PRI Principles for Responsible Investment

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

A BLUEPRINT FOR RESPONSIBLE INVESTMENT

GENESIS, ASSUMPTIONS AND PROCESS

RESPONSIBLE INVESTORS SUSTAINABLE MARKETS A PROSPEROUS WORLD FOR ALL

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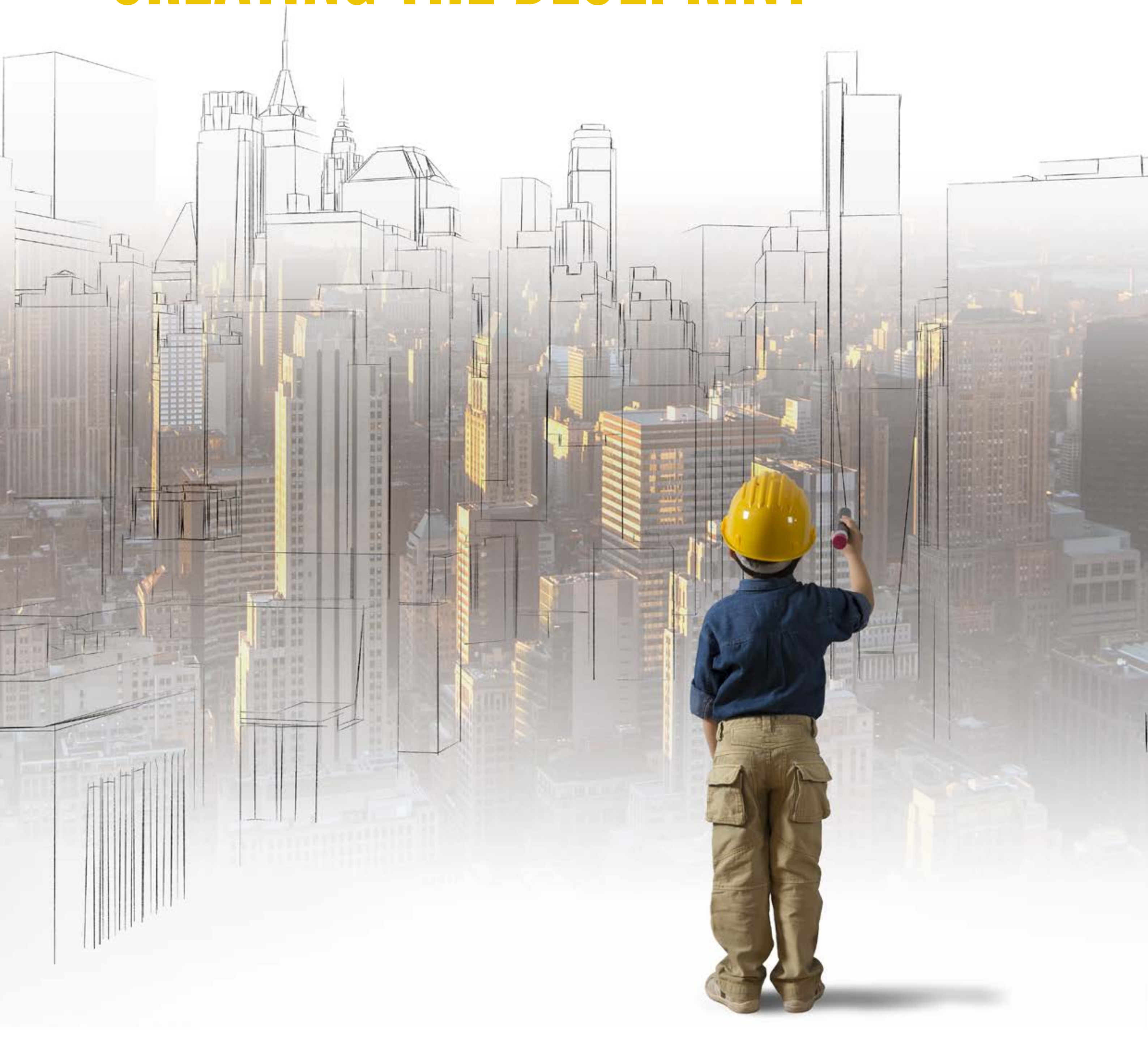
A blueprint for responsible investment, published in May 2017, set out the PRI's vision for how the PRI and the wider responsible investment community should progress over the next 10 years.

This supplement explains the genesis of the blueprint project, the assumptions we've based our thinking on and the process we went through to reach the agenda that *A blueprint for responsible investment* sets out.

INTRODUCTION: CREATING THE BLUEPRINT



THE BLUEPRINT

responsible, *adj. and n.* (rᵻˈspɒnsᵻbl)

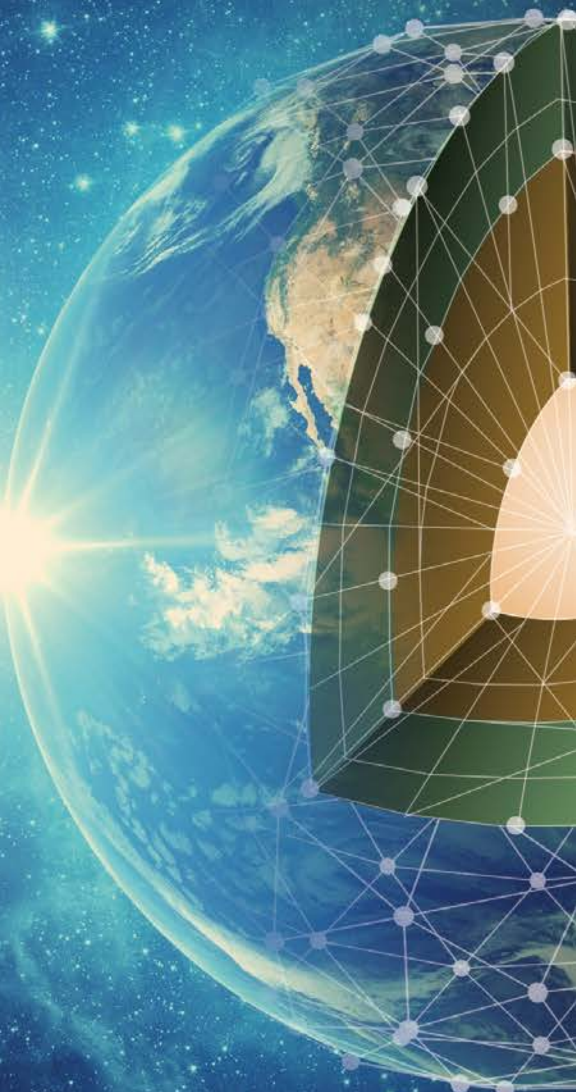
Being appointed to look after something. Answerable to another person for something. Morally accountable for one's actions; capable of rational conduct. Deserving of credit (or blame) for something. Capable of fulfilling an obligation or duty; reliable, trustworthy, sensible. Of a practice or activity: carried out in a morally principled or ethical way.

sustainable, *adj.* (səˈsteɪnəbl)

Capable of being maintained or continued in the long term. Capable of being upheld or defended as valid, correct, or true.

prosperous, *adj.*, (ˈprɒsp(ə)rəs/

Flourishing, thriving. Consistently successful, esp. economically. Of a person or community, relating to well-being: the state of being healthy, happy.



Over the next 10 years, the PRI will focus on the following areas of impact:

RESPONSIBLE INVESTORS

We will strengthen, deepen and expand our core work: to lead responsible investors in their pursuit of long-term value and to enhance alignment throughout the investment chain.

- EMPOWER ASSET OWNERS
- SUPPORT INVESTORS INCORPORATING ESG ISSUES
- FOSTER A COMMUNITY OF ACTIVE OWNERS
- SHOWCASE LEADERSHIP AND INCREASE ACCOUNTABILITY
- CONVENE AND EDUCATE RESPONSIBLE INVESTORS

SUSTAINABLE MARKETS

We will address unsustainable aspects of the markets that investors operate in, to achieve the economically efficient, sustainable global financial system that responsible investors and beneficiaries need.

- CHALLENGE BARRIERS TO A SUSTAINABLE FINANCIAL SYSTEM
- DRIVE MEANINGFUL DATA THROUGHOUT MARKETS

A PROSPEROUS WORLD FOR ALL

We will enable signatories to improve the real world – now and in the future – by encouraging investments that contribute to prosperous and inclusive societies for current and future generations.

- CHAMPION CLIMATE ACTION
- ENABLE REAL-WORLD IMPACT ALIGNED WITH THE SDGs

This supplementary guide on the genesis, assumptions and process of the Blueprint project aims to provide additional context and explanation for the decisions we have made.

As always, the PRI welcomes continuing input from signatories and other interested parties to shape our work within the Blueprint programme, in pursuit of the goals we've laid out. As a signatory organisation, the progress the PRI can make towards those goals will depend on the actions of our signatories.

Our aim over the next 10 years is to bring responsible investors together to work towards sustainable markets that contribute to a more prosperous world for all.

The Blueprint process

The development of the Blueprint followed an external evaluation of the PRI's achievements, impacts and challenges by sustainability consultant Steward Redqueen.[2] It sought to chart the progress of implementation of the Principles across the investment industry since 2006, using activity and data from that year as a baseline, and involving interviews with signatories and stakeholders as well as survey data.

Its report recognised the global leadership position the PRI has established, and our success in helping to embed ESG issues within the core processes of investors around the world. However, it also concluded that considerable work remains to be done to make all investment responsible. It also recommended that the PRI seek to create greater clarity about its purposes and ambitions.

Alongside that work, and in line with the emphasis the PRI places on working on behalf of our signatories, we have carried out several surveys and consultations with our signatory base. Among other things, these have sought views on the PRI's goals and evolving Mission.

These include the **2016 Signatory satisfaction and engagement survey**, the latest in the PRI's regular collection of signatory views on the effectiveness, performance and governance of the organisation.[3] We also conducted a consultation entitled **Recognising diversity, strengthening accountability**, to help determine how the PRI might better reflect the diversity of our signatories, and whether the PRI should introduce additional measures to incentivise signatories to make progress on responsible investment.[4]

In addition, we carried out the **Sustainable Financial System, Principles, Impact** consultation. It sought views on: the obstacles that exist to creating a financial system that is fit for purpose; the use of the SDGs as a means to assess the impact of responsible investment; whether the six Principles should be updated; how the PRI might seek to define its success.[5]

In parallel with these consultations, which generated almost 700 written responses, in 2016 the PRI carried out a series of workshops with signatories and

2 PRI (2016), From principles to performance, (PRI, London)

3 PRI (2016), PRI signatory satisfaction and engagement: 2016 survey chartbook, (PRI, London)

4 The consultation document is available here, while an executive summary of feedback can be found here.

5 The consultation paper is available in English. French, German and Portuguese versions are available. Responses are summarised here. A report, *Sustainable financial system: nine priority conditions to address*, was published by PRI in September 2016.

stakeholders in 21 cities around the world, attended by more than 2,000 delegates.

In addition, our thinking has built upon the work of peer organisations, including landmark reports such as Ceres's *Blueprint for Sustainable Investing*,[6] the UNEP Inquiry into the Design of a Sustainable Financial System,[7] The Investment Integration Project's work on portfolio-level ESG integration,[8] the European Commission's communication on long-term finance,[9] and the World Economic Forum's report on the global financial system.[10]

The 21st Century Investor: Ceres Blueprint for Sustainable Investing

Where the PRI's Blueprint for responsible investment describes the role that the PRI will seek to play in guiding the broad direction of the overall responsible investment industry over the next decade, Ceres's 2013 report *The 21st Century Investor: Ceres Blueprint for Sustainable Investing*[11] (updated 2016) offers a specific 10-step guide on what investors including PRI signatories can do within their own organisation to embed ESG factors into investment policy and practice.

This "virtual owner's manual", whose 10 steps are mapped against the six Principles, references many PRI materials along the way. We encourage signatories to consider its guidance, alongside that offered by the full suite of PRI resources available at www.unpri.org, as they continue their responsible investment journey.

Finally, our executive team and chair have presented our thinking at major industry events, including to over 600 delegates representing about 350 organisations at PRI in Person in Singapore in September 2016.

Framing the challenge

Since the PRI was established, a core part of its work has been to promote the incorporation of ESG issues into investment processes. Our signatories believe that this leads to better long-term financial outcomes, and is therefore a fiduciary responsibility for investors.

We have made significant progress on ESG incorporation, but it needs to become broader and deeper. Broader, in that it is applied across all asset classes and in institutions and jurisdictions that are just beginning to engage with responsible investment, and deeper, so that ESG management becomes an integral part of investment processes throughout the investment chain.

In addition, we recognise that deep incorporation of ESG factors, achieved by applying the six Principles, relies on a supportive enabling environment. This means government policies, market structures and financial actors all working positively within the financial system for sustainable outcomes. The Principles should not be seen in isolation, but instead as a means to an end: a sustainable financial system.

6 Ceres (2013), The 21st Century Investor: Ceres Blueprint for Sustainable Investing (Ceres, Boston)
7 UNEP (2015), *The Financial System We Need: Aligning the Financial System with Sustainable Development.* (UNEP, Geneva)
8 Lydenberg, S. (2015), *Portfolios and Systemic Framework Integration: Towards a Theory and Practice. Exposure Draft* (16 November 2015) (The Investment Integration Project (TIIP))
9 European Commission (2014), "Communication from the Commission to the European Parliament and the Council on Long-Term Financing of the European Economy. COM/2014/0168 Final.
10 World Economic Forum (WEF) (2015), *The Global Financial System: Policy Recommendations for the Future* (WEF, Geneva)
11 Ceres (2013), The 21st Century Investor: the Ceres Blueprint for Sustainable Investing (Ceres, Boston)

We have been working with our signatories to help promote such a financial system since 2006 with our work on investment practice. The Principles focus on investor activities, specifically the relationship between investors and the companies in which they invest. But investors are connected to all the other actors and influence the financial system. Likewise, the behaviours of other actors influence how “responsible” investors can be in practice.

Responsible practices by investors are therefore necessary but not sufficient to deliver a sustainable system. Without a better enabling environment, adoption of the six Principles and ESG integration will not be enough to achieve the PRI’s Mission. Responsible investors need a financial system that works with, not against, their pursuit of long-term value, incentivising long-term investment, taking into account social and environmental impacts beyond the reach of any individual investor, and that works in the interests of its ultimate beneficiaries.

It is also fundamental to the work of the PRI, and to our signatories, that responsible investment practices deliver real-world impact in terms of improved environmental and social outcomes. We believe that the SDGs provide a framework to deliver improved social, environmental and economic outcomes, benefitting our signatories and, crucially, their beneficiaries. By strengthening the link between the work of responsible investors and the SDGs, we will be better able to understand and measure investors’ contribution to the kind of world their beneficiaries want – one of prosperous and inclusive societies in a healthy natural environment.

Setting out our approach

In thinking about the future of our work in the context of the Blueprint, we have been mindful of our strengths and the value we bring – and aware of our limitations.

The PRI is a unique organisation. We have a global signatory base. The assets for which our signatories are responsible represent a majority of the world’s professionally managed investments. We bring together asset owners, investment managers and service providers in one body. Our genesis, as a UN-supported organisation, and our continuing strong links with the UN – centred on our long-standing partnership and collaboration with the UN Global Compact and the UNEP Finance Initiative – enhance our credibility.

We can also bring substantial intellectual capacity to bear. The PRI itself has built up considerable human capital resources, and through our signatories and partners we have access to the world’s leading practitioners of, and thinkers on, responsible investment.

All of this gives the PRI unique convening power. We have demonstrated our ability to bring together investors, policy makers, regulators, companies and academics to address issues around responsible investment and ESG integration.

As a signatory organisation, the PRI exists to create value for our signatories. They have been clear in identifying where they believe we add that value.

We help by sharing knowledge about ESG integration, by supporting networking, sharing best practice and helping signatories interpret developments in responsible investment. We enable collaboration among signatories on ESG issues where collective action is more effective than investors acting alone. We work with our signatories to set standards on reporting and assessment of responsible investment practices and outcomes, helping to promote transparency and performance and we offer a global platform to promote responsible investment and to advocate for policy, regulation and system reform. This Blueprint and the vision for PRI's role over the next 10 years were developed with close regard to our organisational values, our comparative advantage and to the value we bring our signatories.

Determining our priorities

In deciding which initiatives to bring forward as part of our 10-year vision, the fundamental questions we asked were: Would the initiative address an issue of importance to our signatories? Would it help promote a sustainable system?

Then, we carefully considered whether the PRI's strengths and value proposition position us to make a material contribution to addressing the issue in question. Specifically, we have used the following criteria to assess potential action areas:

- Is there a representative role for investors in correcting or mitigating the causal factor or the symptoms that result?
- Is there is a role for the PRI and our signatory base?

  The PRI is an authoritative, credible body with a large signatory base.
- Do we have the capacities and capabilities we need to make a meaningful contribution?

  We now have a robust policy capacity, including staff experienced in public policy, programme management and change management.
- Can we deliver the projects or interventions in question?

  We have a tried and tested model for scaling up and delivering change projects on investment and policy.
- Does the issue in question require extensive consultation and dialogue with investors or other stakeholder groups?

  We have an established track record of consultation with the investment industry and wider stakeholder groups on a variety of issues.

This process has led the PRI to identify nine action areas, set out over the following pages. These initiatives, which we will bring forward working in collaboration with our signatories and UN partners, will help the PRI further our Mission and deliver value for our signatories

Why the Blueprint?

The Principles for Responsible Investment (PRI) were launched in April 2006 at the New York Stock Exchange by the United Nations' then Secretary General Kofi Annan. They launched with 32 signatories from nine countries. Over the following decade, the organisation firmly established itself as the global voice of the responsible investment movement. More than 1,750 asset owners, investment managers and service providers, from over 50 countries and representing approximately US$70 trillion in assets, are now signatories.

This critical mass, allied with our roots in the UN system and underpinned by the skills, competencies and credibility the organisation has built over the last decade, give the PRI unique convening power. It creates possibilities to materially influence the development of responsible investing and the broader financial system, ultimately with the aim of delivering the PRI's Mission of achieving a sustainable global financial system focused on creating long-term value.

We believe that such a system will not only reward its users financially, but also benefit the environment and society as a whole. Achieving our Mission will deliver real-world impact in terms of better outcomes for the financial system's ultimate beneficiaries.

As we marked our 10-year anniversary, we took the opportunity to evaluate our impact so far and to consult extensively with our signatories on the best path ahead to make progress towards achieving our Mission.

The result is *A blueprint for responsible investment*[1], which sets out nine action areas, grouped under three areas of impact – responsible investors, sustainable markets and a prosperous world for all:

- Through the Blueprint, we aim to strengthen, deepen and expand our core work with responsible investors to help them in their pursuit of long-term value and to enhance alignment of interests throughout the investment chain. Specifically, we aim to empower asset owners, support investors in their incorporation of ESG issues, foster a community of active owners, showcase leadership and increase accountability and convene and help educate responsible investors.
- To promote sustainable markets, we will work to remove barriers to a sustainable financial system and to drive meaningful ESG data throughout markets.
- Finally, in working towards a prosperous world for all, we will help our signatories take action to address climate change and enable them to have real-world impact on sustainability challenges, as defined by the UN Sustainable Development Goals (SDGs).

In addition, we will be transparent in tracking the implementation of our 10-year ambitions, setting out a series of three-year strategies and developing and reporting on key metrics to measure our progress.

Significant time and resources were dedicated to considering, consulting on, and debating how the PRI should aim to support our signatories and work towards fulfilling our Mission over the next 10 years.

1 PRI (2017), A blueprint for responsible investment, (PRI, London)

RESPONSIBLE INVESTORS

EMPOWER ASSET OWNERS

Asset owners set the direction of markets: the mandates they award to managers determine the objectives that the world's biggest pools of money are put to. To fulfil their duties to beneficiaries in the 2020s and beyond, asset owners will need robust approaches to investment that acknowledge the effects their investments have on the real economy and the societies in which their beneficiaries live.

The institutions representing the holders of long-term retirement savings – pension funds, sovereign wealth funds, foundations, endowments, insurance and reinsurance companies – sit at the top of the investment chain. It is their investment policies, strategies and the mandates they award to investment managers that set the objectives and scope of investment practice and the direction of travel for investment markets. In addition to these investment signals, responsible investors send policy signals, encouraging policy makers to introduce measures and regulations that support responsible investment.

The majority of the world's professionally managed assets are held by signatories to the PRI.[12] Signatories are required to incorporate ESG issues into investment analysis and decision making (Principle 1) and into their ownership policies and practices (Principle 2). However, while many asset owners have made commitments to responsible investment, most have yet to ensure that these commitments are effectively implemented.

Our data shows that sustainability considerations are often missing from asset owners' investment processes, in particular from the selection, appointment and monitoring of investment consultants and investment managers.

For example, fewer than half of asset owner signatories include specific guidelines on environmental and social issues in their policy and guidance documents, and only 44% include specific contractual requirements for investment managers to incorporate ESG issues in their investment decision making.[13]

We've found that there are a number of internal and external reasons why asset owners are not fully implementing their responsible investment commitments. Internal challenges include board and trustee scepticism about the investment value of responsible investment, skills gaps in relation to ESG analysis and decision making, concerns over costs to develop the necessary processes, systems and skills, and a narrow interpretation of investment objectives. External challenges include the limited range of responsible investment-oriented investment products, and the general lack of interest in responsible investment on the part of investment consultants and legal advisers.

However, for some asset owners, responsible investment is fully embraced and successfully integrated in investment processes. The actions taken by these leaders need to be replicated more widely, in line with Principle 4, which requires signatories to promote acceptance and implementation of the Principles within the investment industry.

12 PRI (2015), Report on progress 2015, (PRI, London)
13 PRI (2016), How asset owners can drive responsible investment, (PRI, London)

Given the important position of asset owners at the top of the investment chain, they have always played a central role in the PRI, in its governance, and in the programmes we have developed.

The PRI's Asset Owner Insight programme provides investment guidance and implementation support to asset owners, with a view to informing them about the potential for ESG incorporation. It aims to empower asset owners to effectively direct investment managers, consultants and other investment stakeholders through engagement and contractual arrangements to realise their promises to their beneficiaries.

Current and future projects from our asset owner-focused work seek to address:

- **Investment strategies**, offering practical guidance for asset owners to outline how robust responsible investment strategies can be formulated and developed;
- **Investment policy**, developing guidance on how to review existing investment policies to include ESG considerations;[14]
- **Asset allocation**, addressing the incorporation of ESG factors and the SDGs in scenario analysis and asset allocation;
- **The under-representation of corporate pension funds** in responsible investment;[15]
- **Fund trustee capacity**, to address responsible investment issues, including through new training programmes and tools;
- **The incorporation of ESG factors in the development of asset owner mandates**, which play a key role in the investment chain and the processes of selection, appointment and monitoring, and which should include asset owners' expectations for ESG incorporation, active ownership and outcomes to society for the investment managers they select;[16] and
- **Manager selection, appointment and monitoring**, to develop a tool to provide asset owners with data from the Reporting Framework on investment managers' responsible investment performance.

Over the life of the Blueprint, the PRI will continue to evolve practice in the above fields and work to drive portfolio/plan-level ESG incorporation. Besides the effects of ESG incorporation on the risk/return profile of investment portfolios, the guidance for asset owners will increasingly take into account the real-world influence on sustainable economic development of asset owner decision making.

The PRI will help its asset owner signatories to recognise long-term global trends that will shape the future investment environment. Robust investment strategies, which acknowledge the effects investments have on society and the real economy, will be prerequisites for asset owners to fulfil their fiduciary duty in the 2020s and beyond. We will support asset owners in this endeavour by helping them develop and implement strategies and practices that lead to long-term investment success.

14 PRI (2016), Investment policy: process and practice, (PRI, London)
15 PRI (2017), Aligning values: why corporate pension plans should mirror their sponsors, (PRI, London)
16 PRI (2017), How asset owners can drive responsible investment, (PRI, London)

We will undertake initiatives through the Blueprint that will:

- champion ESG incorporation throughout organisations, from areas such as strategy, policies and trustee capacity through to portfolio/plan-level decisions, including asset allocation;
- enable asset owners to effectively oversee and monitor investment managers, consultants and others in order to meet their responsibilities to beneficiaries;
- demonstrate how long-term global trends will shape the investment environment of tomorrow;
- establish that asset owners' duties to their beneficiaries extend beyond the risk/return profile of their investments to include making decisions that benefit the world beneficiaries live in.

RESPONSIBLE INVESTORS

SUPPORT INVESTORS INCORPORATING ESG ISSUES

Since the launch of the Principles, the investment industry has made great progress in making ESG factors a part of investment decisions. Deep, systemic incorporation of ESG issues across a firm's entire spectrum of assets, however, is rare, and for investors who do not yet address ESG issues, getting started can be challenging.

The evidence is strong and becoming increasingly compelling: ESG issues affect, to varying degrees across companies, sectors, regions, asset classes and through time, the performance of investment portfolios.

Deutsche Asset & Wealth Management and Hamburg University reviewed more than 2,000 studies carried out since 1970 that examined the relationship between ESG criteria and corporate financial performance. It found that 62.6% of studies revealed a positive relationship, and only 10% a negative one.[17]

Oxford University and Arabesque Partners came up with similar numbers. Of the sources it reviewed, 88% found that companies with robust sustainability practices showed better operational performance. Similarly, 80% demonstrated that prudent sustainability practices had a positive effect on investment performance.[18] A 2015 study from Morgan Stanley's Institute for Sustainable Investing stated that: "Investing in sustainability has usually met, and often exceeded, the performance of comparable traditional investments."[19] Meanwhile, in research published in late 2016, Bank of America Merrill Lynch found that ESG incorporation could have helped investors avoid 90% of bankruptcies in companies that the bank covers, while ESG factors helped predict price and earnings volatility.[20]

It is because of this positive relationship between ESG factors and financial performance that Principle 1 commits signatories to incorporate ESG issues into investment analysis and decision-making processes. Since the launch of the Principles, the investment industry has come a long way with the incorporation of ESG factors in investment decisions.

Our signatories are making significant efforts on ESG integration. According to disclosures to the PRI's *Report on progress 2015*, some 98% of investment manager signatories apply responsible investment practices to their listed equity holdings.[21]

However, systemic and truly insightful incorporation of ESG issues across a firm's entire spectrum of assets is still relatively rare. For example, in the same set of disclosures, only 16% of the 342 investment managers reporting on listed equity incorporation stated that they systematically integrate E, S and G issues into fundamental analysis. Although the PRI does not collect product-level data, we expect that in many cases this will be for specialised products or funds, rather than integrated across signatories' entire investment processes.

17 Deutsche Asset and Wealth Management (2016), *ESG & Corporate Financial Performance: Mapping the Global Landscape* (Deutsche Asset and Wealth Management, London).

18 Arabesque Asset Management (2015), *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (Arabesque Asset Management London; the Smith School of Enterprise and the Environment, University of Oxford, Oxford)

19 Morgan Stanley Institute for Sustainable Investing (2015), Sustainable Reality: Understanding the Performance of Sustainable Investment Strategies. (Morgan Stanley Smith Barney LLC & Morgan Stanley & Co LLC, New York)

20 Bank of America Merrill Lynch (2016), Equity Strategy Focus Point: ESG: good companies can make good stocks, (BofA Merrill Lynch Global Research, New York)

21 PRI (2015), Report on progress 2015, (PRI, London)

The PRI will therefore continue to develop guidance to help broaden and deepen ESG incorporation across assets and throughout the financial industry.

Existing resources include:

- *A practical guide to ESG integration for equity investing*, which aims to guide investors in how to integrate ESG techniques into investment processes;
- our *Fixed income investor guide*, as well as specific reports on ESG risks in sovereign and corporate bonds, plus a series of fixed income case studies;
- a number of guides aimed at private equity investors, including on integrating ESG factors, climate change and guides aimed at both limited partner and general partners;
- guides aimed at real estate investors that, among other things, explain how to implement sustainability management systems and energy efficiency investments;
- a re-launched work stream on responsible investment in infrastructure to raise awareness about, provide guidance on and promote investment in low-carbon infrastructure;
- the first ESG due diligence questionnaire for hedge funds, to help investors assess hedge fund managers on responsible investment policies and practices; and
- for commodity investors, a guide to responsible investment in farmland and a best-practice guide across commodity-exposed asset classes.

For investors who do not yet explicitly address ESG issues, embarking upon ESG incorporation process can be challenging. Over the life of the Blueprint, in high penetration and mature areas of ESG incorporation, the PRI will focus on the depth of practice and insight. In asset classes where the application of responsible investment approaches remains the exception rather than the rule – such as commodities, hedge funds and supranational and asset-backed fixed income – the PRI will continue to create with its signatories some of the basic structures and processes required for ESG incorporation.

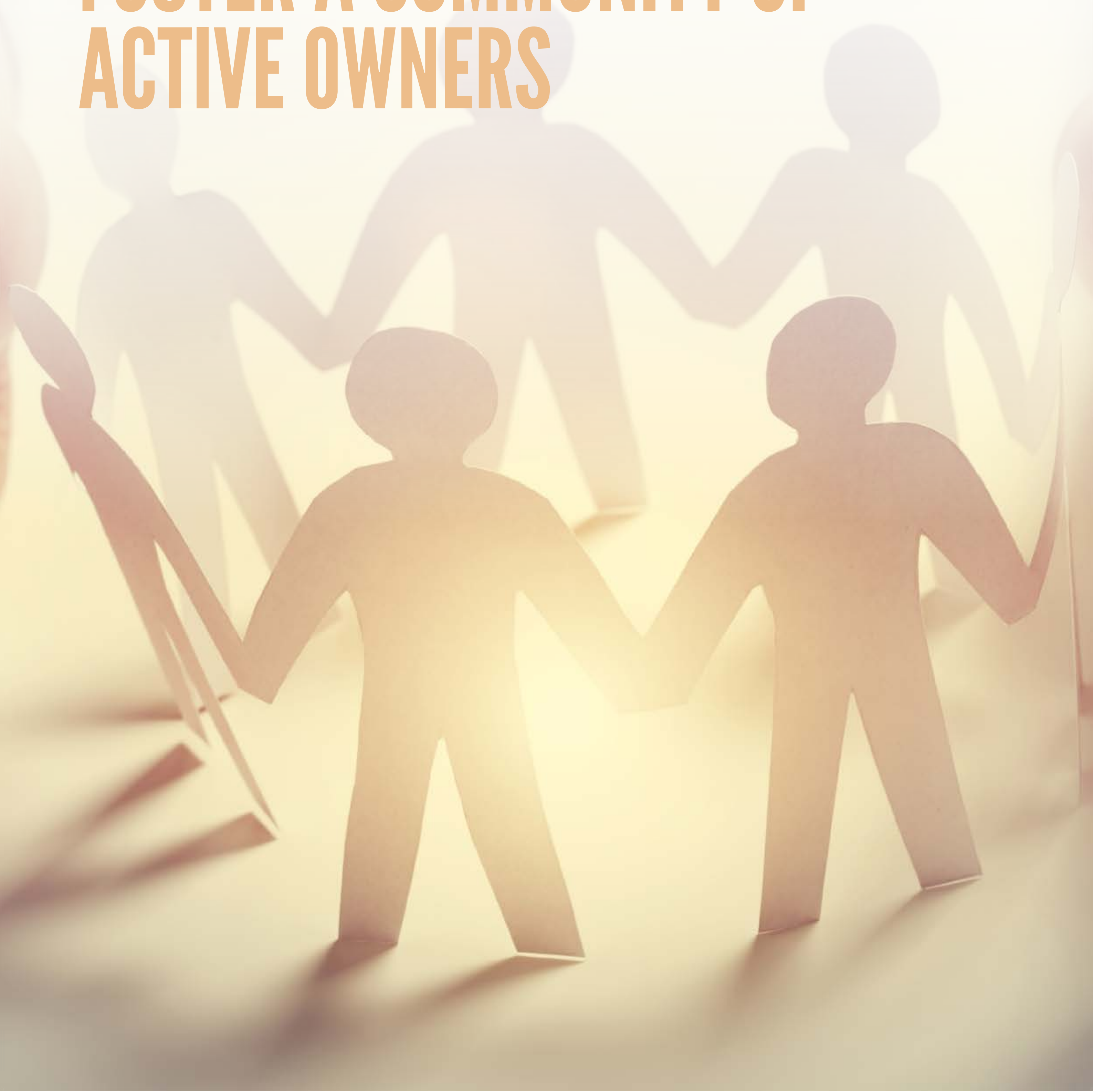
In addition, we will work with our signatories to help them respond to emerging ESG issues. For example, we have announced a project with investment consultant Willis Towers Watson to produce a report on how social, environmental, economic, technological and political megatrends could impact the financial system.

We will undertake initiatives through the Blueprint that will:

- increase the depth of insight and practice in asset classes where ESG incorporation is mature and penetration high – such as listed equity and corporate and government debt;
- build the foundations for ESG incorporation in asset classes where it is still new – such as commodities, hedge funds and supranational and asset-backed debt;
- lead signatories' awareness and response to existing and emerging ESG issues.

RESPONSIBLE INVESTORS

FOSTER A COMMUNITY OF ACTIVE OWNERS



Investors who do not have an active relationship with the companies they are invested in risk holding poorly governed companies that do not perform well over the long term, and risk neglecting beneficiaries' interests. Crucially, for active ownership to be a success, it relies on the investor fully using the information collected when making portfolio decisions. Investors have a much bigger influence on companies when acting together than alone.

The world's financial system is subject to serious principal-agent problems. Its ultimate beneficiaries typically rely on several layers of management to ensure that their savings and investments are managed in the beneficiaries' best interests. At each layer, oversight and appropriate control must be exercised to ensure that agents act in the interests of their principals. In well-regulated markets, laws and regulations exist that give principals – whether shareholders, bondholders or owners of real assets – the right to exercise this oversight and control.

Academic research shows that investors' engagement on ESG issues contributes to sustainability performance, better quality of management and improved risk-return profiles of target companies, to the ultimate benefit of asset owners and their beneficiaries. Research from London Business School found successful engagements on ESG issues were followed by abnormal returns averaging 4.4% twelve months after the engagements were concluded.[22] A study of engagement carried out by the Hermes UK Focus Fund conclude that it created shareholder value and fund outperformance.[23]

Practitioner experience bears this out. For example, pensions giant and PRI signatory CalPERS credits its corporate governance engagement as generating a "CalPERS effect" worth 14.4 percentage points of outperformance against the benchmark index over five years.[24]

There are clear and intuitive reasons why this should be the case. Active oversight of company management by investors helps ensure that managers act in the best interests of company owners – the shareholders – rather than in their own interests, on near-term issues such as executive remuneration. Second, engagement helps investors with long time horizons to influence companies to consider longer-term factors. Third, poorly governed companies face reputational risks that can have serious impacts on share price performance. Finally, engagement provides investors with a deeper understanding of a company's quality and strategy.

There are also clear advantages to investors collaborating on their engagement activities: research has found that collaboration by investors allows them to more effectively influence corporate management on ESG issues.[25]

22 Dimson, E., Karakas, O., Li, X., (2012), "Active Ownership", conference paper (Harvard Business School, Boston)

23 Becht, M., Franks, J., Mayer, C. and Rossi, S. (2010) Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund. *Review of Financial Studies*, 23(3), pp. 3093-3129.

24 "CalPERS Effect" Continues to Improve Company Performance, (October 14, 2014) Retrieved from https://www.calpers.ca.gov/page/newsroom/calpers-news/2014/company-performance

25 Gond, J.P. and Piani, V., (2013). "Enabling Institutional Investors' Collective Action: The Role of the Principles for Responsible investment." *Business & Society*, 52(1), pp. 64-104.

Even the largest institutional investors rarely own more than one per cent of large publicly listed companies, making it more difficult to get their voices heard when acting individually. Engagement is resource-intensive; again, few investors have the internal capacity to carry out in-depth engagements with more than a few dozen holdings. Meanwhile, large institutional investors are likely to be universal owners, affected by a range of environmental and social externalities. Collective and coordinated action by investors is needed to tackle such externalities.

A growing number of investors are undertaking active ownership, especially in listed equity. In 2007, in the PRI's first *Report on progress*, around 40 asset owners disclosed that they were regularly engaging with investee companies. By 2016, that figure had risen to nearly 200, whether directly or through their investment managers. The PRI's Collaboration Platform has become an increasingly important resource for engagement – it has hosted more than 900 collaborations, engaging with almost 1,600 companies, since its launch in 2006.

However, more needs to be done to promote active ownership by investors in line with Principle 2. Even among PRI signatories, almost one in five (17.9%) reported that they are neither engaging with companies directly or through their investment managers.[26] Among investment managers, some of the leading names in the industry – including some PRI signatories – rarely or never vote against management on ESG resolutions, even whilst warning of environmental and social risks faced by companies.

This is despite active ownership showing results: in May 2017, a majority of shareholders voted against ExxonMobil's management to force the oil giant to publish a report on climate risk, following similar successful motions passed at Occidental Petroleum Corp. and PPL Corp.[27]

The PRI will work to encourage signatories to exercise their rights both individually and collectively as ultimate or potential owners across asset classes. In March 2017, we launched our proxy voting declaration system, which allows investors to voluntarily publicly declare how they plan to vote on ESG resolutions in the forthcoming proxy voting season. Additional work will seek to ensure that:

- the quality of dialogue is prioritised over quantity;
- proxy voting practices are consistent with investors' responsible investment strategies and policies;
- coordinated actions independently led by investors follow clear objectives and milestones; and
- information collected through active ownership is fully integrated in financial decision-making processes.

In the next decade, the role of asset owners will also be pivotal to drive investment managers' practices, monitor their activities and keep them accountable for achieving financial and sustainability outcomes. Collaborative engagements will require clear criteria for prioritisation, well-defined objectives, more robust tracking systems to monitor milestones and share information, and defined roles and expectations for participating investors.

26 PRI (2015) PRI Report on progress 2015, (PRI, London)

27 Kerber, R., (May 31, 2017), Exxon vote shows Wall Street diverging from Trump on climate change, Reuters, retrieved from http://www.reuters.com/article/us-exxonmobil-climate-investors-idUSKBN18R3D6

Broadening and deepening of active ownership practices should not be confined to listed equities but should be extended to other asset classes and investment entities. This requires substantial improvement of current ownership rights linked to different asset classes. The PRI will respond with further guidance for signatories on how to be active owners and by taking a specific asset class focus. A bondholder engagement project examining what active ownership means as a fixed income investor is already underway.

In order to achieve impactful investor collaborations, the PRI will continue to coordinate in-depth collaborative engagements. More resources will be directed towards expanding coalitions and sharing lessons learnt beyond those investors directly involved. Extensive resources will also be allocated to enhance the PRI Collaboration Platform with the objective to make it a global hub for active ownership to achieve real-world influence and sustainable development.

We will undertake initiatives through the Blueprint that will:

- increase signatories' understanding of how to exercise their rights as active owners, across all asset classes;
- continue to coordinate collaborative engagements to maximise investors' collective impact, expanding the coalitions and sharing lessons learnt;
- promote alignment of proxy voting practices with responsible investment beliefs;
- enhance the PRI Collaboration Platform to make it a global hub for active ownership.

RESPONSIBLE INVESTORS

SHOWCASE LEADERSHIP AND INCREASE ACCOUNTABILITY

We welcome responsible investment new starters, those who have been leading the field for years, and everyone in between. In doing so, it is important to celebrate the successes of the best that others can learn from, to highlight the progress made across the spectrum and to guard against complacency, at the top or the bottom.

For signatory status to be meaningful, and for beneficiaries to see the benefits they are entitled to, we must ensure that signatories are living up to the commitments they make when signing up to the Principles. Strong accountability processes will identify opportunities for the PRI to engage with struggling signatories and support progress, and will enable us to respond when signatories are not acting in good faith.

The six Principles that inform our Mission are aspirational. We acknowledge that the majority of investors are not yet fully implementing responsible investment practices, which makes transparency and accountability an important element of our work. Indeed, Principle 6 requires signatories to report on their progress towards implementing the Principles.

Such accountability is necessary to demonstrate the impact that the PRI is having in pursuing our Mission. It is also important to encourage signatories to improve their performance in terms of implementing responsible investment. Moreover, it is needed to prevent freeriding among signatories – an issue that has taken on greater salience as the Principles become increasingly embedded in the investment world.

Becoming a PRI signatory confers advantages in reputational terms and, increasingly, in qualifying for tenders and requests for proposals open only to PRI signatories.

However, signing up to the PRI requires signatories to make a number of commitments, including the incorporation of ESG issues into investment processes, pursuing active ownership, seeking ESG disclosure by the entities in which they invest, and disclosing their own progress in these areas. These commitments are not cost-free. Signatories must dedicate time and resources to these commitments, especially in undertaking the annual reporting and assessment process.

There can therefore be an incentive for signatories to sign up to the Principles while doing little or nothing to meet the commitments involved. This has led to calls for the PRI to hold signatories more accountable for their progress in applying the Principles to their investment activities, including by delisting signatories that do not achieve minimum standards.

Improving accountability processes will help the PRI to better understand where signatories are not acting in good faith, and where there is an opportunity for the PRI to engage and encourage signatories to progress, using our networks and resources. The Steward Redqueen assessment of the PRI recommended such measures, and noted that there is room for improvement in the current reporting and assessment system to reduce the risk of gaming.

In this regard, the breadth of the PRI's signatory base presents challenges. As Steward Redqueen noted in its assessment of the PRI's impacts over its first decade: "The PRI is serving a diverse signatory base, which contributes to its strength and credibility. This also implies that signatories are in different stages of integrating RI into their investment practices. […] The challenge for the PRI is to service both front runners and late adopters in a way that satisfies all, while maintaining a strong brand value."[28]

Steward Redqueen recommended that the PRI design positive incentives to recognise and highlight leading practice to encourage a race to the top. Ultimately, improved governance and systems for implementing responsible investment processes will feed through to better outcomes.

We are mindful that there is a balance to be struck. The objective will be to delist the worst offenders – those signatories that have no intent to progress. It will not be designed as a hurdle to entry for those just starting their responsible investment journey or those who are committed but for various reasons are slow to make progress.

In response to these concerns, the PRI has resolved to work with signatories to develop a criteria and process to define a minimum standard of activity that signatories must achieve in order to remain a signatory. Signatories at risk of delisting will be placed on an internal "watch list" for further engagement by the PRI and will remain on this list for a maximum of two years. The watch list will not be made public. After two years, the signatory will be delisted and their identity publicly disclosed.

These delistings will be carried out in accordance with published criteria and overseen by the PRI Board. An appeals process will be put in place; these will be heard by the PRI Board.

Conversely, there is merit in providing a means to recognise leading practice among signatories, with a view to encouraging a race to the top. The PRI will develop and publish a leadership table each year and showcase evolving best practices.

We will undertake initiatives through the Blueprint that will:

- launch a responsible investment leadership table and awards, to reward and highlight top performers;
- share examples of what the best are doing;
- define a minimum standard of activity that signatories must achieve;
- monitor and engage with those that are not meeting this standard and delist any that fail to do so over a two-year period;
- delist signatories that contravene the spirit of the Principles.

28 Steward Redqueen (2016), *From Principles to Performance: An independent evaluation of the PRI's achievements and challenges at 10 Years*, (Steward Redqueen, Haarlem, The Netherlands)

RESPONSIBLE INVESTORS

CONVENE AND EDUCATE RESPONSIBLE INVESTORS

Connecting signatories with each other and reaching out to potential new ones is central to the work of the PRI – many signatories consider meeting their peers to share knowledge to be a primary reason for joining the PRI community.

Our regional networks have been instrumental in promoting and advancing responsible investment around the world. We also provide formal training through the PRI Academy, and we continue to support practitioner-focused academic research.

Principle 5 requires that signatories work together to enhance implementation of the Principles, emphasising the importance of collaboration and knowledge sharing to the objectives of the PRI.

Indeed, according to a survey of our signatories, networking and knowledge sharing is considered the primary role of the PRI by 36% of respondents. We have established regional networks in: the US, Canada, Latin America, Continental Europe, Benelux, Germany/Austria/Switzerland, France and Southern Europe, Nordic/CEE/CIS, UK and Ireland, Africa, Japan, China, the rest of Asia and Australasia.

These networks have provided a focal point for the promotion of responsible investment, and have been particularly important in jurisdictions with relatively small investment management sectors. These networks have proved invaluable in helping to tailor PRI resources to local markets, co-ordinate engagements with local companies, address local regulatory issues, raise awareness about responsible investment and recruit new members. The role of the PRI in promoting responsible investment, especially in new markets, was recognised in the Steward Redqueen impact evaluation.

The regional networks also provide the focus for much of the PRI's event organisation. In the 10 years since the PRI was launched, we have organised more than 400 events around the world. These information and networking events play a vital role in promoting responsible investment and in supporting signatories and prospective signatories on their responsible investment journeys. In addition, we have established the PRI in Person conference as the largest annual event for the responsible investment community. More than 1,000 delegates from over 500 organisations attended PRI in Person in London in 2015, and the 2016 event in Singapore was our largest ever in Asia.

It is also important for the PRI to reach out to and support potential signatories who are just beginning to implement responsible investment. For some potential signatories, the requirement to report publicly on their responsible investment activities within a year of joining the PRI presents a substantial hurdle.

To help remove this obstacle, the PRI has introduced a new Associate Member category for asset owners new to responsible investment, with a focus on learning, development and education. These members will not initially be required to report publicly, giving them time to build their responsible investment capacity, and removing one of the often-cited barriers to PRI membership.

Associate members will be allowed to remain in this category for a maximum of two years, after which they must become regular signatories or discontinue their membership.

The PRI Academy, meanwhile, provides CFA-accredited online training in how ESG issues impact company performance, shareholder value and investment decisions. More than 1,500 students have completed online courses through the Academy since its launch, with a satisfaction score in 2016/17 of 94%.

In addition, the PRI brings together academics and investors to undertake practitioner-focused research on issues of relevance to responsible investors. We organise events and sponsor original research, as well as working to bring the best insights from existing research to investors in a practical format.

We will undertake initiatives through the Blueprint that will:

- focus global recruitment on growing the number of asset owner signatories;
- reach new markets and institutions, including establishing a strong Asian signatory base, having more signatories in developing markets and achieving penetration rates in North America never previously seen outside Europe;
- introduce an Associate Member category for asset owners new to responsible investment – with an emphasis on learning, development and education;
- expand the reach of responsible investment training, including the formalised courses provided by the PRI Academy.

CHALLENGE BARRIERS TO A SUSTAINABLE FINANCIAL SYSTEM

For investors to fully pursue responsible investing, they need the global financial system in which they operate to be sustainable. The global financial crisis of 2007–2008 gave dramatic and incontrovertible evidence that investors need to play their role in ensuring the stability and sustainability of the financial system on which they rely.

We will work on the parts of the system where we can make a difference – beneficiaries; investors; their advisors and service providers; companies and issuers; securities exchanges; regulators – and will monitor environmental, social, technological, economic and political trends that will continue to reshape the financial system as we work.

The PRI's Mission explains why signatories are seeking a more sustainable financial system. It states that: "We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation."

A sustainable financial system is one that is resilient and contributes to the needs of society by supporting sustainable and equitable economies, while protecting the natural environment. It should enable savers to reliably store and manage their income for future use; enable custodians or trustees to protect and build financial value; and enable companies, governments and other parties to access capital for investment, innovation and consumption.

However, it is clear that there are structural barriers to the global financial system operating efficiently and sustainably. In the wake of the financial crisis, investors need to play their role in ensuring the stability and sustainability of the financial system on which they rely. Excessive leverage, dealing in complex derivatives, and high-frequency trading may benefit some actors in the short-term, but they undermine the resilience of the system as a whole.

The next 10 years will therefore see an extension of the concept of responsible investment to new areas of activity – broadening from a focus on the relationship between investors and investee companies to also address the health of the financial system as a whole. We have already established, through consultation with our signatories, that there is a case for the PRI and its signatories to participate in public policy, given the role policy plays in regulating and framing relationships between companies, investors and wider society.[29]

To build on this work, in 2016 we established our Sustainable Financial System programme to develop a framework for our signatories to begin this effort. Its work first involved a review of significant recent reports and research, followed by a signatory consultation to build consensus around the purpose of the financial system, barriers to its sustainability, drivers of change, risk and sustainability challenges and how to develop signatory activities to contribute to a sustainable financial system.[30]

29 PRI (2014), The case for investor engagement in public policy, (PRI London)

30 The analysis can be found at here, while the consultation document canbe found here.

This work identified nine priority conditions to address.[31] These are:

1. **A focus on short-term investment objectives**, to the detriment of considering longer term risks and value creation opportunities. Accountability and remuneration is also skewed towards short-term outcomes.
2. **Narrow attention to beneficiary interests**, often framed purely in near-term financial returns. Beneficiaries' interest in financial returns relates to the usefulness of their savings in the future. If the future is severely resource-constrained, inequitable and insecure, beneficiaries are unlikely to receive the intended benefits of their savings.
3. **Unintended or ineffective policy maker influence on markets**. Finance ministries often have limited understanding or concern about ESG issues, while policy makers outside finance ministries often have limited understanding of how financial markets work. This can lead to poor policy making relating to responsible investment.
4. **Capture of government policy by vested interests**, preventing effective policy on ESG issues, such as climate change, labour standards, corruption and tax, that are fundamental to the ability of investors to generate long-term investment returns.
5. **Influence of brokers, rating agencies, advisors and consultants on investment decisions**. Many institutional investors rely heavily on their consultants and advisors. However, the latters' business models often focus on short-term financial performance, meaning they downplay longer-term ESG issues.
6. **Principal-agent relationships in the investment chain** can mean that the views of asset owners regarding responsible investment preferences may not be properly communicated to companies and other actors in the investment chain. Too much intermediation can exacerbate short-termism, make oversight more challenging, and diversify ownership – all to the detriment of managing ESG issues.
7. **Cultures of financialisation and rent-seeking in market actors**. A financialised system is one in which the primary emphasis is on issues that can be captured or measured in financial terms – and which therefore struggles to properly account for wider ESG or ethical considerations. Rent seeking, or the attempt to extract financial value without adding value, is not an inevitable consequence of financialisation, but it is closely related.
8. **The misalignment of investment incentives and sustainable economic development**. A failure to properly value public goods and externalities can incentivise investors to invest in areas that are harmful to society and/or the environment.
9. **Investor processes, practices, capacities and competencies** that flow from an investor's beliefs and values set a framework for the priorities and outcomes of investment activity. If these do not signal that responsible investment is a priority, it will not be treated as such by consultants, investment managers, investee companies, trustee boards, etc.

31 PRI (2016), Sustainable financial system: nine priority conditions to address, (PRI, London)

Addressing these issues calls for investor action to tackle obstacles that lie within market practices, structures and regulation. These actions go beyond the realm of ESG incorporation or active ownership.

It is important that the PRI works in parts of the system where it can make a difference, namely with: beneficiaries (e.g. savers, insurance policy holders); asset owners (e.g. pension funds, (re) insurers); investment managers, advisors and service providers (e.g. investment consultants, rating agencies, investment banks); and companies and issuers, securities exchanges and related regulators/regulations.

Following this consultation, the PRI proposed an initial set of projects addressing:

- asset consulting services;
- trustee readiness for a sustainable system;
- macro risks - investor response to threats and instability;
- sustainable system linkages and the role of actors;
- sustainable finance instruments and incentives;
- governments linking financial and sustainability policy;
- banking sector sustainability review;
- ESG investment/modern portfolio theory.

These projects will begin to bridge the gap between how the financial system currently works and how a sustainable system should operate.

We are cognisant that the world – and the financial system – is not static and will continue to evolve. Our work and the projects we undertake will also evolve over the course of the Blueprint. We will monitor the drivers of change in the financial system and adapt the programme accordingly.[32]

Our work programme is ambitious and is a major undertaking for the PRI. It also comes at a time when technology disruption and a wide reform movement are starting to reshape the financial system. We will need to work with our signatories and other organisations to support system change and to realise our Mission.

We will undertake initiatives through the Blueprint that will:

- address key obstacles to creating the sustainable financial system that long-term investment performance requires;
- champion changes to the financial system's structure that would promote long-term investing;
- target behaviours, practices and incentives within the financial system that create short-termism.

32 Drivers of change were described in the Sustainable System, Principles, Impact consultation report and Supplementary Document in May 2016.

DRIVE MEANINGFUL DATA THROUGHOUT MARKETS

Reliable, timely information is needed for beneficiaries to understand and influence their investments, for asset owners to monitor their managers and for investment managers to accurately price assets and assess risk. That this includes information on material ESG issues is fundamental to responsible investment, but opinions vary on what ESG data companies should disclose and investors should report and how, making analysis difficult.

As beneficiary and asset owner demands change, investment managers will increasingly have to share information on any screening they have applied to the pool of securities considered and how they are integrating material ESG issues into their analysis. Asset owners and investment managers will both need to better demonstrate what the impact of their investment decisions has been in the real world.

Financial markets rely on accurate information to allow investors to properly price assets and assess risk. It is a fundamental of responsible investment that such disclosure extends to material ESG metrics; Principle 3 commits signatories to seek appropriate disclosure on ESG issues by entities in which they invest.

In addition to corporate ESG disclosure, we recognise that transparency must apply along the investment chain, beginning with signals from beneficiaries to asset owners, in turn to asset managers and down to the investment vehicle-level. For asset owners and investment managers, there is a need to better demonstrate impacts and outcomes of their responsible investment activities.

In terms of corporate reporting, enormous progress has been made in the provision of ESG-related information. According to the Corporate Register database, almost 13,000 organisations have voluntarily produced corporate responsibility reports. Information providers such as Bloomberg, Thomson Reuters and MSCI track ESG data on thousands of companies. Almost 6,000 companies currently disclose environmental information to CDP (formerly the Carbon Disclosure Project).

Securities regulators and stock exchanges are increasingly mandating disclosure. The Sustainable Stock Exchanges (SSE) Initiative, co-founded by the PRI in collaboration with UNCTAD, the UN Global Compact, and the UNEP Finance Initiative, reports that 12 stock exchanges incorporate ESG disclosure requirements in their listing rules, 15 provide formal guidance to issuers on ESG reporting and another 23 have committed to do so.[33] As of July 2017, 64 exchanges, representing more than 70% of global listed equity market capitalisation, were SSE partners.[34]

Despite this progress, challenges remain. There is no consensus as to exactly what ESG data should be disclosed, or how it should be disclosed. This creates obstacles for investors and service providers to effectively analyse this data.

33 2016 Report on progress, Sustainable Stock Exchanges Initiative, 2016

34 UNCTAD presets SSE at United Nations Partnership Exchange, (July 17, 2017), retrieved from http://www.sseinitiative.org/home-slider/unctad-presents-sse-at-united-nations-partnership-exchange/

Needs around transparency and disclosure vary across different styles of investors. Differences in investment processes drive some investors to a preference for standardised and comparable data across industries and companies, and others to a preference for customised data specific to a certain company.

The PRI will seek ways to improve and standardise disclosure from listed companies across these styles, acting in close collaboration with other investor organisations, companies and reporting standard setters. Similar initiatives will be undertaken for other asset classes.

One of these is the work of the Task Force on Climate-related Financial Disclosures (TCFD), established by the Financial Stability Board with a mandate to promote voluntary disclosure of climate change issues. The PRI has provided input to the TCFD's work.

In final recommendations published in June 2017, the Task Force sets out how organisations across all sectors and jurisdictions might produce consistent climate-related financial disclosures of use to investors, lenders, and insurance underwriters in understanding material risks.[35] The PRI will align with the recommendations from the Task Force as a first step towards measuring impact.

The increased use of ESG information by investors will drive improvements in how that data is collected from companies and used, marking a shift towards integrated outcomes. Given the PRI's focus on incorporating ESG factors into investment management, we see clear advantages in encouraging companies to disclose material financial and ESG performance information in the same place.

In addition, we would like to see a reversal of the proliferation of reporting standards and regimes: the Task Force estimated that more than 400 climate or sustainability disclosure regimes exist. Instead, there needs to be an alignment of reporting frameworks to ensure that companies and other issuers produce comparable ESG data that meets global standards, and we believe the PRI is well positioned to drive this alignment on behalf of investors.

For asset owners and investment managers, meanwhile, there is a need to more consistently disclose how they screen potential investments regarding ESG issues, and how they integrate ESG issues into their investment analysis.

Investors should also seek to demonstrate impacts and outcomes of their responsible investment activities. The responses to our consultation showed a clear preference for allowing flexible reporting (as opposed to promoting a one-size-fits-all approach). Signatories also expressed opposition to additional mandatory reporting, but supported the provision of a database to which signatories could voluntarily submit specific data.

The logical next step for the PRI will be to look towards investors' impact and outcomes, as a contribution towards our Mission. The current Reporting Framework, while comprehensive, focuses primarily on the processes in place to implement responsible investment policies and activities. It is a long-term goal that the Reporting Framework will be developed to allow us to better measure the contribution that responsible investment has to tangible ESG improvements.

35 Task Force on Climate-Related Finance Disclosures (2017) Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD, London).

The PRI has been instrumental in facilitating disclosure among our asset owners and investment managers. In 2006, only a handful reported publicly on their responsible investment activities. In 2016, over 1,000 PRI signatories produced publicly available Transparency Reports through the PRI. These reports help to communicate expectations from asset owners to managers, and for managers to demonstrate their responsible investment activities. The 2017 launch of our Data Portal has enhanced asset owners' access to investment managers' reporting data, facilitating better dialogue – a crucial step on a longer journey.

As asset owner demands are changing, transparency and disclosure by investment managers will increasingly have to contain information on the investable universe (or applied screening), the processes and practices of integration of material ESG issues (fundamental integration), and the contributions their investments make to a more sustainable society (outcomes, real-world influence and the SDGs).

As with corporate disclosure, we will do more over the next decade to streamline and consolidate reporting by investors. Global standards are needed to encourage the production of comparable data, including on impacts and outcomes, as well as ESG risks and opportunities, and the PRI will play a role in the standardisation and integration of ESG reporting and traditional financial reporting.

Ultimately, adequate disclosure on responsible investment, incorporation of ESG factors and outcomes to society should be part of mainstream reporting by all financial institutions who manage other people's money.

We will undertake initiatives through the Blueprint that will:

- advocate for meaningful, forward-looking and globally comparable company disclosure and investor reporting;
- promote the inclusion of material ESG information alongside other financial data;
- encourage consolidation of reporting standards and regimes;
- seek to understand and overcome situations where available data is not being used effectively;
- develop the PRI Reporting Framework to measure the contribution that responsible investment makes to tangible ESG improvements in the real world;
- enhance the PRI Data Portal, empowering asset owners to assess investment managers' responsible investment activity.

CHAMPION CLIMATE ACTION

It is in signatories' interests that global warming is limited in line with the Paris Agreement: well within 2°C of pre-industrial levels, with an aim of 1.5°C. Investors' interpretations of what this means for their investment activities will vary, but ambitious action will be required to protect portfolios from risks and to expose them to opportunities in the shift to a low-carbon global economy

In surveys of our signatory base, investors have repeatedly identified climate change as their highest priority ESG issue. Similarly, investor interest in understanding, quantifying and managing the investment implications of climate change has been growing strongly.

The investment case for long-term investors taking action to address climate risk is well rehearsed. The Bank of England's Prudential Regulation Authority defined three risk factors through which climate impacts on investors might arise:[36]

- physical risks from weather-related events (e.g. floods and storms), including direct impacts, such as damage to property, and indirect impacts, such as disruption of global supply chains or resource scarcity;
- transition risks, or the financial risks caused by the transition to a lower-carbon economy, specifically from the re-pricing of carbon-intensive assets, such as fossil fuel companies and major carbon emitters;
- liability risks faced by insurers and firms subject to claims from those who have suffered loss and damage from climate change.

These risks are systemic: they have the potential to affect entire swathes of the economy, making their avoidance difficult for most investors, and impossible for so-called universal owners: those who hold large, diversified portfolios across asset classes, sectors and geographies. The risks are enormous: the Economist Intelligence Unit estimated mean expected losses due to climate change of US$4.2 trillion by 2100 at today's prices – equivalent to the value of the entire oil and gas sector.[37]

The regulatory response to climate change is well underway. Developed world governments have been imposing a cost on carbon emissions, either through taxes or emission trading schemes, since the 1990s. Similarly, they have been incentivising low-carbon technologies, particularly in the energy sector, through subsidies and tax breaks. In 2015, the landmark international Paris Agreement set a goal of limiting warming to no more than 2°C above pre-industrial levels, and ideally no more than 1.5°C. Countries are developing national plans that set out how they intend to meet their (voluntary) commitments under the agreement.

Regulators are also turning their attention to risks in the financial markets. In June 2017, the TCFD issued its final recommendations. Charged with ensuring transparency around climate risks within financial markets, it has set out core elements of climate disclosures, which should include scenario modelling and sit within financial reporting.

36 Prudential Regulation Authority (2015), The impact of climate change on the UK insurance sector, (Prudential Regulation Authority, London)
37 The Economist Intelligence Unit (2015), The cost of inaction: Recognising the value at risk from climate change (The Economist Intelligence Unit, London)

Leading responsible investors are also responding, including through initiatives undertaken by the PRI. As far back as 2000, the Carbon Disclosure Project (now CDP) brought together institutional investors to pressure large listed companies to disclose their carbon emissions and provide information about their climate strategies. Other groups such as the Institutional Investors Group on Climate Change, set up in 2001, and Ceres in the US, set up in 1989, run investor-led campaigns to address climate risk.

In 2014, in the run-up to the Paris talks, the PRI launched the Montreal Climate Pledge, through which investors commit to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis. In its first two years, more than 120 investors, managing over US$10 trillion, made the pledge. According to an assessment of its first two years, 80% had disclosed their carbon footprints, and 16% had set emissions targets aligned with the goals of the Paris Agreement.[38] However, the range of methodologies used, and gaps in the underlying data, illustrated the challenges faced by investors seeking to manage climate risk.

The PRI was highly active ahead of the climate talks, working with investors on high-level policy engagement with G20 governments, and working with our UN Partners on a number of climate initiatives.

The following year, we launched the PRI Climate Change Strategy Project. The first phase involved the publication of a discussion paper setting out the case for asset owner action on climate change, and providing advice on measuring carbon footprints and setting emission reduction goals.[39]

Later the same year, as the second phase of the project, the PRI published *Developing an asset owner climate change strategy*, which sets out a pilot framework for a step-by-step approach to addressing climate change across three main strategies: engage, invest and avoid.[40]

Climate change features in a wide range of our activities, with recent outputs including climate change guides for private equity investors[41], a webinar on climate change for fixed income investors, and our collaboration with think tank Carbon Tracker on the *2° of Separation* report, which examined which oil and gas companies are most exposed to climate risk.[42]

However, while investors are making progress, it is still slow. A study published by investment consultant Mercer in June 2017 found that only 5% of 1,241 European pension schemes surveyed had considered the investment risk posed by climate change.[43] That this figure had risen by 25% in one year – from 4% of surveyed firms in 2016 – provides some encouragement, but clearly the vast majority of institutional investors have not even begun the process of addressing the issue.

Among those investors who have begun considering climate change, the response in many cases is, thus far, superficial. According to our 2015 signatory survey, measuring a portfolio carbon footprint remains the most popular exercise used by PRI signatories to address climate change, and just 11% of asset owners and 10% of investment managers have implemented a climate change-sensitive or -integrated asset allocation strategy.

38 Novethic (2016), *Montréal Carbon Pledge, accelerating investor climate disclosure* (Novethic, Paris)
39 PRI calls on investors to improve their climate reporting and encourage companies to do the same (December 14, 2016)
40 PRI (2015), Developing an asset owner climate change strategy (PRI, London)
41 Updated guide on climate change for private equity investors (June 1, 2016)
42 Carbon Tracker (2017), 2° of Separation (Carbon Tracker, London)
43 Mercer (2017), European Asset Allocation Report 2017. (Mercer, London)

The PRI will redouble its efforts in this area, and focus on its strengths to support signatories on climate change by:

- **Conducting research to inform investor action**, providing signatories with research to better inform investment strategies and decisions, in collaboration with the PRI's Academic Network and other research organisations;
- **Enabling investor disclosure** on assessment and management of climate-related risks and opportunities consistent with the Task Force on Climate-related Financial Disclosures. We will adjust and align the PRI Reporting Framework with the Task Force's recommendations, while supporting disclosure in financial filings.
- **Supporting investor assessment of climate-related risks and opportunities**. We will focus on enabling investors to assess how well-positioned companies, issuers and their portfolios are for the transition to a low-carbon economy, to better inform investment decision making.
- **Convening investor engagement** with companies on management of climate-related risks and opportunities, including corporate climate disclosure.
- **Encouraging private sector capital allocations consistent with the Paris Agreement** by supporting investors in understanding the implications of public policy climate change goals incorporated in the Paris Agreement and the Sustainable Development Goals, evaluating investment strategies for low-carbon investment, and collaborating with policy makers to address the barriers investors face in scaling up such investments.

In doing this, we will encourage and support investors and the groups they have established to address climate-related risks and opportunities. We will collaborate with our UN partners, UNEP FI and the UN Global Compact, and existing investor initiatives and networks such as CDP, the Portfolio Decarbonization Coalition (PDC), Ceres/ the Investor Network on Climate Risk, the Institutional Investor Group on Climate Change and the Investor Group on Climate Change Australia, New Zealand & Asia.

We will undertake initiatives through the Blueprint that will:

- work with our UN partners to meet the Paris Agreement;
- empower investors to assess how well positioned companies, issuers and their portfolios are for a just transition to a low-carbon economy;
- align the PRI Reporting Framework with the Financial Stability Board's Task Force on Climate-related Financial Disclosures;
- convene investor engagement with companies on climate risks and opportunities;
- encourage investors to make substantial allocations to clean assets and technologies;
- demonstrate the investment implications of national governments' climate change goals;
- collaborate with policy makers to address the barriers investors face in scaling up clean investments.

A PROSPEROUS WORLD FOR ALL

ENABLE REAL-WORLD IMPACT ALIGNED WITH THE SDGs

For us to fully realise our Mission, adoption of the Principles must have an impact on the world in which we live, and contribute to prosperous and inclusive societies for current and future generations. The UN's 17 Sustainable Development Goals (SDGs) and their targets provide a way for us to measure our real-world impact.

They provide an opportunity for responsible investors to demonstrate how their efforts to incorporate issues such as climate change, working conditions and board diversity into their investment approach are contributing to sustainable development. The SDGs also provide investors with a clear vision of how government decision making and company behaviour will shape how the global economy develops over the next 15 years. By setting policy makers' priorities, the SDGs will be a key driver of global GDP growth and a source of investment opportunities.

In addition to risk and return, responsible investment will increasingly include a third dimension, the real-world influence of investment practices. The Principles are not an end in themselves, but are a means towards the end of a sustainable global financial system that will allow investors to achieve long-term value creation and which benefits the environment and society as a whole.

The PRI's Mission is to support long-term value creation by our signatories for their beneficiaries. This requires that the responsible investment practices that the six Principles promote have real-world impact – that is, they lead to measurable improvements in ESG outcomes. Furthermore, the preamble to the six Principles states: "We recognise that applying these Principles may better align investors with broader objectives of society."

For our impact on investors to be meaningful, it needs to be reflected in their impact on companies and society at large. Identifying and measuring these real-world impacts is not a straightforward process, but the 17 SDGs provide a framework against which impact might be measured, and offer guidance in defining the "broader objectives of society" to which our signatories aim to contribute.

The SDGs were agreed in September 2015 by 193 governments under the auspices of the UN. Underpinned by 169 individual targets to be met by 2030, they provide a definitive framework for sustainable development. They are the result of arguably the most inclusive process carried out by the UN, which included the business and investment communities as well as governments and civil society groups. Unlike their predecessors the Millennium Development Goals, they apply to industrialised countries as well as the developing world.

Most PRI signatories expect the SDGs to play an important role in the development of a responsible investment agenda for the next decade. They believe there is a clear investment case for aligning responsible investment with the SDGs.

First, many PRI signatories believe that ultimately their investments in companies (and other entities) will only be profitable over the long term if societies and the financial system develop in an equitable and sustainable way. Failing to achieve the SDGs will put value at risk. As well as system-wide sustainability risk, there are specific risks for particular industries, companies, geographies and countries.

These risks may be regulatory, ethical or operational and are often also financially material. Integrating an SDG risk framework into investment decision-making processes is therefore crucial for any responsible investor.

The SDGs also represent investment opportunity. They provide a clear road map for the development of the global economy over the next 15 years that will guide decision making and behaviour of both governments and companies. With governments introducing regulation and incentives to promote the SDGs, and companies globally moving towards more sustainable business practices and innovation in sustainable products and services, investors who integrate the SDGs in their investment strategies and decisions are likely to identify well-managed, forward-looking companies, helping them to financially outperform. Furthermore, GDP growth is the main structural source of financial returns. Achieving the SDGs will be a key driver of global GDP growth over the next 15 years to 2030.

Acting on this investment case will, however, involve a realignment of responsible investment from a focus on process – integrating ESG issues into investment policies, decisions and ownerships – towards an outcome-based approach that explicitly aims to contribute to the sustainability challenges set out by the SDGs.

Many investors are keen to grasp the opportunities presented by the SDGs: according to a recent survey of institutional investors, more than four-fifths plan to engage with investee companies on the SDGs and allocate capital to investments that support the goals.[44]

The sums involved are enormous. UNCTAD estimates that globally, the level of investment needed to achieve the SDGs will be between US$5 trillion and US$7 trillion per year, on average, over the period 2015-2030. Of this, just US$1 trillion is expected to come from public funds, with the private sector expected to contribute the remaining US$6 trillion.

Given the scope of PRI membership, with our signatories representing around one third of global private capital, meeting the SDGs would require our signatories to invest US$2 trillion annually in companies and other investments that directly contribute to the goals. By 2030, that would represent a cumulative 25% of assets under management having a direct positive contribution to the SDGs.

This is not something to which institutional investors will commit easily, especially given the challenges they face relating to the SDGs. These include a lack of clarity around SDG-relevant investment opportunities, inadequate data, and insufficient company transparency on ESG issues. The current design and operation of the financial system does not always provide the necessary incentives to encourage investors to work towards the SDGs and, in some cases, may even be detrimental.

There is, therefore, a clear role for the PRI to help translate the SDGs into investor action, and helping our signatories deliver real-world impact as a consequence.

To do so, the PRI has launched an SDG work programme. Its first task is to prepare a landscape map of institutional initiatives towards meeting the SDGs, to ensure that the PRI is not duplicating work that is being undertaken elsewhere. In doing so, we will work closely with our partners in the UN and with our peer organisations.

44 Investors can play a central role in achieving Sustainable Development Goals (March 21, 2016)

It will also ensure that work on the SDGs is integrated into our work on a Sustainable Financial System, specifically to promote public policy and regulatory coherence to attract capital into the SDGs, ensure environmental and social externalities are addressed, and potentially offer guidance to governments to help them make their national plans for the SDGs investible.

The work programme will also aim to integrate the SDGs into how signatories implement their commitments under each of the six Principles. Taking each of the Principles in turn, the programme will:

- Provide investment practice guidance on how to integrate the SDGs in investment strategies, policies and investment decisions (Principle 1). Our new work on investment strategy is already introducing a shift towards a new approach, adding "real-world impact" as a third dimension that should be incorporated into investment strategy, alongside risk and return. To further this work, the programme will provide guidance on integrating the SDGs into investment strategy, policy and asset allocation, and into mandates and monitoring of investment managers, as well as providing guidance and tools on applying the SDGs to different asset classes and financial products.
- Integrate the SDGs in active ownership and engagement (Principle 2), by ensuring that discussion of the SDGs is included in dialogues between investors and companies. This will involve general guidance on the SDGs in active ownership, using the Collaboration Platform to promote SDG engagements (Principle 5), and defining and measuring PRI and collaborative investor engagements in support of the SDGs.
- Promote improved disclosure on ESG factors and the SDGs by companies and other entities (Principle 3), by promoting SDG disclosure, working with peer initiatives such as the Sustainable Stock Exchanges initiative, the UN Global Compact, and the Global Reporting Initiative, and the Sustainable Accounting Standards Board, and by encouraging investors to disclosure around the SDGs.
- Provide information on the SDGs to create awareness, education and promote research (Principle 4) through campaigns, academic research, and by encouraging service providers to explicitly cover the SDGs.
- Define and measure the impact of current PRI and investor activities in support of the SDGs and communicate publicly about the ways in which the PRI's current activities support the goals (Principle 6). Among other things, the programme will aim to stimulate investor reporting on outcomes relating to the SDGs by updating our Reporting Framework.

The PRI work on the SDGs will be supported by an SDG advisory committee (made up of approximately 20 members). The committee will advise the executive and the board on the PRI's work on the SDGs.[45]

45 Its terms of reference can be found here.

We will undertake initiatives through the Blueprint that will:

- work with our UN partners to deliver the SDGs, such as by leveraging UNEP FI's Principles for Positive Impact Finance and the UN Global Compact's Ten Principles;
- set out steps and develop tools for investors to align their investment activities with the SDGs;
- encourage investors to seek, through the full range of active ownership activities, corporate responsibility enhancements that advance the SDGs;
- encourage capital towards projects with positive, real-world impact;
- introduce the SDGs into the PRI Reporting Framework;
- map our work against the SDGs, and report on our contribution towards them;
- engage policy makers to encourage public policy that supports the SDGs.

MEASURING SUCCESS

Over the 10-year life of this Blueprint (2017–2027), responsible investors' actions, the nature of markets and the world we live in will change – with or without our intervention. The most meaningful way to assess our effectiveness will therefore be to create specific and timely measures for the individual projects we initiate within the Blueprint programme.

We aspire to be as transparent in our activities, just as we expect transparency on responsible investment issues from our signatories. Given the evolving nature of financial markets in general, and responsible investment practices in particular, it would neither be practical nor wise to attempt to set specific goals to be met at the end of the Blueprint's envisaged 10-year life.

Instead, the PRI will identify metrics that will help us and our signatories measure our progress towards aspects of the goals. We envisage these goals covering areas such as:

- our growth among asset owners, particularly in under-represented markets;
- our work towards the SDGs, using national and UN data;
- signatories' contributions towards meeting the SDGs, using capital flow and corporate responsibility data;
- asset owners' assessment of investment managers' responsible investment capabilities, using PRI Data Portal data;
- investor support for clean assets and technologies, using capital flow data;
- the depth and breadth of responsible investment throughout organisations, using PRI Reporting Framework data;
- the characteristics of the financial system, using systems analysis and signatory implementation of recommendations;
- the depth and breadth of responsible investment throughout organisations, using PRI Reporting Framework data;
- investors engaging companies and policy makers on climate change, using PRI Reporting Framework data;
- alignment of proxy voting with responsible investment policies, using PRI Reporting Framework data and publicly available data;
- quantity and quality of ESG reporting using PRI Reporting Framework data;
- uptake of responsible investment training using national and UN data;
- engagement activity using PRI Reporting Framework data and PRI Collaboration Portal data;
- quality of investor ESG reporting using PRI Reporting Framework data; and
- quantity and quality of corporate ESG reporting, using Sustainable Stock Exchanges data and publicly available data.

We will undertake initiatives through the Blueprint that will:

- be transparent in measuring the implementation of our 10-year ambitions;
- outline, in the three-year strategies that will underpin this vision, the key performance indicators (KPIs) that we will measure our progress against;
- report annually against the KPIs active in any given year, throughout the life of the Blueprint;
- monitor developments such as technological disruption, market shocks and changing regulation that could impact our work as the Blueprint unfolds;
- report publicly, as our signatories do.

The Blueprint sets out an ambitious agenda for the next 10 years. The next steps will involve the PRI drawing up the first of a series of three-year strategies that will implement the agenda. As part of this process, we will continue the extensive consultation with our signatories that we have undertaken to reach this point with the Blueprint. We welcome continuing input to shape the evolution of the Blueprint and our three-year strategies, and how we progress towards achieving our Mission.

We are cognisant that delivering the fundamental goal of a sustainable financial system, and the benefits that flow from that, is beyond any one organisation. Much of the progress we can make towards that goal will depend on the actions of our signatories, and our success in convening, supporting, and facilitating them in their efforts. Similarly, much of our success will depend on the degree to which we are able to efficiently provide our signatories and their trustees with the information and resources they need to embrace responsible investment practice.

We are also aware that external drivers of change, such as technological disruption, market shocks, changing regulation and the erosion of trust in the financial system, might prevent us from achieving the goals of the Blueprint. We will monitor these drivers as the Blueprint unfolds.

What is clear is that the social and environmental challenges facing our signatories, the wider investment community, and humankind as a whole are, if anything, more pressing than when the PRI was launched 10 years ago. Then, the adoption of our six Principles by investors was an aspirational goal. Now, we need to move beyond adoption, to outcome; from implementation, to impact.

Ultimately, the success of the PRI will not be measured by our number of signatories, nor by their assets under management, important as those metrics are: it will be measured by our ability to build a financial system that supports the society and the environment in which we want to live, and pass on to future generations.

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