PRI Principles for Responsible Investment

RESPONSE TO THE EUROPEAN COMMISSION'S SUSTAINABLE FINANCE PROPOSALS: DISCLOSURE, TAXONOMY AND BENCHMARKS

22 August

The PRI is a membership organisation of over 2000 global institutional investors, (including insurers, investment managers and advisors) with approximately US $82 trillion in assets under management. Over 1000 of these signatories are based in the Europe.

The PRI strongly supports all four of the Commission's recent regulatory proposals. The proposals are strongly aligned with the Six Principles that investors agree to implement when they become PRI signatories. The PRI believes the Commission's approach is comprehensive. We welcome the opportunity to contribute to the Commission's work through the High Level Expert Group (HLEG) and The Expert Group (TEG) on Sustainable Finance.

The PRI published analysis of the EU Action Plan for Financing Sustainable Growth, updated to reflect the Commission's regulatory proposals. For further details on PRI's policy programme, please email policy@unpri.org.

REGULATION ON DUTIES AND DISCLOSURES RELATING TO SUSTAINABLE INVESTMENTS

The PRI considers the Commission's Investor Duties and Disclosures proposal (2016/2341)[1] critical for the success of its sustainability objectives. We agree that it "lays the foundation for an EU framework which puts ESG considerations at the heart of the financial system." We believe the proposal is consistent with the PRI's principles and mission statement.

[1] https://ec.europa.eu/info/law/better-regulation/initiative/1185/publication/238004/attachment/090166e5baea374d_en

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Clarifying investor duties and ESG disclosure requirements has long been a priority of the PRI.[2] PRI's Principle 1 states that signatories "will incorporate ESG issues into investment analysis and decision-making processes."

Despite significant progress, some institutional investors believe that ESG issues are not relevant to portfolio value and are therefore not consistent with their duties. While support for this assumption is limited, the PRI finds that implementation is progressing at different rates, in different asset classes and in different geographies. Across EU member states, there is high awareness and intention, but low implementation.

For example:

- PRI's reporting data finds that 95% of all reporting signatories have an investment policy that covers their responsible investment approach. However, only 54% of European asset owners define ESG objectives in their mandates and only 40% of European asset owners set ESG standards or benchmarks to be followed in their mandates. As stated in the PRI's response to the Commission's consultation on duties: *"analysis of PRI reporting data demonstrates that a number of asset owners and investment managers in Europe have made commitments to ESG issues in their responsible investment policies, however, we find that depth and scale of implementation varies. In particular, implementation varies across asset classes, with ESG incorporation reported more frequently in listed equity than other asset classes."*

- Mercer surveyed 1,241 European pension funds in 2017 and found that that only 5% of funds have considered the investment risk posed by climate change.

- ShareAction conducted an in depth study of 40 European asset managers and found wide variation between leaders and laggards on ESG factors. This report also concluded legal clarity around ESG was necessary.

As such, the PRI agrees with the Commission that regulation is required. The PRI also believes the conditions are in place for regulation, to:

- address a need for more sustainable investment (as articulated by governments in support of the Paris Climate Agreement and the UN Sustainable Development Goals);
- build on a foundation of existing finance industry literacy and sustainability expertise (as demonstrated by signatory reporting to the PRI);
- reduce compliance costs by aligning existing regulation (for example, UCITS, AIFMD, EuVECA, EuSEF and IORP ii); and
- "level the playing field" to reward good performers that fully integrate ESG issues in investment processes.

[2] See www.fiduciaryduty21.org.

COMMENTS ON ARTICLES OF THE DISCLOSURES PROPOSAL 2016/2341

- Article 2 (o) – the Commission might wish to refer to common ESG factors listed as part of the PRI's reporting framework, for example:
  - Environmental: climate change, greenhouse gas (GHG) emissions, resource depletion, including water, waste and pollution, deforestation.
  - Social: working conditions, including slavery and child labour, local communities, including indigenous communities, conflict, health and safety, employee relations and diversity.
  - Governance: executive pay, bribery and corruption, political lobbying and donations, board diversity and structure, tax strategy.
- Article 3 1 – The PRI supports the proposal for financial market participants to publish their policies on the integration of sustainability risks on their websites. We recommend amending the wording to "sustainability risks *and opportunities.*" We recommend a format that can be easily accessed and understood by beneficiaries.
- Article 5 – The PRI supports the disclosure of sustainability objectives and we believe PRI's reporting and assessment data will be a useful input for the supervisory authorities as they consider technical standards.
- Article 6 1 (b) – we support the proposal to disclose methodologies, data and indicators.
- Article 7 1 (a) – we support the proposal to disclose overall sustainability-related impact.
- Article 10 – the PRI strongly supports the Commission's proposal for delegated acts to the IORP ii Directive, as well as UCITS, AIFMD, EuVECA and EuSEF Directives, to codify ESG integration and disclosure requirements. We consider this critical to ensure consistency across directives.

  As stated in the PRI's response to the Commission's consultation on duties: *"In particular, the PRI believes that asset owners are uniquely positioned to drive responsible investment [many of which are regulated by the IORP II Directive]. A number of European asset owners have made considerable efforts to integrate ESG factors in their investment processes, however, the PRI finds that depth and scale of implementation can vary. Weak implementation sends signals to the market as a whole that ESG factors are not a priority for asset owners, which in turn limits the willingness of investment consultants and investment managers to consider ESG factors in their advice and products."*

  The PRI recommends that the wording of the delegated acts responds to the recommendations made by the HLEG, which we set out in our response to the Commission's consultation on duties: *"Investors should consider ESG factors on the basis that they can be material to investment risk and return over a range of timeframes and therefore are central to performance of the duty of care. In doing so, investors should ensure that they consider ESG factors over a time horizon that is consistent with the obligation to the pension fund member or individual client. This is to ensure that the investment approach reflects the interests of the beneficiary or client."*

TAXONOMY

The PRI welcomes the proposal to establish a framework to facilitate sustainable investment. We believe the taxonomy will create additional demand for and supply of sustainable financial products by simplifying, and as such, enabling, the investment of private capital in economic activity consistent with the EU's sustainability objectives.

We support the Commissions' approach to establish the environmental sustainability of economic activities. In turn this will provide investors with:

- clarity on the sustainability of assets they choose to invest in, that can be derived from the taxonomy, with no obligation to adopt any prescriptive targets on asset allocation or investment style
- the ability to compare the sustainability of assets and funds based on a robust and common framework, which also encourages transparency, integrity and efficiency in the market for sustainable finance

We agree with the proposed regulatory approach and believe that delegated acts should enable timely updating of the taxonomy which is essential for its success. The PRI is pleased to participate in the Technical Expert Group (TEG).

COMMENTS ON ARTICLES OF THE TAXONOMY PROPOSAL 2018/353

- Article 5 – The PRI supports the proposal to establish six environmental objectives that the taxonomy need support. The PRI has multiple environmental workstreams underway (for example, on climate change, water and deforestation) which may be useful for the Commission.
- Article 13 – The PRI supports minimum safeguards on social issues. The PRI recommends that the safeguards refer to UN Guiding Principles on Business and Human Rights because they encompass both ILO conventions and the International Bill of Human Rights, which have a broader scope than labour rights only, including: right to privacy, right to an adequate standard of living, right to health, and many more issues which have all been deemed at potential risk from private business activities.
- Article 15 – The PRI supports establishing an expert group to advise on the technical screening criteria. Drawing on private market expertise is important for the success and practical application of the taxonomy.
- Article 17 1 (b) – The PRI supports the need to review the criteria used to define what is environmentally sustainable, which provides a clear process for updating the taxonomy. We believe it is critical to the success of the taxonomy that it remains dynamic to incorporate scientific, technological and environmental developments and changes in environmental objectives as necessary, and to ensure that changes are made in a timely way.

LOW CARBON BENCHMARKS AND POSITIVE CARBON IMPACT BENCHMARKS

The PRI welcomes the Commission's benchmarks proposal. We agree with the Commission's approach to start by focusing on benchmarks with characteristics that support investors in meeting their climate objectives. We believe it important that asset owners and managers are able to monitor their performance against a benchmark that reflects an economy oriented towards environmental goals, such as the Paris Agreement.

COMMENTS ON ARTICLES OF THE BENCHMARKS PROPOSAL 2018/353

- Article 13 1 – The PRI supports the proposed amendment on transparency of the methodology, which will allow for greater comparability between benchmarks and therefore better investment decision-making by portfolio managers.
- Article 27 – The PRI supports the proposed amendment on the "benchmark statement" to require that for benchmarks that pursue ESG objectives, benchmark administrators must explain how ESG factors are reflected for each benchmarks or family of benchmarks.