THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

PRI’S MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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ACKNOWLEDGEMENTS

This report is supported by the European Climate Foundation.

The project team would like to thank all contributors for their time and valuable contribution, in particular:

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This document is prepared by the PRI and does not necessarily represent the individual views of interviewees.

For any further questions email: policy@unpri.org
EXECUTIVE SUMMARY

In recent years, the EU and its member states have sought a global leadership role on sustainability in general and climate change in particular. Private finance is critical to the realisation of the EU’s sustainability objectives. Despite the ongoing disruption caused by the COVID-19 pandemic, ambitious climate policy remains high on the EU’s agenda.

Specifically, the EU Green Deal, set out in 2019, provides a roadmap for making the EU’s economy sustainable. The forthcoming revised Action Plan on Financing Sustainable Growth, which aims to reorient capital flows towards sustainable objectives, manage sustainability risks, and promote financial and economic long-termism, seeks to be the most ambitious plan of its kind in the world.

This paper sets out recommendations to ensure that investors can make an appropriate contribution to the EU Green Deal and the EU’s sustainability goals more broadly. These recommendations are based on interviews with institutional investors and the PRI’s own analysis. They represent the views of the PRI.

SUMMARY OF RECOMMENDATIONS

In the following five areas, the EU and its member states should:

<table>
<thead>
<tr>
<th>CLIMATE, LEADERSHIP AND THE REAL ECONOMY</th>
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<tr>
<td>Provide the necessary certainty and clarity for investors in the drafting of the EU Climate law, and ensure high standards of technical rigour</td>
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<td>Ensure that existing instruments intended to provide incentives for transition support the necessary transition of high-emitting sectors</td>
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<td>EU should use its leverage as a global sustainability leader and major economic power to advocate for global ambition on sustainability</td>
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<th>DISCLOSURE AND TRANSPARENCY</th>
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<td>Within the NFRD revisions, ensure that ESG data is disclosed together with traditional elements of corporate and financial reporting and released at the same time; including a core set of mandatory ESG KPIs; Third-party assurance over ESG data and KPIs should be required; the NFRD is aligned with TCFD recommendations</td>
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<tr>
<td>In developing an EU Non-Financial Reporting Standard, build upon existing standards and provide a coherent vision for how existing standards can and should work together; Provide the basis for international dialogue around global harmonisation of reporting standards</td>
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| PUBLIC AND PRIVATE FINANCE | Develop enabling frameworks supporting the “crowding in” of private finance  
Strengthen sovereign guarantees to unlock public/private finance collaboration  
Further develop technical assistance to project promoters to advance the pipeline of investable projects and aggregation of projects to reach the scale necessary to enable institutional investment  
Review the role of public-private partnerships and consider whether improvements in transparency and measurement criteria could increase their contribution, where appropriate |
| STEWARDSHIP | Set an aspirational (non-binding) standard for outcomes-focused stewardship and develop and encourage adoption of a standard for system-level stewardship  
Revise or supplement the Shareholder Rights Directive II  
Further develop ESMA guidance and work with national regulators to ensure acting-in-concert and anti-trust regulations do not impede collaborative engagement by investors around common sustainability goals |
| EU TAXONOMY | Explicitly align the EU Taxonomy with the EU’s net-zero aligned trajectory to give clarity and certainty around the expected evolution of the technical screening criteria  
Prioritise development of the Taxonomy to include activities that can make a substantial contribution to social issues, resulting in a tool which will allow investors to map their contributions against the Sustainable Development Goals  
Work towards a common approach for global Taxonomy development, building from the TEG’s principles for Taxonomy harmonisation |

**ABOUT THIS REPORT**

The PRI’s policy team actively engages in support of continuous policy reform in Brussels and at EU member state-level to promote a sustainable financial system. The PRI was an observer to the High-Level Expert Group (HLEG) on Sustainable Finance, appointed by the European Commission to propose reforms across the investment chain, and is a member of the Technical Expert Group (TEG) on Sustainable Finance, which supports the Commission in implementing its Action Plan on Financing Sustainable Growth.

The EU has already established a suite of actions through this Action Plan to promote a financial system that supports sustainable investment. Its ambitions in this area – and the demands these make on private finance – are only likely to grow as it moves from policy design to implementation. This paper sets out recommendations to inform climate and sustainable finance policy priorities during this next phase to ensure that investors can play their role in delivering the EU Green Deal, a roadmap that sets out how to make Europe climate-neutral by 2050.
The report showcases six policy areas that the PRI and its signatories consider priorities as the EU develops a sustainable financial system. Each section explains the thinking behind these priorities, which are based on investor views gained through interviews and PRI analysis, and recommends policy changes that have the potential to further align the European economy with the Paris Agreement and the UN Sustainable Development Goals (SDGs).

This report was largely produced before the COVID-19 crisis in Europe, and therefore does not explicitly address the immediate priority: safeguarding people’s health and mitigating the most immediate suffering caused by the pandemic. But the priorities it sets out should remain valid as policy makers and investors consider how to align the economic recovery with long-term environmental goals.
INTRODUCTION

The European Green Deal, announced in December 2019, is the most comprehensive roadmap released to date for the transition to a climate-neutral, sustainable economy. Many aspects of the Green Deal are still under development, but it is clear that private finance will play a critical role in the realisation of its vision for the EU’s economy.

Europe finds itself at an inflexion point. The COVID-19 pandemic is already causing profound changes to Europe’s economy and society. As the impacts of the pandemic become clearer, many in Europe are beginning to argue that the post-pandemic recovery must be aligned with the EU’s broader green goals, and that reforms must be put in place to address some of the underlying issues that the crisis has brought into focus.

Regardless of how the EU responds to COVID-19, climate and sustainability will remain key policy priorities for the EU and its member states. The degree to which private capital can participate in and contribute to Europe’s efforts to meet its environmental objectives will depend on how the suite of supporting and related policies and regulations are drafted. This report offers views from the PRI and engaged signatory investors on where the EU should prioritise its policy making to ensure the maximum contribution from private sector investors.

RESEARCH APPROACH

In January 2020, the PRI published a briefing paper on sustainable finance within the EU, which included a set of interview questions.¹ The briefing paper set out recent policy developments at the EU level and acted as a discussion prompt and a primer to ensure a similar level of knowledge among interviewees. Interviews took place between January and March 2020. During this period, the EU made substantial policy announcements, including the launch of the European Green Deal Investment Plan,² the Circular Economy Action Plan³ and the initial consultation on the revision of the Non-Financial Reporting Directive (NFRD).⁴ In addition, the TEG made its final recommendations on the EU Taxonomy⁵ and released a usability guide⁶ to the proposed EU Green Bond Standard. For this reason, the interviewees had differing levels of understanding of some of the key initiatives. The PRI has taken this into account in the formulation of our recommendations.

In addition, the PRI undertook a literature review of existing recommendations, taking into account the final report of the High-Level Expert Group on Sustainable Finance,⁷ the European Parliament’s own initiative report on sustainable finance,⁸ and the PRI’s Sustainable Financial System analysis⁹ and programmatic research, among others. Recommendations were assessed on their likely impact, their

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¹ PRI (2020), EU Sustainable Finance: Where Next?
² European Commission (2020), The European Green Deal Investment Plan and Just Transition Mechanism
⁴ European Commission (2020), Non-financial reporting by large companies (updated rules), proposal for regulation
⁵ European Commission (2020), Sustainable Finance: TEG Final Report on the EU Taxonomy
⁷ EU High-Level Expert Group on Sustainable Finance (2018), Financing a sustainable European economy
⁸ European Parliament Committee on Economic and Monetary Affairs, Motion for a European Parliament Resolution on sustainable finance, (2018/2007(INI))
⁹ PRI website, Sustainable finance system webpage
alignment with the PRI’s theory of change and mission, and the intended target audience (only those where the EU or member states have the means to act were selected for further analysis).

**INVESTOR AWARENESS AND ENGAGEMENT**

The interviews for this report sought the views of a range of investors on the European Green Deal and other relevant policy initiatives. Although the invitation to be interviewed was open to all PRI signatories, the PRI proactively sought input from those with a particular interest in policy – for example, participants in the PRI’s Global Policy Reference Group, participants in EU-led Expert Groups and other established policy stakeholders.

While most participants are engaged in EU policy development, some have focused on specific components, such as the EU Taxonomy, Benchmarks regulation or the development of the EU Ecolabel for Financial Products. Many also follow developments at member state-level and track international developments, either in strategic markets or via multilateral bodies.

While interviewees generally stated that they did not face barriers accessing information regarding these developments, engagement is sometimes limited by internal capacity and some felt that keeping up with the pace of developments at EU level can be challenging.

Interviewees described a range of methods for engaging in the policy process, including direct engagement, participation in expert groups at EU or national level, and engagement through industry associations.

Many of the investors interviewed stated that knowledge gaps regarding sustainable finance policy persist across the finance industry, in the corporate sector and among consumers and end-investors. This presents challenges to engagement around these topics.

In addition, interviewees recognised that the debate around sustainability and sustainable finance has a tendency to be siloed. The TEG was highlighted as a good example of an initiative that brought together stakeholders from the financial sector, the real economy, civil society and academia.

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10 A list of the individuals and organisations currently contributing to PRI advisory committees, including members of the Global Policy Reference Group, can be found on its Signatories page

“**The work of the Technical Expert Groups has not only created technical expertise available for everyone, it has also allowed to incorporate different perspectives from all kinds of stakeholders and therefore builds the consensual foundation for future developments.**”

Brenda Kramer, Senior Advisor Responsible Investment, PGGM Investments
POLICY OUTLOOK

During the 2014-19 Commission mandate, sustainable finance emerged as a significant pillar in the EU’s sustainability commitments. In 2016, the Commission established a High-level Expert Group on Sustainable Finance (HLEG), to which the PRI was an international observer. The HLEG recommendations laid the foundations for the EU Action Plan on Financing Sustainable Growth, which was adopted by the European Commission in March 2018. Since then, there have been a multitude of developments of a legislative or technical nature, such as the amendments to the Benchmarks regulation, the regulation on disclosures relating to sustainable investments and sustainability risks, the work of the TEG and the launch of the International Platform on Sustainable Finance. Recent and upcoming developments are further described below.

COVID-19

The current report has been drafted in an uncertain policy environment, while governments respond to the global health crisis caused by the COVID-19 pandemic. This intense period of policy development will have important impacts on EU economic, sustainability and finance policy reform.

However, as the world responds to the pandemic, and the resulting economic slowdown, the PRI believes that the European Green Deal and sustainable finance policy measures should remain priorities for the bloc and offer an opportunity to rebuild a more sustainable Europe.

The pandemic may have temporarily shifted public focus away from the twin climate and biodiversity crises but, as COVID-19 is stabilised, efforts to address these systemic environmental issues will be more critical than ever. The PRI welcomes continuing expressions of commitment from the Commission and other public bodies to focus the recovery on creating a more sustainable and resilient economy.

12 European Parliament Regulation 2019/2088, 27 November 2019, on sustainability-related disclosures in the financial services sector
13 European Commission (2020), Factsheet: International platform on sustainable finance
The European Commission has drafted a Climate Law as part of the European Green Deal. The draft law is framed as a regulation and establishes a framework for achieving the binding objective of climate neutrality in the EU by 2050, aligned with the Paris Agreement goals, as well as establishing a process for interim 2030 targets. The objectives of the Climate Law are four-fold: (i) to achieve the 2050 climate-neutrality objective through various policies, in a socially fair and cost-efficient manner; (ii) to create a system for monitoring progress and taking further action if needed; (iii) to provide predictability for investors and other economic actors; (iv) to ensure that the transition to climate neutrality is irreversible.

The Technical Expert Group on Sustainable Finance published its final reports on the EU Taxonomy and proposed EU Green Bond Standard. The EU taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable, to

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<tr>
<td>10 March 2020</td>
<td>EC Communication on the EU Industrial Policy</td>
<td>This aims to set a clear direction for a globally competitive, climate-neutral and digitalised industry. Its main objective is to support EU industry and develop its capacity to lead on the green and digital transitions while staying competitive at a time of geopolitical uncertainty.</td>
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<tr>
<td>TBC</td>
<td>Revision of the Non-Financial Reporting Directive</td>
<td>As announced in its December 2019 Communication on the European Green Deal, the European Commission has launched a review of the Non-Financial Reporting Directive (NFRD) as part of its strategy to provide a stronger foundation for sustainable investment. The launch was followed by a public consultation to 11 June 2020. The review aims to tackle problems regarding the publication of non-financial information by companies pursuant to Directive 2014/95/EU (NFRD) and improve disclosure practices.</td>
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<tr>
<td>TBC</td>
<td>Renewed EU Sustainable Finance Strategy</td>
<td>The EU plans to publish a renewed EU Sustainable Finance Strategy, as announced in the Commission’s Communication on the European Green Deal. It aims to encourage the flow of private capital to green investments, ensuring that sustainable investments are mainstreamed across the financial system. It will also contribute to the Commission’s strategy for achieving the SDGs. A consultation was launched at the beginning of April to gather stakeholders’ views.</td>
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<tr>
<td>TBC</td>
<td>International Platform on Sustainable Finance (under the Taxonomy regulation)</td>
<td>The platform will advise the Commission on the development, analysis and review of technical screening criteria, including their potential impact on the valuation of assets that, until the adoption of the technical screening criteria, were considered as green assets under existing market practices. The platform will also advise the Commission on whether the technical screening criteria are suitable for further uses in future EU policy initiatives aimed at facilitating sustainable investment.</td>
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16 European Commission, 10 March 2020, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions: A New Industrial Strategy for Europe

17 European Commission, Consultation on the renewed sustainable finance strategy, consultation period from 8 April to 15 July 2020
POLICY PRIORITIES

This section showcases six policy areas that PRI and its signatories see as priorities for the future development of sustainable finance. Each section reflects on these priorities, based on investor perspectives gained through interviews and PRI analysis, before recommending policy changes that have the potential to further align the European economy with the Paris Agreement and the SDGs.

1. CLIMATE, LEADERSHIP AND THE REAL ECONOMY

INVESTOR PERSPECTIVE

Investor-led initiatives such as the UN-convened Net-Zero Asset Owner Alliance and the Global Investors for Sustainable Development Alliance demonstrate that investors are willing to invest aligned with global climate and sustainability goals.

However, those interviewed for this project made clear that, despite these commitments, they find it difficult to find investment opportunities aligned with such goals. Furthermore, the sustainability of institutional investors’ portfolios is limited by the sustainability of the real economy in which they invest. Investors suggested that a change in real-economy policy might help to increase the number and size of investment opportunities aligned with the global goals.

Another point made was the lack of alignment and coherence between member state and EU policies. Interviewees noted that implementation deadlines are not always met at member state level and, ideally, sustainable finance measures would apply consistently across all member states simultaneously.18

Additionally, investors stated that the legal obligations that apply to financial market participants should be aligned at least among EU member states, and ideally globally, although those interviewed recognised the leadership role played by the EU, which could bring competitive advantages.

“As a member of the United Nations-convened Net-Zero Asset Owner Alliance, we are committed to transition our investment portfolio to net-zero GHG emissions by 2050. To assess the trajectory towards net-zero of our assets, we need clearer definition and tools such as a global carbon pricing mechanism in place”

Magnus Billing, CEO, Alecta Pensionsforsakring

Different member states are going their own way in terms of sustainable finance policy, creating policy variation at the member state level. This might cause different degrees of implementation that can

18 Recent legislative initiatives, such as the EU Taxonomy, Benchmarks regulation and regulation on sustainability disclosures take the form of regulations which do apply simultaneously in all member states.
lead to economic disadvantages, competitive differences and difficulties in tracking the progress of implementation at the member state level. The EU has shared competency with member states on many critical aspects of financial services and real-economy policy.

The following barriers were identified:

- **Uncertainty regarding ambition and timelines.** A lack of certainty hinders planning. Under the EU Green Deal, substantive real-economy policy reform is expected in areas such as energy, transport and industry. The EU is working towards establishing a legal commitment to net-zero emissions by 2050 and interim targets. However, detail on implementation is still lacking (see the Climate policy section). Furthermore, important aspects of the climate and energy transition are led by member states and their plans can prove to be inconsistent with EU-wide climate goals.

- **Siloed debate.** Debates around the sustainability of sectors including energy, agriculture and fishing, transport and industry have been underway for many years, with high levels of complexity. Investors noted that connections are not being made between sustainable finance and discussions underway in the real economy, and investors do not always feel they have the same influence and access as groups such as NGOs or business associations. Despite this, some stakeholders said that the Technical Expert Group on Sustainable Finance provided a positive model and the forthcoming International Platform on Sustainable Finance should encourage inter-sectoral dialogue.

- **Clear definitions:** Investors, companies and regulators still lack clarity on what can be considered “sustainable” or aligned with EU and international goals such as the SDGs or the Paris Agreement. The EU Taxonomy begins this work, by highlighting activities aligned with climate mitigation and adaptation, but clarity is still lacking on the social aspects of the SDGs, and the broader transition expected from key polluting industries. This lack of clarity risks sending conflicting signals to the market and weakening the impact of investor action.

- **A lack of investment opportunities.** Insufficient climate ambition by companies reduces the opportunities available to investors seeking sustainable investments. (Interviewees noted a wide range of challenges in relation to investable opportunities; these are covered below, in The Public and private finance section).

- **A poorly functioning carbon pricing mechanism.** In particular, interviewees felt that the absence of a comprehensive and effective carbon pricing mechanism is hindering the development and deployment of low-carbon projects.

**ANALYSIS**

Decisions by investors have outcomes in the real economy, irrespective of whether these are intentional or measured. Financing and stewardship decisions made can help to maximise positive outcomes and minimise negative ones. However, investors are not solely responsible for the real economy – they are part of a complex ecosystem in which real-economy policy also plays an important role. Investors are increasingly expected to scrutinise and challenge the behaviour of the entities in which they invest and, in doing so, contribute to common goods. This is to be welcomed. But for this to be effective, climate and corresponding real-economy policy should be ‘investment-grade’ if it is to build investors’ confidence in the transition.
Climate policy

Many of the issues identified by investors related to climate and energy policy. Under the Green Deal, the European Commission has brought forward a proposed Climate Law which would:

- Embed a legal commitment to climate neutrality (net-zero emissions) by 2050 in all EU member states;
- Empower the European Commission to assess how the EU’s existing 2030 carbon emissions target should be amended, potentially within the range of a 50-55% reduction compared with 1990 levels;
- Empower the European Commission to develop an EU-wide climate trajectory from 2030-50;
- Require member states to adopt climate change adaptation strategies; and
- Require the European Commission to assess, by September 2023 (and every five years thereafter):
  - Collective progress on net-zero and adaptation, and the consistency of EU-wide measures with the trajectory; and
  - The consistency of member states’ National Energy and Climate Plans (NECPs) and national measures on adaptation and make recommendations to member states on remedial actions.

The Climate Law is part of the EU’s effort to take a global leadership role, but it also reflects its responsibility as an industrialised bloc responsible for a substantial portion of the world’s emissions. The PRI welcomes the Climate Law as a necessary step to providing clarity and certainty to companies and investors in the EU around the nature and scale of the climate transition. The PRI nonetheless recognises some concerns with the proposal:

- The proposed Climate Law has no fixed target before 2030, which is beyond the typical horizons for political, investment and business planning. This compares less favourably with the approach of leading EU member states such as France and Denmark, which have interim five-year targets. For the climate transition to be factored into current political and investment decision-making, interim targets consistent with the 2030 and 2050 targets are required.

- The proposal combines executive and evaluation functions, with the European Commission responsible for establishing the EU-wide trajectory and for monitoring and reporting on progress on implementation and delivery against targets. Best practice from other countries such as the UK, Netherlands and Sweden suggests that a fully independent evaluation body is important.

Legal clarity. The EU has unequivocally clarified that all investors should consider financially material ESG issues in investment, risk management and governance. However, questions remain over the extent to which investors can incorporate real-economy objectives into their strategies and planning. In addition to this report, the PRI, UNEP Finance Initiative and The Generation Foundation are undertaking a major review of the legal framework and potential legal constraints investors face when considering whether to take additional, non-financial objectives into account.
Finally, existing subsidies and incentives do not adequately address the scale of the challenge. In particular:

- **Emissions trading.** The EU Emissions Trading Scheme (EU ETS) was established in 2005 but the comparatively low carbon price remains insufficient to incentivise widespread emissions reductions. Key sectors, such as buildings, waste and agriculture do not fall under its scope. Furthermore, although the EU has discussed the possibility of a carbon border adjustment mechanism – an import fee to compensate for the difference in the costs of products from countries with and without carbon pricing systems – detail is still missing on when and how this might be implemented.

- **Fossil fuel subsidies.** In 2010, the EU committed to phasing out fossil fuel subsidies by 2025. By the end of 2019, all EU member states were required to submit a 10-year integrated National Energy and Climate Plan, covering 2021-30. These should explain existing fossil fuel subsidies and how countries intend to phase them out. However, as of March 2020, seven countries – including Germany, France and Spain – had not submitted final NECPs, while analysis of draft NECPs indicates that many either do not mention these subsidies or put forward plans to continue subsidies.

**RECOMMENDATIONS**

1. **EU Climate Law:** To provide the necessary certainty and clarity for investors, and to ensure high standards of technical rigour, the EU Climate Law should include the following:
   a. Five-year targets and the establishment of the EU-wide climate trajectory, brought forward by five years, beginning in 2025;
   b. Provision for independent scientific review of the EU-wide trajectory, progress reporting and the consistency of EU instruments with the climate trajectory. This should be separate to the European Commission and the Platform on Sustainable Finance.

2. **Incentives for transition:** Existing instruments should provide strong incentives to support the necessary transition in high-emitting sectors. These should include:
   a. A comprehensive package of measures to strengthen the EU ETS before expansion to currently non-traded sectors such as transport, buildings, waste and agriculture. These could include: aligning the cap with a revised 2030 target; increasing the intake rate of the EU ETS market stability reserve mechanism to absorb past and future surpluses of carbon permits; and introducing a carbon price floor amongst leading member states.
   b. Set a clear timeline for the establishment of a carbon border adjustment mechanism to ensure a level playing field between countries with and without carbon pricing; and
   c. Bring forward a revised plan for the phase-out of fossil fuel subsidies as part of NECPs.

3. **An inclusive debate.** The climate transition will require debate between actors from different sectors of the economy. The Platform on Sustainable Finance could provide a forum for a broad
range of stakeholders to contribute to the dialogue around the low-carbon and environmental transition. However, this should be distinct from the independent and primarily scientific scrutiny and input required.

4. **International leadership.** The EU should use its leverage as a global sustainability leader and major economic power to advocate for global ambition on sustainability, including lobbying for the integration of sustainable finance policy within the core mandates of existing global financial policy forums and international dialogues.

### 2. DISCLOSURE AND TRANSPARENCY

**INVESTOR PERSPECTIVE**

The investors interviewed for this project were almost unanimous in stating that a lack of the necessary data prevents them from contributing to the EU's objectives to their full potential. Most mentioned a data gap at company level, while some also see gaps at the project level. Further, the majority of investors mentioned that what data is available is often of poor quality, preventing investors from using it to assess trajectories or evaluate companies' impact on global goals such as the SDGs or the Paris Agreement. In addition, data is often difficult to compare, a result of the variety of standards and reporting methodologies used by companies. The company or project scores provided by research organisations can vary, due to the different methodologies used, which are often not publicly available.

"The NFRD review and recent developments on European non-financial reporting standards are a great opportunity to overcome one of the main barriers to implementing sustainable finance: a lack of comparable data. Nonetheless, we ultimately need greater integration with financial reporting - an issue to be tackled by international standard setters."

Michael Schmidt, CIO, Lloyd Fonds AG

The review of the EU Non-Financial Reporting Directive (NFRD) has been well received, with some support for the recent announcement that the EU will commence development of European non-financial reporting standards. Nonetheless, interviewees see greater potential to overcome current data issues with the development of a global standard.

On investor disclosure, many of those interviewed welcomed the review of the EU regulation on sustainability-related disclosures in the financial services sector, which introduces new obligations.
and clarifies existing ones. In particular, it aims to create comparable disclosure requirements for financial market participants in the EU and align existing disclosure requirements at member state level.

Despite this, interviewees said that the different application timelines might cause some difficulties for implementation at organisational level. For example, the Taxonomy regulation imposes new disclosure requirements for companies that fall under the scope of the NFRD, with a related delegated act to be adopted by June 2021, while the financial services sector needs to meet the provisions of the amended sustainability-related disclosure regulation (2019/2088) by January 2022.

**ANALYSIS**

The Financial Stability Board’s Task Force for Climate-related Financial Disclosures (TCFD) published in June 2017 recommendations for climate-related financial disclosures that are consistent, comparable, reliable, clear and efficient, and which create for lenders, insurers and investors a global framework for translating information about climate into financial metrics.

Since the publication of its recommendations, the TCFD has won widespread backing from across the financial sector. Every major systemic bank, nine of the top 10 asset managers, all the major credit rating agencies, leading accounting firms and over 50 central banks and financial supervisors have backed the TCFD’s recommendations. The PRI believes the EU could play an international leadership role in the build up to the COP 26 climate talks, to be held at some point in 2021, to help accelerate the take-up of the TCFD, including through formal regulation of listed companies and large asset owners.

**Corporate disclosure**

Without reliable data and metrics, it can be difficult, if not impossible, to link ESG factors meaningfully to corporate strategy, risk management and executive remuneration.

The term ‘non-financial’ is widely used, but it can misleadingly imply that ESG factors are financially immaterial. Although companies can also report such information for a broader stakeholder audience, the ESG information they produce for investors should be material to investment decisions. The concept of materiality always includes financial materiality, but both companies and investors may have broader interpretations that reflect a values-driven or impact investing orientation.

The NFRD requires large companies to disclose certain information on the way they operate and manage social and environmental challenges and impacts. Companies under the scope of the NFRD must report on their policies relating to environmental protection, social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery, and the diversity of their boards (in terms of age, gender, education and professional background).

While the NFRD has improved the availability and quality of corporate reporting, it does not adequately address the needs of the investment community. Under the current framework, non-financial statements can be made separately to annual financial reporting and released at up to a six-

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21 Task Force on Climate-Related Financial Disclosures list of supporters as of February 2020
month delay, meaning investors may not have the complete information they need to assess a company’s performance and impacts. The NFRD sets high-level principles, supported by non-binding guidelines, but it does not mandate specific key performance indicators (KPIs) or methodologies. This can lead to the publication of fragmented and limited data, making comparability between companies difficult. While the directive’s principles are required to be transposed into member state law, member states vary in their legal interpretation of them.

Furthermore, with an increasing focus on key sustainability goals – such as the EU’s climate neutrality objective – a key challenge is translating these goals into thresholds or performance standards that companies and investors can respond to. The EU Taxonomy is an important step forward. By setting out thresholds consistent with EU objectives, the Taxonomy shifts the conversation away from measuring incremental performance improvements towards measuring alignment with sustainability goals. Mandatory reporting by companies against the Taxonomy is therefore welcome.

The review of the NFRD provides an opportunity to integrate and align financial markets data requirements and make the directive fit for purpose, allowing for a swift implementation of existing sustainable finance policy measures and future developments.

The European Commission announced in January 2020 that it will support a process to develop European non-financial reporting standards and invited the European Financial Reporting Advisory Group (EFRAG) to begin preparatory work.22 Previously, EFRAG has initiated a Project Task Force on Climate-related Reporting, which presented its best-practice findings in late 2019. These pointed out that climate-related financial disclosures are at an early stage of implementation, and that there is room for improvement, even among more mature reporting companies.23

A number of reporting standards have emerged during recent years. Harmonising what already exists into an internationally recognised standard is one option, which should be further assessed. The Corporate Reporting Dialogue, an initiative convened by the International Integrated Reporting Council, is an example of how, rather than creating new standards, existing frameworks can be coordinated. However, it is incumbent on the standard-setting organisations to be active participants in developing a coherent vision of how these standards can and should fit together at global level.

**Investor disclosure**

The EU’s regulation on sustainability-related disclosures in the financial services sector introduces new requirements and clarifies the sustainability-related disclosure obligations in the financial services sector.24 Disclosure requirements are set out at entity and product level, and the requirements distinguish between all financial products and those financial products targeting or promoting environmental and/or social objectives. The Taxonomy regulation25 and the sustainability-related disclosures regulation apply to the same categories of funds and are designed to be complementary disclosure frameworks. The European Supervisory Authorities (ESAs) will develop regulatory

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22 Remarks by Executive Vice-President Dombrovskis at the Conference on implementing the European Green Deal: Financing the Transition, 28 January 2020, European Commission website
23 EFRAG (2020), How to Improve Climate-Related Reporting: A Summary of Good Practices from Europe and Beyond
24 European Parliament Regulation 2019/2088, 27 November 2019, on sustainability-related disclosures in the financial services sector
25 See the 17 December 2019 amendment to the regulation above
technical standards on the details of the content and the presentation requirements, taking into account the various types of financial products, their characteristics and the differences between them. The standards will include sustainability indicators relating to social and employee matters, respect for human rights, anti-corruption and anti-bribery measures.

**RECOMMENDATIONS**

The EU should work to create a “closed data cycle” that aligns investor and corporate disclosure obligations. Data needs to be consistent, comparable, reliable, clear and efficient to provide decision-useful information to lenders, insurers and investors.

The PRI therefore recommends:

5. **Revision of the NFRD:** The EU should use the opportunity of the NFRD revision to ensure that:
   a. ESG data is disclosed with and released at the same time as traditional elements of corporate and financial reporting;
   b. Reporting should include a core set of mandatory ESG KPIs;
   c. Reporting standards are applied consistently across Europe, which may require the use of regulations and/or the establishment of supplemental ‘level 2’ measures.
   d. Third-party assurance of ESG data and KPIs is provided;
   e. Reporting is aligned with the recommendations of the TCFD and builds on the existing TCFD-aligned recommendations in the Non-Binding Guidelines; and
   f. Consideration is given as to how thresholds aligned with long-term goals – such as those set out by the EU Taxonomy – can be integrated into corporate reporting.

The PRI will further elaborate more specific asks regarding a revised Non-Financial Reporting Directive in its response to the public consultation, which will be published in due course.

6. **Development of an EU Non-Financial Reporting Standard:** The PRI supports global and regional action that further harmonises corporate reporting standards. EFRAG should ensure that the proposed EU Non-Financial Reporting Standard:
   a. Builds on existing standards applied in the EU and internationally, and reflects work underway by standard setters;
   b. Provides a coherent vision for how existing standards can and should work together; and
   c. Supports international dialogue around global harmonisation of reporting standards.

**Investor disclosure:** The EU should provide a clear vision of how different pieces of disclosure regulation can help investors produce clear and coherent disclosures of their ESG risks, impacts and contributions to the EU’s sustainability objectives, and ensure that investors have the necessary information to do so. In particular, the EU should provide clarity on how the TCFD recommendations should be used to discharge investors’ existing responsibilities to disclose how sustainability risks, including climate, are integrated into governance, strategy and risk management, as well as the requirements to disclose how the principal adverse impacts of their approaches to investment are identified and mitigated.

26 European Commission (2019), [Guidelines on reporting climate-related information](#)
3. PUBLIC AND PRIVATE FINANCE

INVESTOR PERSPECTIVE

Many of the investors interviewed for this project were of the view that public finance could play a greater role in enabling private finance to contribute to the EU Green Deal. Financing the EU Sustainable Investment Strategy must not be regarded solely as a public finance exercise.

Many investors already recognise the business case for investing in low-carbon, environmentally sustainable projects and companies and, in many cases, other forms of support – such as policy certainty or data provision – are required to increase financial flows. Nonetheless, the low-carbon transition will require large-scale deployment of innovative technologies and projects, and development of markets where the business case is as-yet uncertain. Furthermore, certain types of project – such as the development of critical infrastructure – may depend on collaboration between public and private finance.

For the majority of investors interviewed, public and private finance are currently not collaborating at their full potential when it comes to sustainability. Investors stated that action is needed to mobilise capital through stronger policies aimed at both public and private finance, especially those that encourage partnerships.

Public support was seen as important in several ways. Investors expressed a desire for the creation of additional risk-sharing mechanisms. Further, they proposed the rehabilitation of public-private partnerships (PPPs) as a mechanism for collaboration. Finally, a common concern from investors seeking opportunities to invest in real assets aligned with ESG goals is that few projects meet the scale required to cover management and due diligence costs. While some investors have actively sought opportunities to invest in smaller-scale local infrastructure, such as local hospitals, schools or nursery facilities, or local district heating or energy production projects, the scale of such projects creates challenges.

ANALYSIS

The European Green Deal’s Investment Plan – the Sustainable Europe Investment Plan, presented in January 2020 – aims to mobilise public investment and unlock private funds through EU financial instruments. It proposes a range of initiatives, such as: leveraging the EU’s budget guarantee under

“We welcome the suggested uptake in the EUInvest Programme under the European Green Deal allowing for additional private finance to be crowded in. We see risk-mitigating mechanisms for private investors as an important tool for SRI projects and green and social projects in general”

Marisa Parmigiani, Head of Sustainability, Unipol Gruppo S.p.A - UnipolSai Assicurazioni
the InvestEU Programme Fund (the umbrella body for all EU financial instruments) to crowd in additional private funding; increasing climate and environmental spending under the EU budget to trigger additional national co-financing through the multiannual financial framework; and developing specific funding vehicles, such as innovation and modernisation funds or a ‘Just Transition’ fund to support workers and communities employed in declining carbon-intensive industries. The public sector contribution is split across existing EU climate-related budget commitments and the InvestEU fund, and it seeks to leverage an additional €279bn from the private sector over the next decade, leading to a total of €1trn. Further, the European Investment Bank (EIB) has already announced to end financing for fossil fuel energy projects from the end of 2021 and some EU member states Finance Ministers are supporting the Helsinki Principles which also includes the mobilization of private sources of climate finance by facilitating investments and the development of a financial sector which supports climate mitigation and adaptation.

Under the proposed EU Climate Law, all EU instruments will be reviewed to ensure their consistency with the EU’s climate trajectory and net-zero target. This includes instruments such as the Projects of Common Interest, an important infrastructure development mechanism. As above, the PRI recommends the EU climate trajectory and interim targets should be brought forward to ensure they are within political, business and investment planning cycles.

Risk-sharing mechanisms
The EIB and, to some extent, the World Bank play a decisive role by shaping policy development with a view to easing the use of risk-sharing mechanisms in the EU and emerging markets. In long-term infrastructure finance, those actors, alongside national public investments banks, are considered crucial to inject public finance in order to kick-off projects, in particular those projects that might struggle to raise purely private finance, such as those with a strong sustainability dimension or which involve immature technologies. Developing common tools and knowledge sharing mechanisms could help improve the dialogue between public and private actors, as well as close the communication gap between the EIB and national authorities, who are sometimes unaware of the de-risking opportunities offered by the EIB.

The Green Deal, especially through InvestEU and the development of new public funding vehicles could create additional co-financing opportunities. Sharing risk between private investors and public entities could help incentivise sustainable finance further by improving trust among private and public actors. In economic theory, this could lead to a crowding-in effect; encouraging additional private investment and therefore greater employment and economic growth.

The role of sovereign guarantees
Aside from risk-sharing mechanisms, additional state guarantees could lead to greater long-term certainty for investors, creating an additional incentive for private actors to step in. This could be achieved by improving capacity for blended-capital projects that would bring a mix of government funding, equity investment, and bank loans into sustainable investments. This could also be achieved by governments extending guarantees for specific, targeted types of risk that are best borne by the public sector. Doing so would improve the risk-return profiles for private investors as some risk would

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27 EIB energy lending policy: Supporting the energy transformation
28 Helsinki Principles
be shifted to public bodies. This can have an important leverage effect, increasing the pipeline of projects.

**Scaling up projects**

To attract a wider range of investors – beyond the local or public authorities that would traditionally finance sustainable projects through local procurement – projects need to be aggregated to become attractive enough for larger institutional investors. This could be achieved through multiple-project investment programmes, through investment funds or other types of financial intermediaries that deal with project origination and financial structuring as well as the establishment of investment platforms in order to aggregate projects.

**The role of public-private partnerships**

PPPs or public finance initiatives (PFIs) have fallen out of favour in Europe, but they may still prove to be useful tools to deploy. It is therefore worth reviewing PPP mechanisms to better understand their advantages and disadvantages. Specific standards aiming for improved transparency regarding partnership structuring, as well as stronger measurement criteria, could be developed to improve knowledge sharing and good practice. Specific disclosure rules, set out in legislation governing public finance spending, including for PPP mechanisms, could be strengthened. Greater attention could be paid to benchmarking PPP mechanisms and the identification of good practice. Better relative and absolute measurements, as well as encouraging ex-post PPP analysis, could help to increase common understanding, especially where PPPs can be more effective that traditional procurement.

To increase the pipeline of projects, the HLEG recommended a “Sustainable Infrastructure Europe” facility be established to support project development capacity at national and local levels to “advance the use of standardised public-private partnership contracts where possible”, to improve predictability in project deals. The recent EU Industrial Strategy has not, for now, taken up this suggestion.

As an example, the Canadian government has established the Canadian Infrastructure Bank (CIB) with the aim of bringing in private investors to support “infrastructure projects that are in the public interest”. Green infrastructure is one of its priorities. The bank is intended to be a platform for building stronger engagement and relationships between private investors and all levels of government in Canada. The CIB will only support projects brought forward by the authorities which have the potential for revenue generation and to attract private investment. Further analysis of national infrastructure plans and the investment opportunities they can create has been recently published by the PRI.29

**Involving various actors in sustainable infrastructure projects**

Pension funds, especially public entities, could play a bigger role in financing sustainable infrastructure. However, it can be practically difficult for them to do so as they typically invest through funds, rather than directly into projects. They often have limited internal expertise and costs are considered too high for them to do so directly. Finally, they are by nature risk averse when it comes to allocating capital to sustainability projects, as they habitually face regulatory requirements to focus on long-term, less risky projects. However, public finance can lead by example. Public pension funds can

29 https://www.unpri.org/infrastructure/are-national-infrastructure-plans-sdg-aligned-and-how-can-investors-play-their-part/5636.article
take a lead with a view to influencing the rest of the sector. Similarly, states and regions can also further align their investments with sustainability goals to encourage other actors to follow their lead. Active investment rather than passive management from public institutions should be encouraged to lead to positive crowding-in effects.

RECOMMENDATIONS

7. **Enabling frameworks**: EU institutions, member states and EU and national financing bodies should ensure that the right frameworks exist to help “crowd in” private finance in support of the Green Deal. These could include:
   a. Strengthening sovereign guarantees to unlock public/private finance collaboration and blended finance for future sustainable development;
   b. Further developing technical assistance to project promoters to advance the pipeline of investable projects, as well as support for the aggregation of projects to reach the scale necessary to enable institutional investment;
   c. Enable knowledge sharing between EIB and other public and private financial institutions, serving as a repository of expertise in low-carbon infrastructure finance;
   d. Reviewing the role of PPPs and considering whether improvements in transparency and measurement criteria could increase their contribution, where appropriate.

Throughout 2020, the PRI will engage investors to explore the investment opportunities presented by the Green Deal and explore the necessary financial instruments or other forms of public-private collaboration required to enable private finance to scale up its contribution.

4. **STEWARDSHIP**

**INVESTOR PERSPECTIVE**

The High-Level Expert Group on Sustainable Finance concluded that stewardship is a critical tool for European investors seeking to manage ESG risks and improve outcomes in the real economy. It recommended additional action from the EU to strengthen and facilitate engagement and voting. However, stewardship, engagement and voting are absent from the EU Action Plan on Financing Sustainable Growth and the EU Green Deal. The background papers for this report were framed around the key initiatives already underway and, as a consequence, interviewees focused on the improvement of existing instruments. However, stewardship was stressed by a minority of those interviewed, and recommendations relating to stewardship have been included to reflect the broader consensus from the PRI’s own work, the HLEG and other commentators that stewardship is not given adequate consideration in the EU frameworks and legislative instruments that address sustainable finance.

“We would welcome if stewardship were to become much more of a focus area for European policy makers”

Ingrid Holmes, Head of Policy and Advocacy, Federated, Hermes International
ANALYSIS

Stewardship is one of the most powerful tools investors have to influence underlying investees. In the case of equity investors, it is a critical lever to influence corporate strategy and corporate capital allocation.\(^{30}\)

Exercising stewardship is central to investors’ fulfilling their fiduciary (or equivalent) duties,\(^{31}\) and it provides a powerful lever to drive real change in the global economy, environment and society. It will be central to many investors’ responses to recently agreed EU regulations such as those on sustainability-related disclosures in the financial services sector (both the integration of material ESG risk and the mitigation of principal adverse impacts) and the Taxonomy regulation.

Stewardship is fundamental to responsible investment practice; the signatories to the PRI commit to “be active owners and incorporate ESG issues into [their] ownership policies and practices.” In late 2019, the PRI launched Active Ownership 2.0 – an aspirational standard for effective, outcomes-focussed stewardship which explicitly prioritises common goals and shared effort over individual corporate performance.\(^{32}\)

Despite this, many investors exercise stewardship predominantly to manage short-term issues within individual companies, and therefore are not using it to its fullest potential to help manage and address risks that span the economy, such as climate change or public health. For example, an investor would generally not engage with a pharmaceutical company to ask it to lower prices of a critical drug, even if doing so would deliver overall portfolio returns far in excess of what would be delivered by the additional profits earned by the company itself. Stewardship is not delivering real-world outcomes at the necessary pace and scale. Technical, policy and practice barriers remain.

To enable effective stewardship around shared objectives, policy makers need to provide clarity and certainty around long-term sustainability goals. The EU Green Deal and the proposed Climate Law provide an overarching framework that promises to offer such clarity. However, connecting these high-level goals to day-to-day investment practice is a central challenge faced by the finance industry. The EU Taxonomy provides one tool to facilitate this, but more needs to be done.

At a practical level, the existing EU legislative framework could go further to incentivise high-quality, impactful stewardship. The EU Action Plan on Financing Sustainable Growth is the most comprehensive strategy of its type in the world but, despite this, some investors complain that the Action Plan and associated legislation and tools do not adequately recognise the role of stewardship.

There are foundations in EU policy which could be built upon. The 2016 revision of the Shareholder Rights Directive (SRD II) requires investors to establish an engagement and voting policy and disclose how it is implemented on an annual basis, or explain why they do not do so. Investors are

\[^{30}\] “Capital allocation is highly relevant, even critical, for the success of, and sustainable value creation by, companies.” ICGN Viewpoint (July 2019), Capital Allocation.

\[^{31}\] HLEG final report: “The exercise of stewardship responsibilities is a key expression of investor duties to integrate material ESG risks into their investment process.”

\[^{32}\] PRI (2019), Active Ownership 2.0: The Evolution Stewardship Urgently Needs.
also required to disclose how their equity strategies align with the profile and duration of their long-term liabilities, and how their external managers are incentivised to do the same.

SRD II is a welcome step and sets a minimum baseline for stewardship activities. However, it does not reflect global best practice in stewardship guidelines. In particular, it does not explicitly reference the role of sustainability, its scope is limited to equities, and it does not set expectations for how different actors across the investment chain should discharge their stewardship responsibilities.

In addition, a small number of investors consider that acting-in-concert rules to prohibit them from participating in collaborative engagements. This is despite guidance from the European Securities & Markets Association (ESMA) in 2014 on acting in concert, which clarified that investor engagement would typically not be in breach of these rules.

**RECOMMENDATIONS**

8. **Enhancing stewardship:** Investor stewardship should be central to the private finance elements of the EU Green Deal and any future legislation under the EU Action Plan. Such elements and legislation could include:

   a. An aspirational (non-binding) standard for outcomes-focused stewardship and the development and adoption of a standard for system-level stewardship, where efforts are focused on achievement of outcomes on common goals rather than on outperformance of individual assets;
   
   b. Revisions or supplements to the Shareholder Rights Directive II or other relevant instruments to:
      - Require investors to clarify the intended overall objective of their stewardship activities (for example, to maximise performance of individual holdings, to maximise performance of the portfolio overall, or to maximise net financial (and/or non-financial) benefits to client/beneficiaries;
      - Clarify that stewardship should be considered across all asset classes; and
      - Clarity that sustainability is a central component of stewardship; and
   
   c. The further development of ESMA guidance and work with national regulators to ensure acting in concert and anti-trust regulations do not impede collaborative engagement by investors around common sustainability goals.

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33 The PRI monitors the development of global responsible investment regulations including stewardship related rules and guidelines: see PRI (2019), Responsible investment regulation map.

34 European Securities and Markets Authority, Public Statement, 20 June 2014, Information on shareholder cooperation and acting in concert under the Takeover Bids Directive.

5. THE EU TAXONOMY

INVESTOR PERSPECTIVE

Of all the developments under the EU Action Plan on Financing Sustainable Growth, the EU Taxonomy received the most attention from the investors interviewed for this project. The Taxonomy is considered an important contribution to the agenda as it creates a common language between investors, issuers and policy makers. It can also build confidence that investments are meeting robust environmental standards and are consistent with high-level policy commitments, such as the EU’s goal to achieve net-zero by 2050.

Many investors are already working on implementation of the EU Taxonomy. The PRI has established a practitioners group which, at the time of writing, had 37 institutional investor and fund manager members, each of whom is working to implement the Taxonomy in one or more of its existing portfolios.

The most significant challenge – also reflected in the final report of the Technical Expert Group – is the absence of Taxonomy-aligned corporate data. Some of those interviewed for this project are concerned that this will only allow them to issue a small number of Taxonomy-aligned products in the short to medium term. The data gap is particularly acute for firms not required to comply with the NFRD – that is, firms with fewer than 500 staff, privately owned companies and those located outside of the EU. Investors also note that the timeline for corporate Taxonomy-aligned disclosures presents challenges, as the first corporate reports will be published after the investor disclosure requirement enters force.

The initial sectors prioritised by the Technical Expert Group – energy, agriculture and forestry, transport, industry, buildings, water and waste – are closely aligned with those that will be subject to dedicated sector reforms under the EU Green Deal. However, not all sectors have been fully evaluated for their potential contribution – or harm – to the EU’s environmental objectives, which may present challenges for investors.

Taxonomy: Implementation already underway

Many investors responded that they are already testing the Taxonomy against existing portfolios or beginning to build Taxonomy-aligned portfolios. In some cases, investors have set up internal working groups consisting of representatives of different teams to support effective implementation. Some investors have started to assess asset classes and bonds consistent with economic activities covered by the Taxonomy regulation.

Many of those interviewed were also participating in the PRI’s EU Taxonomy Practitioners Group. The group brings together investors who are exploring how the EU Taxonomy will apply in practice. It will share tools and experiences to help members understand and overcome barriers to implementation of the Taxonomy.
The EU Taxonomy establishes minimum social safeguards, but investors also recognised that the Taxonomy could be an important lever to encourage investment in socially beneficial activities – an aspect of the sustainable finance agenda that has received relatively limited attention from policy makers.

Finally, a common concern among investors is the international applicability of the EU Taxonomy, and the potential relationship between the EU’s approach and other taxonomies under development.

**ANALYSIS**

As required by the Taxonomy regulation, the European Commission will establish a long-term Platform on Sustainable Finance. The platform will: advise the Commission on technical screening criteria; analyse the impact of the screening criteria in terms of potential costs and benefits of their application; and monitor and report regularly to the Commission on capital flows towards sustainable investment to inform the Commission’s decision making.

**RECOMMENDATIONS**

The final report of the TEG on the Taxonomy has already issued recommendations for the platform. These include that:

- Recommendations for priority sectors should be included in future iterations of the Taxonomy;
- Activities should be included which can make a substantial contribution to social objectives, in addition to environmental objectives and minimum safeguards;
- Technical screening criteria be established for activities which significantly harm environmental objectives – the so-called “brown” taxonomy.

The TEG recognises that international taxonomies are being developed that will reflect the specific environmental objectives and development context in other markets. The TEG therefore recommends minimum principles for taxonomy harmonisation.

To complement these, the PRI makes the following recommendations.

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37 TEG recommends renaming this to something more appropriate in different cultural contexts.
9. **Development of the EU Taxonomy**: the EU Taxonomy framework should be developed and further integrated into the EU’s overall climate planning. This should include:

   a. As soon as feasibly possible, the Taxonomy should be explicitly aligned with the EU’s net-zero trajectory to give clarity and certainty around the expected evolution of the technical screening criteria;

   b. Priority should be given to defining Taxonomy-aligned activities that can make a substantial contribution to social issues, resulting in a tool which will allow investors to map their contributions against the SDGs;

   c. Ensuring that Taxonomy-aligned disclosures from companies are available ahead of the deadline for investor reporting on the Taxonomy; and

   d. Working towards a common approach for global taxonomy development, based upon the TEG’s principles for taxonomy harmonisation.
6. PENSION MARKET REFORM

INVESTOR PERSPECTIVE

By setting mandates and incentives, pension funds drive behaviour throughout the investment chain. However, to be effective, retirement schemes and other asset owners need the internal capacity to consider sustainability issues, to set clear policies and to challenge their fund managers and other service providers. Many of the fund managers interviewed for this study noted that their engagement with sustainable finance was limited by the mandates received from asset owners. However, interviewees also noted that there have been positive moves by asset owners, such as the UN-convened Net-Zero Asset Owner Alliance.

ANALYSIS

Pension funds, in terms of weight of capital and influence, have the potential to substantially contribute to the sustainability goals the EU and its member states have set themselves. Pension funds are often focused on the long-term, with new members likely to be drawing their pensions well into the second half of this century.

The type and structure of pension provision within a country can substantially influence markets for sustainable finance, with smaller funds typically (although not always) showing less interest in sustainability issues than larger funds. Put simply, some markets are set up so that pension funds are typically “product takers”, responding to the services offered, while others enable them to be “product makers”, setting clear expectations and creating demand for products and services that are aligned with their long-term investment horizons.

The EU has taken steps to ensure that pension funds’ fiduciary obligation to consider financially material ESG issues is clear. The revised Institutions for Occupational Retirement Provision (IORP) Directive (2016)\(^{38}\) clarifies that the prudent person principle does not prevent IORPs from considering the impact of their investments on society and the environment. Furthermore, the sustainability-related disclosures regulation and the EU Taxonomy set out enhanced disclosure requirements for pension funds around sustainability risk management and impact. The European Insurance and Occupational Pensions Authority (EIOPA) has also included sustainability issues in its 2019 pension stress-tests. In addition, the EU has developed the Pan-European Personal Pension Product (PEPP), an EU-wide Pillar III product framework regulation, and PEPP providers are expected to provide information related to the performance of the investment policy in terms of ESG factors. PEPP providers are also required to keep the PEPP saver informed throughout the term of the contract of any change concerning information on how the investment policy considers ESG factors.

Despite these measures, the PRI recognises that pension funds’ internal capacity still acts as a barrier to a fuller contribution to EU sustainability goals. EIOPA’s 2019 stress test found that only 30% of those surveyed had ESG-related risk management systems in place.

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\(^{38}\) EU Directive 2016/2341 (12 December 2016) of the European Parliament and of the Council the activities and supervision of institutions for occupational retirement provision (IORPs)
This analysis is included because it was a theme of the investor interviews conducted. However, the EU does not officially hold the competency to reform member states' pension systems, and the PRI therefore does not recommend further action at the EU level at this stage. The PRI is currently undertaking research into pension system design and sustainability at a global level and may make further recommendations for individual member states in future.
OUTLOOK

The policy developments under the umbrella of the EU Green Deal offer a great opportunity for investors to support the process of shaping a sustainable economy in Europe.

The PRI will continue to engage investors to explore the opportunities presented by the EU Green Deal and advocate for the political instruments necessary to accelerate the implementation of sustainable finance in Europe.

However, many elements required for the implementation of the Green Deal – in particular, proposed sectoral strategies such as Farm to Fork, Industrial Strategy or Renovation Wave – are either lacking in detail or are yet to be released. These fall out of the scope of this project, but the PRI will undertake further research into the investment opportunities they present and the real-economy policies required to enable the transition in key sectors over 2020-21.

The picture is, of course, complicated by the COVID-19 pandemic and the necessary policy response. The PRI has recently established global investor working groups to explore the short- and long-term implications of the COVID-19 crisis, which will include considering how the development of a more sustainable financial system can be ensured during the economic recovery phase. The PRI will apply these considerations to the European policy context and continue to express, through appropriate fora, the support of our signatories for a low-carbon recovery.

CREDITS:
This report has been prepared by Alyssa Heath, Elise Attal and Susanne Draeger (lead).

Cover design by: Alessandro Boaretto, PRI
The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org/