companies have produced volumes of separate sustainability reporting and stock exchange listing committees are often inundated with sustainability data.

The problems with this are several: companies have tended to self-select the data they choose to disclose and much of it lacks materiality to investors. Information is often packaged in sleek glossy brochures that ignore the requirement for more specific quantitative assessments and less marketing 'spin', which has frequently won over eco-conscious consumers but is seen as 'green wash' by seasoned investment professionals.

If stock exchanges are to require companies to address long-term sustainability issues, investors and companies will need to help determine the quality and materiality of the ESG reporting required. The requirement for this data is predicated on the risks caused by poor sustainability performance and the opportunities resulting from good understanding and management of ESG risks within a specific business model.

Second, stock exchanges should be able to determine differing ESG measurements required across different industries. Because a company may have impeccable sustainability credentials, from ecological initiatives and employee benefits to leadership focus on broad ESG issues, does not mean that it is immune to specific industry and economic risks that can adversely affect the firm and its ESG credentials.

Accidents do happen...

Source: The Commons 2010

Moves Towards Better ESG Reporting

Important steps are being taken by various organizations globally to address the quantification and quality of ESG reporting to investors.

Of particular note is the significant and laudable effort, 'KPIs for ESG', a reporting framework in development since 2005 by the Society of Investment Professionals in Germany (DVFA) and the European Federation of Financial Analysts Societies (EFFAS).[3] The most recent Version 3.0 exposure draft was released in May 2010, with a final version to be published by the end of the year. The framework integrates ESG data into corporate performance reporting and applies clear, quantitative measurements to that reporting. Notably, it makes a clear distinction between general ESG topics and sector-specific ESG areas, and suggests Key Performance Indicators (KPIs), the actual line item to be reported. In the framework, ten 'general' ESG factors are identified which should be reported by all corporations. Additionally, ten sectors are determined which should be reported on issues relevant to that industry. The framework then develops KPIs for 114 subsectors following the Dow Jones Industry Classification Benchmark.

Investment banks, whilst frequently conflicted in terms of delivering investor-relevant information, are working towards constructing innovative methodologies to determine material sustainability information for investors. For example, analysts at Goldman Sachs have developed GS Sustain, which provides 'an objective, quantifiable framework linking the impacts of structural trends in the global economy, society and government on global industries to investment conclusions on a sector-by-sector basis.'[4] BNP Paribas is also noteworthy in its attempts to define materiality of 'non-financial risk' by sector.

Quality independent research in the ESG sector, however, will continue to be in demand as investors seek more transparency on issues delivering investment risk. Investment data providers have begun to dramatically ramp up their ESG data offerings. Thomson Reuters acquired ESG data providers ASSET4 and Point Carbon, and MSCI recently took over RiskMetrics, whose assets also include the former Innovest and KLD research organizations. Bloomberg recently bought New Energy Finance, an environmental data provider, and is building a platform to formalize the data delivery, standardized by industry and product lines. However, Bloomberg ESG data covers only around 15 percent of the almost 20,000 companies examined globally and few have published material and consistent ESG data. Emerging market data is poor and even developed exchange companies lack sufficiently rigorous or standardized data to be useful in comparable analyses.

With more robust definitions and quantitative measurements of ESG, stock exchanges should have additional clarity in pursuing enhanced sustainability initiatives by their listed companies. However, as seen in the following section, additional challenges remain.

SUSTAINABLE STOCK EXCHANGES: INTERNAL ISSUES AND INITIATIVES

All stock exchanges perform due diligence of companies prior to listing, theoretically shielding investors from the worst corporate governance abuses. Over the past decade however, the importance of good sustainability practices has increased at stock exchanges. Many have been increasing their efforts in promoting good sustainability practices in their listed companies, notably through guidelines on voluntary sustainability practices and reporting and sustainable investment indices. This section considers the success of these initiatives and the stock exchange governance issues that affect how sustainability requirements can be implemented.

i. Guidelines on Sustainability Practices and Reporting

Stock exchange sustainability guidelines reflect ESG imperatives that are globally aligned but locally relevant, and direct companies to enact specific best practices in their businesses. By practicing and disclosing on select sustainability initiatives, companies can come closer to meeting or exceeding investors' expectations for good governance, sound ethical and strong environmental practices whilst reducing risk in their business models and enhancing its chances of long term viability. Additionally, a company has a greater chance of being included in an exchange's sustainability index that can make it a more attractive investment proposition and thus theoretically command a premium valuation rating.

> **"Stock exchange sustainability guidelines reflect ESG imperatives that are globally aligned but locally relevant."**

Several ESG guidelines developed from earlier stock exchange efforts to improve corporate CSR practices, and some of these CSR guidelines were eventually mandated. For example, Bursa Malaysia introduced its CSR Framework in 2006, supported annual awards for CSR reporting, and published a detailed report on companies' progress. Since the end of 2007, listed companies are required to disclose their CSR activities or practices (and of their subsidiaries) and if there are none, provide a statement to that effect under the exchange's listing requirements.

Sustainability guidelines issued by stock exchanges are primarily voluntary at this stage, although a few are beginning to consider or implement some mandatory requirements. As noted in the survey in Question 2, the Johannesburg Stock Exchange (JSE) has made notable efforts in this regard. The Singapore stock exchange also recently issued a 'Policy Statement on Sustainable Reporting' and proposed guidelines for its listed companies to use in formulating their sustainability reporting. It further stated that it is "of the view that as more companies become inspired to adopt sustainability reporting, it will be natural to take the next step on guidelines and standards leading to rules."[5]

Because of their ability to directly influence and monitor the operations and strategy of companies seeking to access the equity markets, stock exchange guidelines are an effective, efficient way to improve corporate sustainability performance within a specific jurisdiction if properly monitored and enforced. The Global Reporting Initiative (GRI), a network-based organization which has developed the most widely used framework for sustainability reporting, has made notable efforts in prompting firms to issue sustainability reports based on its 'G3' guidelines. However, firms following GRI reporting still comprise a minority of all listed companies. Similarly, the regulatory practice of 'comply or explain' – which requires companies to disclose the extent of their compliance to corporate governance codes or explain deviations from them – requires institutional investors, investment banks, analysts and compliance officers to play an active, dedicated role in monitoring ESG practices by companies.

ii. Sustainability Indices

Sustainability-related investment indices, also referred to as socially responsible investment indices (SRIIs), are benchmarking products offered by exchanges for investors seeking exposure to sustainable industries and companies. There is a growing awareness of the value of SRIIs as Question 5 of our survey revealed with 15 of 16 respondents noting that their exchanges have already launched, or have plans to launch, a sustainability related investment index. SRIIs tend to fall in one of four categories:

• Broad-based: constituents from all sectors, meet certain ESG criteria (e.g. Dow Jones Sustainability Index)
• Sector-based: constituents from one sector, meet certain ESG criteria (e.g. sustainable real estate or finance)
• Sustainable Sector-based – constituents from a sustainable sector, do not necessarily meet minimum ESG criteria (e.g. 'green', clean tech, renewable)
• Sustainable Issue-based: non-sector specific firms that focus on an sustainability theme (e.g. water scarcity, diversity, good governance)

"Many SRIIs are at a crude level of development and their sophistication will need to increase over time."

These indexes can have a significant impact on the business practices of firms that look to be included as well as well as on investors seeking robust, well-scrutinized exposure to ESG issues or industries. For instance, of the 2,608 companies invited to apply for the Dow Jones Sustainability Index (DJSI) in 2009, only 319 qualified for listing after a thorough analysis of sustainability practices.

That said, many SRIIs are at a crude level of development and their sophistication will need to increase over time. Investors, advisory panels and other stakeholders can help facilitate that development by providing independent feedback.

iii. Elite Boards, Carbon Markets, and Community Development

Some exchanges are also pursuing a separate board that lists companies that subscribe to voluntary or mandated corporate governance measures. Perhaps the most well known example is the Novo Mercado in the BM&FBOVESPA. Launched in 2000, Novo Mercado helped to transform the Brazilian market, with companies committing to enhanced criteria for corporate governance, constituting 58 percent of overall trading volume and market

capitalization by the end of 2006.[6] The Philippines Stock Exchange looks set to launch a similar entity, the Maharlika Board, later this year. The Maharlika Board (meaning 'elite' or 'noble' in Tagalog) seeks to distinguish and provide incentives to listed companies that voluntarily elevate their corporate governance practices to international standards.

Although not directly related to sustainable listing requirements, several exchanges support the development of carbon trading markets, and see this as a sign of their commitment to sustainability issues. Even though not yet enacted in law, stock exchanges are preparing for possible emissions trading schemes. For example, the Tokyo Stock Exchange (TSE) set up the TSE Carbon Market Study Group with to examine practical issues required to establish a carbon market exchange. As previously noted, together with the Tokyo Commodity Exchange, it created a joint-company to prepare for the establishment of an emissions trading exchange.

Similarly, several stock exchanges engage in community outreach activities or public-private partnerships to foster greater development. One example from Question 7 in the survey is the eight-year 'Contribution to National Education Project' adopted and financed by the Istanbul Stock Exchange (ISE). The initial fund, which reached US$1 billion, was managed by the ISE and used to construct 376 schools, offering over 200,000 students modern, high-quality educational facilities.

CONSIDERATIONS FOR MANDATORY SUSTAINABILITY PRACTICES AND REPORTING

As mentioned above, most sustainability listing guidelines are voluntary but being more widely enacted, and SRIIs and enhanced corporate governance-focused boards of exchanges are also becoming more commonplace. A logical next step is to ask when and how stock exchanges might enact regulations that require companies to provide sustainability reporting and align incentives with long-term, sustainable growth. To answer this question, it is necessary to consider some of the structural concerns that currently inhibit exchanges from adopting such requirements.

iv. Demutualization

The past two decades have seen a transition by global stock exchanges towards demutualization – converting from non-profit, member-owned organizations to for-profit, investor-owned corporations. Many of these exchanges have also become publicly traded companies themselves, some of whom are multinational companies owning multiple exchanges. NYSE Euronext, Inc., for example, is a Euro-American company that operates multiple securities exchanges, most notably Euronext, New York Stock Exchange (NYSE), and NYSE Arca (formerly known as ArcaEx). NYSE Group also operates NYSE Regulation, a non-profit Self Regulatory Organization that oversees securities firms and companies listed on the NYSE and NYSE Arca.

As a result of these organizational changes, previous sources of revenue have diminished: exchanges must keep listing fees competitive in order not to lose out to other exchanges, have to replace membership fees with fees generated by trading income and must also contend with technological innovations that have reduced the importance of their proprietary data provisions. With fewer sources of revenue, exchanges may feel that the costs of imposing sustainability criteria and enhanced reporting (and to devote additional resources for enforcement) may be too crippling.

v. Competition

Rather than list on a local stock exchange, companies now have a greater choice of global bourses to list on. Companies may be reluctant to undergo an IPO due to the costly changes to their business operations and reporting practices that enforced sustainability practices may require. As a result, some companies may consider listing on exchanges where sustainability requirements are less strict or, alternatively, revert to private ownership or continue to rely exclusively on bank lending and the bond market. This could arguably have the effect of reducing access to capital for small, emerging companies feasibly curtailing entrepreneurship. The actions of listed companies following the implementation of the Sarbanes-Oxley Act in the United States provides a glimpse into the potential impacts of increased due diligence and regulations. The legislation introduced higher standards for all US public company boards, management and public accounting firms.

Effects of the implementation of Sarbanes Oxley on US equity markets

The US Securities and Exchange Commission implemented the Sarbanes-Oxley Act (SOX) in 2002 following a series of highly publicized frauds. Many companies considering an IPO determined that the costs of complying with SOX outweighed its benefits, negatively impacting the NYSE In 2006, an influential, bipartisan research group, the Committee on Capital Markets Regulation reviewed the competitiveness of US capital markets following SOX and found the following statistics regarding the introduction of SOX[7] :

• In 2000, around 50 percent of worldwide initial public offerings by value was raised in the United States, falling to five percent in 2005

• The US share of total equity capital raised in the world's top 10 markets was 41 percent in 1995, falling to about 28 percent in 2006

• The listing premiums on US stock exchanges declined substantially

• Since 2003, private equity fundraising in the United States exceeded net flows into mutual funds, and private transactions have accounted for more than a quarter of publicly announced takeovers. This can signal that small firms preferred to be bought by private equity firms as an exit strategy rather than have an IPO that would burden them with SOX implementation costs

Although the growth of global capital markets in Europe and Asia also contributed to these post-SOX trends, the Committee stated, "in the shift of regulatory intensity, balance has been lost to the competitive disadvantage of US financial markets" and advocated against a "regulatory race to the bottom."

"While being mindful of enacting requirements that may be viewed as too stringent or inflexible, requiring companies to adopt sustainability measures can improve the competitiveness of an exchange."

While being mindful that requirements may initially be viewed as too stringent or inflexible, exchanges that require companies to adopt sustainability measures can nonetheless improve their competitiveness. Indeed, the enhanced international image and reputational benefits can attract companies seeking a higher 'stamp of approval.' Allowing only firms with the strongest ESG credentials also improves risk management, and insures that the listed companies and their investors will be less likely to be subject to the risks from poor governance issues that can threaten the reputation of the exchange.

Sustainability requirements can also allow for the creation of new products and services, such as ESG advisory work, for exchanges and sponsors of companies seeking to list on the exchange. More revenue can also be created through the better development and possible licensing of SRIIs. Additionally, a potential proposal can even include subsidising listing and trading fees for companies that adopt improved sustainability practices.

For exchanges in developing countries, establishing robust sustainability requirements for listed companies establishes a high level of quality, diligence and stability in the eyes of global investors while serving as a role model for other developing exchanges.

vi. Conflicting Interests

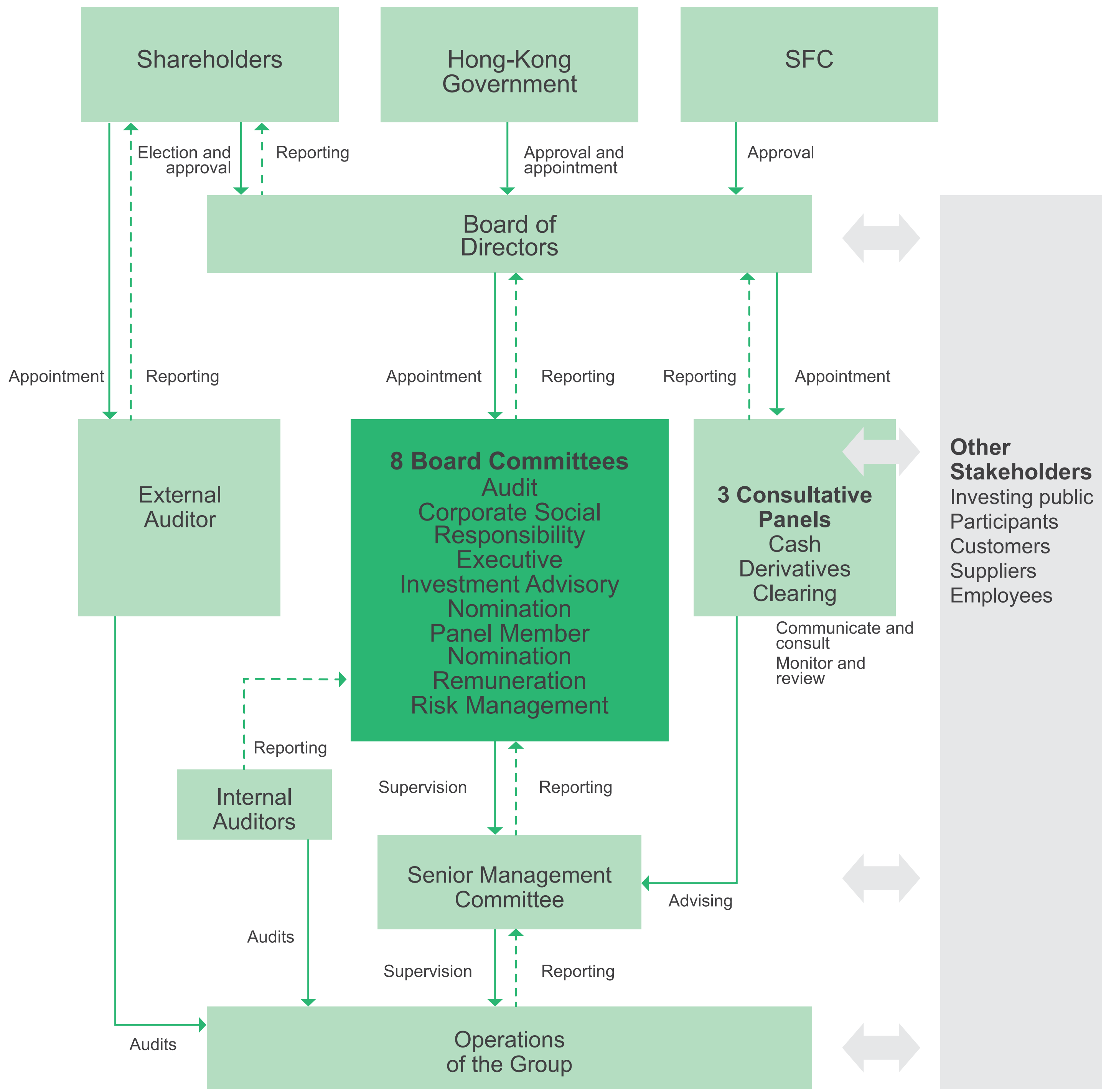
Despite the trend towards demutualization, several stock exchanges continue to be influenced by their largest shareholders, which are often government ministries or other sovereign institutions. One example is the Shanghai Stock Exchange, whose leaders are directly appointed by the country's regulator, the Chinese Securities Regulatory Commission. Even exchanges that are not quasi-state institutions can be beholden to development and national security policies of their countries.

At the same time, the not-for-profit structure of several stock exchanges can encourage a longer-term perspective less focused on generating trading volumes for revenue. Indeed, the counter-productive incentive structures of demutualized stock exchanges creates another type of conflict of interest, as they are less likely to institute policies which would lessen the focus on achieving short-term profits (and resultant management bonuses).

vii. Committees

Many exchanges have made notable efforts to develop a robust corporate governance structure that addresses some of these cultural legacy issues while providing a laudable framework that defines specific roles for committees and departments while attempting to avoid conflicts of interest. The Listing Committee of the Hong Kong Stock Exchange (HKEx) for example, operates independently with no apparent influence from the board. A regulatory function is assumed by the Listing Division, which is functionally separated from the income-generating business operations of HKEx.[8] The complete governance structure of HKEx is detailed in Figure 2.

Figure 2. Corporate Governance Structure of the Hong Kong Stock Exchange



Source: www.hkex.com.hk

Other stock exchanges continue to make efforts to improve their internal corporate governance. However, the ownership structures and fiduciary duties of stock exchange boards are designed to maximize returns to their own shareholders, with no mandates to improve ESG practices by listed companies. For stock exchanges to consider requiring sustainability reporting, a close examination and possible reconfiguration of their board and committee missions may be needed, focusing on the importance of long-term efforts to enhance profitability.

"A close examination and possible reconfiguration of the board and committee missions and roles may be needed, focusing on the importance of long-term efforts to enhance profitability"

viii. Relationship with Regulators

Lastly, the different regulatory regimes influence how stock exchanges address sustainability practices. In the 'regulatory spaghetti' of the United States, for instance, the Securities and Exchange Commission oversees the stock exchanges although other agencies can regulate listed companies depending on their business classification (prior to the financial crisis, AIG was notoriously regulated by the lesser known Office of Thrift Supervision). Additionally, the prescriptive, rules-based approach of the US regulatory system differs from the principles-based approaches elsewhere. As such, the 'comply or explain' principle on sustainability could not easily be enacted in the United States.

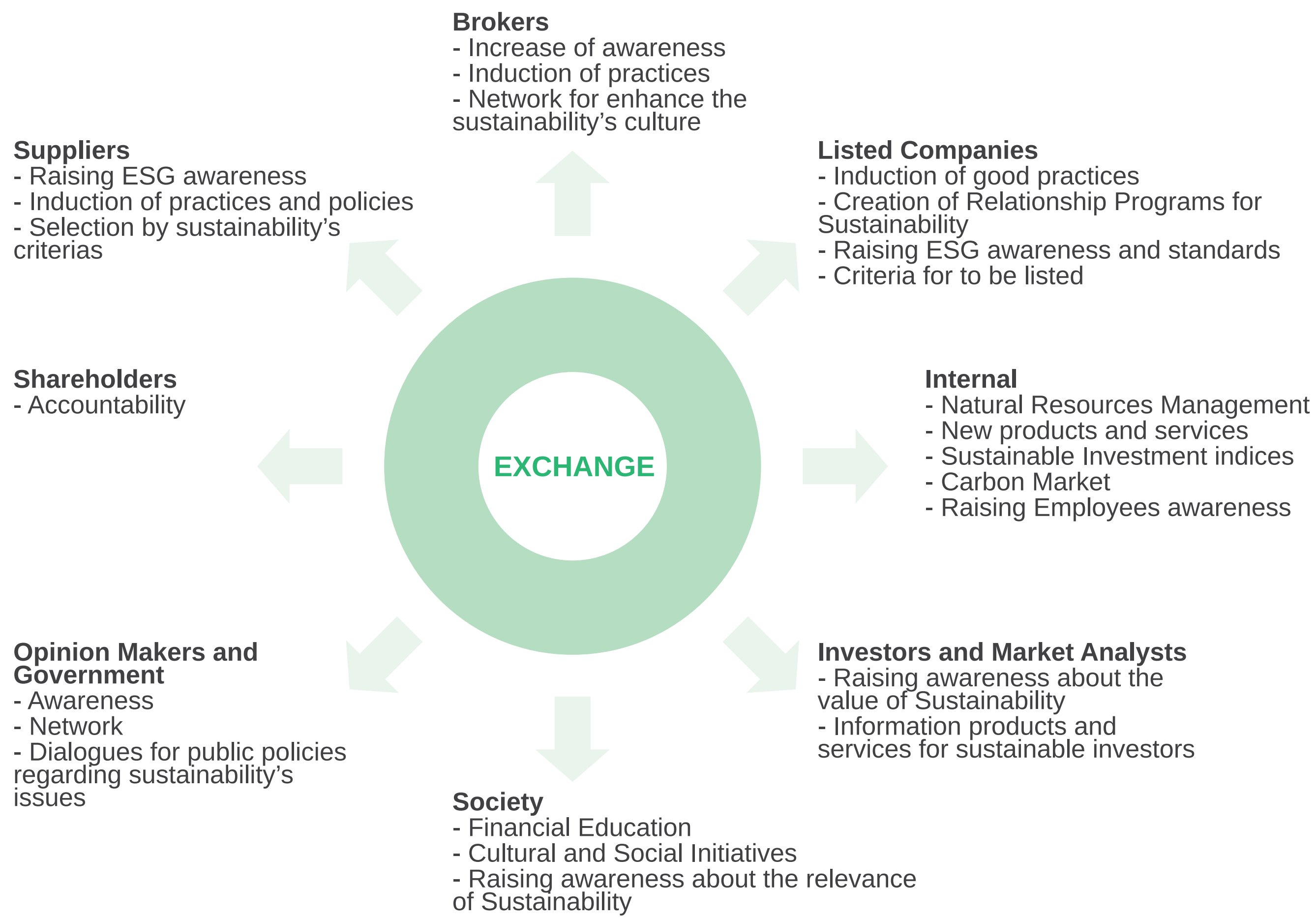
In many instances, it is also uncertain who is more dominant: the exchange or the regulator. The Kuwaiti Stock Exchange was the Middle East's first bourse, established in the 1970's but did not have a market regulator until this year. Even recently in Hong Kong, after a controversial IPO for the Russian company Rusal, the world's largest aluminum producer, was approved by the HKEx, the local Securities and Futures Commission stepped in with 'unprecedented' restrictions for the offering including minimum take-up size for the IPO to reduce its appeal to retail investors.[9]

To require companies to improve their sustainability practices, exchanges are urged to enhance their dialogue and partnership with exchange regulators. In speaking with a united voice, they can more forcefully impress upon businesses as well as investors the value of effective ESG policies. Together, they can also work towards improved disclosure statements to assist investors with analysis and monitoring.

SUSTAINABLE STOCK EXCHANGES: EXTERNAL ISSUES AND INITIATIVES

Stock exchanges do not just work directly with listed companies to improve sustainability practices. They also influence other stakeholders to raise ESG awareness, as depicted in Figure 3 below.

Figure 3. The Potential Role of Stock Exchanges with Different Stakeholders



Source: BM&FBOVESPA

Together, these stakeholders impact whether and how an exchange can influence enhanced ESG corporate practices. Governments can pass financial legislation, the public can demand greater consumer protection, and so on. However, as noted in the prior section, one of an exchange's most pressing needs is to understand the business case for adopting long-term sustainability practices. To do so, it must consider the behavior of the market itself in communicating the value of long-term ESG initiatives.

i. Investors and 'Short-termism'

Investors are becoming powerful and vocal supporters of improved ESG reporting. Of the 785 signatories to the UN Principles for Responsible Investment, 208 are asset owners and 426 are investment managers.[10] Earlier in 2010, a global coalition of investors, representing 13 countries and managing over US$2 trillion in assets, joined to call for improved corporate reporting of ESG activities by writing to 86 major companies urging them to honour the reporting requirements of the UN Global Compact, the world's biggest voluntary corporate responsibility initiative.[11]

On the other hand, global assets under management in 2009 totaled over US$110 trillion, suggesting a much larger number of investors who may not be fully attuned to sustainability issues.[12] More to the point, prior to the global financial crisis, investors focused on 'short-term' market returns, with these investment strategies tending to penalize companies engaged in efforts that take longer to bear fruit, such as sustainability initiatives. It remains to be seen whether investors will realize the value of actively integrating sustainability considerations into their investment decisions as global markets continue to emerge from the crisis.

Statistics about market short-termism are stark[13]

- The average mutual fund holding period for investments in equities has shrunk to less than a year
- A recent Mercer study of almost 1,000 equity fund managers found that from 2006 to 2009, two-thirds of the managers exceeded their target turnover rates, with an average annual turnover rate of 72 percent
- A study of 400 public company financial executives revealed that the majority would not initiate a positive net present value project if it negatively affected the next quarter's earnings

In such an environment, it is difficult for public companies to implement sustainability initiatives that are generally time-consuming and costly up-front. Exchanges must know that in their efforts to make companies consider how to align incentives with long-term, sustainable growth, the marketplace as it exists today is not their friend. Greater education and outreach to investors, as well as appeals to policymakers, will be needed to eradicate the worst of short-termism.

"It is in a stock exchange's better interests to promote a long-term focus by businesses and investors in order to ensure continued strength and stability in the capital markets."

The Business and Society Program at the Aspen Institute launched a Corporate Strategies Values Group that has made recommendations on this issue. Including members such as Warren Buffet and James E. Rogers, Chairman and CEO of Duke Energy, it is 'focused on promoting changes in corporate and investment practice, as well as in public policy, to support long-term orientation in business decision making and investing.'[14] Other groups and policymakers are also raising their voices on this matter. A survey conducted by Accenture and the UN Global Compact in June 2010 found that 86 percent of company CEOs wanted investors to more accurately value sustainability in their long-term investments.[15]

As mentioned, for-profit, demutualized exchanges are dependent on trading commissions as a significant source of revenue, and developments such as high-frequency trading (using computer algorithms to generate thousands of trades a day) are contributing to their healthy bottom lines. NYSE Euronext, for example, made profits of approximately US$220 million in net profits on revenues of US$4.7 billion in 2009.

This structural short-termism has encouraged more cavalier risk-taking, especially by fund managers, brokers and analysts whose pay packages have been linked to short-term performance and trading volumes, leading to an unjustifiable focus on quick gains over long-term value. This consequently creates market instability as revealed in the 2008 global financial crisis. For these reasons, it is in a stock exchange's better interests to promote a long-term focus by businesses and investors in order to ensure continued strength and stability in the capital markets.

"Integrated reporting reflects a company's performance within a comprehensive business strategy that embeds sustainability practices throughout the organization."

ii. Reporting Standards

Many firms themselves usually do not provide that data in a way that facilitates comprehensive analysis. Even companies that do provide insightful sustainability reporting sometimes do so months after a firm's annual financial report. This effectively underscores that ESG-indicators are somehow less important in forward-looking investment analysis. Moreover, company reporting is not easily comparable across countries, raising the issue of difficulty in assessing the results of a global firm's long-term sustainability efforts.

Efforts are now being made towards internationally integrated reporting, which aims to offer investors and regulators a single report addressing a company's overall performance on economic factors as well as ESG. It is important to highlight that integrating reporting does not mean inserting a company's sustainability report onto its current financial information in an annual report. Rather it reflects a company's performance aligned to a comprehensive business strategy that embeds sustainability practices throughout the organization.

Currently, only three percent of Fortune 250 companies utilize integrated reporting.[16] However, more groups are actively engaging in its creation and standardization. In August 2010, the International Integrated Reporting Committee (IIRC) was officially launched, comprising corporate, accounting, securities, regulatory, NGO, IGO and standard-setting sectors. Importantly, its supporters include the International Accounting Standards Board (IASB), the US Financial Accounting Standards Board (FASB) and the International Organization of Securities Commissions (IOSCO). The IIRC aims to publish a framework for a global integrated reporting model that conveys a firm's strategic objectives, governance and business model, integrates both financial and non-financial information, and is comparable across borders. The intent is to present the framework to the G20 in November 2011 in France.

iii. International Governance and Convening Forums

Stock exchanges have natural allies in the several international groups and social investment forums that are focused on sustainability issues and the capital markets. Such organizations and dialogues can help stock exchanges consider how to best implement requirements addressing long-term sustainability practices, and advocate for best corporate ESG practices to policymakers and other key stakeholders.

For example, since 2009 UNCTAD, the UN Global Compact and the PRI, have organized a dialogue on sustainable stock exchanges. The dialogue joins together regulators, exchange representatives and investors, and looks at how their joint efforts can enhance the ESG disclosure and listed company performance.

Moreover, the PRI, with over 800 signatories representing more than US$20 trillion in assets under management, is the largest initiative focused on mainstreaming the integration of ESG issues within investment decision-making. Signing on as professional service partner, stock exchanges can commit to working towards implementing the six PRI principles to the best of their ability and collaborating with the investors on the ESG agenda. The exchange signatories now hold conference calls every other month as part of their informal working group.

Groups such as the Social Investment Forum (SIF) in the United States, the UK Sustainable Investment and Finance Association (UKSIF) and the European Sustainable Investment Forum (EUROSIF) bring together investment management and advisory firms, mutual fund companies, research firms, financial advisors, broker-dealers, banks, pension funds, foundations and other asset owners. Their missions are centered on addressing sustainability through the financial markets.

iv. Social Stock Exchanges

Recently, social stock exchanges or 'impact exchanges' are emerging as a means in which social enterprises can access the capital through a regulated trading platform. Unlike social business platforms, which primarily help to channel philanthropic or charitable giving to not-for-profit entities, these exchanges will facilitate actual market investments in a regulated environment to general both economic and ESG returns.

One example is the UK-based Social Stock Exchange (SSE), which aims to combine profitable trading with social or environmental missions, and include healthcare, first world development projects, clean technologies and help for disadvantaged communities. Its mission is to lower the cost of capital-raising for companies with a social purpose. The exchange will function like any other, will be regulated and could list up to 300 companies within five years.

"Social stock exchanges are natural potential partners or advisors for global exchanges as they look to implement new initiatives and requirements regarding corporate sustainability practices"

Another example is the Impact Investment Exchange (IIX), a regulated stock exchange that is set to help companies in Asia with a social mission raise capital. IIX will list only fungible, tradable securities – with an attendant secondary market – as authorized and regulated by the financial regulator of its selected jurisdiction, likely to be Singapore.

Some stock exchanges have or are considering integrating social business platforms. For example, BM&FBOVESPA facilitates grants from philanthropists to not-for-profit entities in a non-regulated environment, and Deutsche Börse is working to increase transparency in the non-profit sector by considering establishing a social market place where social projects that have been positively evaluated are listed.

In contrast, social stock exchanges function like regulated stock exchanges. As a result, they are natural potential partners or advisors for global exchanges as they look to implement new initiatives and requirements regarding corporate sustainability practices. They also understand the practical needs of investors, and can help in the broader education of market participants of the value and profitability of sustainable investments.

By sharing best practices, stock exchanges gain even more insight and leverage in accomplishing the task of requiring listed companies to provide sustainability reporting and considering how to align incentives with long term, sustainable growth. The main hurdles in the development of these exchanges is funding to enable the preliminary research and development to take place, defining the minimum listing criteria and social returns and the listing fees and professional pre-listing expenses which are likely to be prohibitively high for most companies seeking to list.

SUGGESTIONS FOR INTEGRATING SUSTAINABILITY AT EXCHANGES

As demonstrated, there are real obstacles and real opportunities facing stock exchanges in requiring companies to develop long-term sustainability practices. Current guidelines, reporting standards, market behavior, and relationships with investors, regulators, advocacy groups and other exchanges, all affect how an exchange approaches enhanced corporate ESG practices. What follows are some practical suggestions for stock exchanges to achieve this goal.

1. Create a Sustainability Committee at each stock exchange, reporting to the Board of Directors, with a mandate to pursue the following actions:

A. Listing Requirements

a) Define the minimum expectations for sustainability reporting by sector for new listings

b) Provide training for the listing committee on understanding the submitted data

c) Enhance the ESG due diligence capacity in the pre-IPO ecosystem

B. ESG Data and Reporting Standards

a) Educate companies on the difference between qualitative and quantitative sectorally material ESG reporting and CSR

b) Keep current on global best practices of sustainability reporting by sector and disseminate the information throughout the stock exchange's management and boards

c) Support efforts to quantify ESG criteria and define reporting KPIs by sector and incorporate them into guidelines

d) Assist in the development of integrated financial reporting and comparable financial statements across borders

e) Comment on the quality of the sustainability data reported by listed companies

f) Introduce a watch list for companies not reporting on ESG or lacking clarity in their reporting

g) Support the efforts of external data providers of sustainability information

C. Stakeholder Engagement

a) Listed companies

• Encourage better internal corporate governance within companies, such as improving structure, independence and quality of boards of directors

• Consult with companies on how they should be integrating sustainability into long-term strategic decision-making – e.g. highlighting risks and opportunities within the existing business model on their website

• Consider mandating a non-binding shareholder vote on the sustainability report or sustainability strategy to be put to the AGM

• Educate listed companies on material sustainability issues, global initiatives and opportunities

b) Policymakers and regulators

• Improve dialogue with policymakers and regulators to work in partnership to achieve improved corporate ESG practices

• Work with regulators to create stronger local Institutes of Directors with a focus on training future board leaders who can integrate sustainability into the business model

• Work with regulators on aligning board and management incentives with long term, sustainable growth of listed companies

"Create a Sustainability Committee at each stock exchange, reporting directly to the Board of Directors, with a mandate to pursue initiatives in the following areas:

- Listing Requirements

- ESG Data and Reporting Standards

- Stakeholder Engagements"

c) Investors

• Provide a framework for communication on ESG issues to stakeholders – e.g. a possible annual ESG call (in addition to four quarterly earnings calls) between company management and investment analysts and portfolio managers, until a standard for integrated reporting on the issues has been established

• Support collaborative initiatives which work towards eradicating market short termism

• Develop and subsidize financial education training programs for investors wishing to adopt more sustainable investment practices

d) Advocacy groups

• Work with strategic partners such as UNCTAD, UN Global Compact, UNEPFI, GRI and PRI to develop sustainability standards and foster improved corporate ESG practices

• Join the PRI Stock Exchange Working Group calls as guests with a view to signing up to the PRI over time and collaborating on ESG issues with investors.

e) Other stock exchanges

• Collaborate with the sustainability committees at other global stock exchanges to share best practices, highlight areas of concern, and potential for partnership for projects.

• Increase dialogue with social stock exchanges to learn from their efforts with listed companies, investors and sustainability

2. Create/enhance an additional and separate Corporate Responsibility Committee at the stock exchange that focuses on operational issues.

Whereas the Sustainability Committee provides strategic guidance on the planning and macro-initiatives of the exchange's sustainability agenda, the Corporate Responsibility committee will be responsible for exchange operational issues such as the following:

"Create/enhance a Corporate Responsibility Committee at the stock exchange that should focus on operational issues at the stock exchange"

• Employment and human resources issues
• Health and safety practices
• Energy and natural resources usage
• Board of Directors and Committee issues (e.g. independence, alignment of incentives, number of directorships)

The Corporate Responsibility Committee should report separately into the board in order to demarcate the functions between sustainability strategy and socially responsible operations. If possible, reporting of this committee should be integrated into the Stock Exchange annual report, to highlight the importance of the data. It should be this Committee which is responsible for creating a culture of sustainability by conducting education sessions for exchange employees on the importance of sustainability in the exchange's business practices and, lastly, by Implementing targeted community outreach projects.

CONCLUSION

This report has attempted to provide an overview of current and planned ESG initiatives at stock exchanges and draw an accurate picture of the obstacles and opportunities associated with requiring long-term sustainability practices by publicly listed companies. It further demonstrates the importance of engaging all stakeholders – stock exchanges, listed companies, investors, regulators, and international organizations – into the process. Unless the landscape is fully defined and there is efficient collaboration, and unless structural change at exchanges are enacted and mandates are altered, any call to action will struggle on a longer road to success.

There are, of course, costs associated with implementing the recommended policies and committees. Further studies and dialogues will be needed to determine how and who can pay for the changes and where budgets can be reallocated. Additionally, there will likely be more obstacles that will materialize as the process to mandate improved corporate sustainability practices continues.

The key is to focus on the opportunities and the ultimate end game: companies that do not practice sustainable practices will find it more difficult to survive if access to capital through global stock markets is denied to them. This would consequently encourage all companies to pursue enhanced sustainability practices with large and positive environmental and social benefits to society. Moreover, improved governance would benefit not just the operations of the listed company but contribute towards greater stability of the stock exchange itself through the company's improved managerial performance and risk management.

While the process is challenging, the rewards of pursuing a multi-stakeholder initiative towards improved corporate ESG reporting are clear. This report is hopefully but a part of a growing and greater collaboration to make improved corporate sustainability practices a flourishing reality.

www.responsibleresearch.com

REFERENCES

1. WFE (2010). Statistics and Key Market figures. http://www.world-exchanges.org/statistics/ytd-monthly.

2. KPMG (2005). KPMG International Survey of Corporate Responsibility Reporting 2005. http://www.kpmg.com.au/Portals/0/KPMG%20Survey%202005_3.pdf.

3. DFVA and EFFAS (2010). "A Guideline for the Integration of ESG into Key Performance Indicators for Environmental, Social & Governance Issues". KPIs for ESG version 3.0. Germany.

4. GS Sustain (2010). Crossing the Rubicon: Our investment framework for the next decade. Goldman Sachs. http://www2.goldmansachs.com/ideas/long-term/crossing-the-rubicon/rubicon-exec.pdf.

5. Singapore Stock Exchange (2010). "Proposed Policy Statement and Guide to Sustainability Reporting for Listed Companies". Media release on 28 August 2010. http://www.sgx.com/wps/wcm/connect/cp_en/site/regulation/public_consultation/pc_28Aug2010?presentationtemplate=design_lib/PT_Printer_Friendly

6. OECD (2007). "Bovespa awards OECD for supporting Corporate Governance improvements in Brazil". Corporate Governance Principles News, March 2007. OECD. http://www.oecd.org/document/32/0,3343,en_2649_34813_38279136_1_1_1_1,00.html

7. The Committee on Capital Markets Regulation (2006). Interim report of the Committee on Capital Markets Regulation. USA. http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf.

8. http://www.hkex.com.hk/eng/index.htm

9. AFP (2010). "Hong Kong Bourse Winning IPO Race But Questions Raised About Quality". The Jakarta Globe. 11 January 2010. http://www.thejakartaglobe.com/analysis/hong-kong-bourse-winning-ipo-race-but-questions-raised-about-quality/352057.

10. UNPRI (2010). List of Signatories to the Principles for Responsible Investment as of June 2010. http://www.unpri.org/signatories.

11. UN Global Compact (2010). "Investors Step Up Pressure on Corporate Responsibility Reporting". UNGC, London. http://www.unglobalcompact.org/news/9-02-12-2010.

12. Daisy Maxey (2010). "Global Assets Up 11.5% to $111.5 Trillion". The Wall Street Journal. 11 June 2010. http://online.wsj.com/article/NA_WSJ_PUB:SB10001424052748703627704575298753609350186.html

13. Damon A. Silver (2010). Testimony on Short-termism in Financial Markets for the Policy Director and Special Counsel of the American Federation of Labor and Congress of Industrial Organizations, Senate Committee on Banking, Housing & Urban Affairs, Subcommittee on Economic Policy, 29 April 2010. http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=42df5020-5cd1-4761-9ecb-d9c7b05c21a6.

14. The Aspen Institute (2010). The Aspen Corporate Values Strategy Group. http://www.aspeninstitute.org/policy-work/business-society/corporate-programs/corporate-values-strategy-group (accessed 22 July 2010).

15. UNPRI (2010). "Global CEOs want investors to create sustainability "tipping point"". Media release on World Business leaders' UN Summit in NY the 24th of June 2010. New York: UNPRI, 24 June 2010. http://www.unpri.org/files/UNGCLS_final.pdf.

16. KPMG (2008). International Survey of Corporate Responsibility Reporting 2008. http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/International-corporate-responsibility-survey-2008.pdf.

TERMS AND CONDITIONS AND DISCLAIMER

MARKT DESIGNS
VISUAL COMMUNICATION

FSC Mixed Sources
Product group from well-managed forests and other controlled sources
www.fsc.org Cert no. DNV-COC-000051
© 1996 Forest Stewardship Council

RESPONSIBLE RESEARCH
ENVIRONMENT | SOCIAL | GOVERNANCE

RESPONSIBLE RESEARCH

ENVIRONMENT | SOCIAL | GOVERNANCE