Principles for Responsible Investment

SUSTAINABLE FINANCIAL SYSTEM, PRINCIPLES, IMPACT

PRI FORMAL CONSULTATION

JUNE 2016

MESSAGE FROM THE CHAIR

The PRI's Mission calls for it to promote a sustainable global financial system that supports long-term value creation and benefits the environment and society as a whole. It states that we will work to achieve this system by "encouraging adoption of the Principles and addressing obstacles [...] that lie within market practices, structures and regulation." Widely endorsed by signatories, our Mission was borne from a belief that the financial system must contribute to sustainable economic development if it is to effectively serve society.

Ten years after the PRI's launch, we are well positioned to lead projects to help create such a system and support our 1,500 signatories to contribute to these efforts. We have been working with signatories to positively influence the financial system for some time. In recent years, we have built our internal capacity and competencies and through our signatories, partners and the United Nations, we have access to enormous convening power, intellectual resources and expertise.

We believe that because the operation of the financial system influences the performance of institutional investors, investors should consider the operation of the financial system as a whole, including its purpose, its design, its effectiveness and its resilience to risks and sustainability challenges.

We are already supporting signatories to respond to financial system risks through our work programmes, for example, by improving disclosure via the Sustainable Stock Exchanges initiative and supporting asset owners to embed material environmental, social and governance (ESG) considerations into their mandates and across asset classes.

More recently, we have re-stated the case for action on ESG issues as part of investors' fiduciary duty and we are seeking to implement our policy recommendations in eight countries. Through our engagement, investment practice, policy

and research work we have also worked with investors to address climate risk. This work follows requests from signatories, who see addressing financial system risks as a priority within their responsible investment strategy.

In this paper, we identify the areas of the financial system we believe the PRI, working with signatories and partners, is best placed to positively influence; the underlying causes of risk and sustainability challenges in the system; and the drivers that may shape these over the next decade. We invite your feedback on each of these areas, to help us devise a framework that will allow us to more effectively convene signatories and prioritise projects in this area in the future.

It is of course not possible or desirable for us to respond to every issue identified in this paper. We will focus our efforts on the parts of the financial system that are within our influence; which play to our strengths; and where we can match our ambitions with our resources and expertise.

Our aim is to shortlist 5-10 projects that will make a material contribution to mitigating these risks and challenges over the next decade, and for which the PRI has a unique advantage in leading investor activities. As always, creating opportunities for learning and collaboration will be an overarching driver and each project will have a working group through which signatories can participate. Depending on which projects are taken forward, we will seek additional expertise and/or partner with external organisations with relevant expertise.

While our Mission has called for work by signatories to promote a sustainable financial system for some time, this has yet to be codified in our Principles-based framework, as such we believe now is the time to revisit the content of the Principles. In this consultation, we invite you to consider whether changes to the Principles are required to capture our work on the financial system and the impact responsible investment has on society as a whole.

We are also seeking your views on how the PRI can better align its work – and support signatories to better align the outcomes of their responsible investment activities – with the objectives of the newly-adopted Sustainable Development Goals (SDGs). This may include evolving our Reporting Framework so that it better captures the outcomes and impacts of signatory responsible investment activities, not simply the policies and processes that support them.

Importantly this consultation also looks at how we measure the success of the PRI over the next decade, ensuring that our work has real world impact and contributes to more resilient investment markets that benefits society as a whole.

Findings from this consultation will form part of our Blueprint for Responsible Investment, which will be published in early 2017. While the Blueprint will not contain all of the answers to the challenges we seek to overcome, it will draw on feedback from several signatory and stakeholder surveys, consultations and engagement workshops being held throughout our anniversary year. The Blueprint will set out an ambitious agenda for action by the PRI and the wider responsible investment community. This agenda will be developed and approved with input from the PRI Board and will inform our strategic and business planning activities for the decade ahead.

I would like to thank you for your contribution to this important work. We know that we are asking a lot of our signatories through this consultation process, with nearly 400 of you already responding to our global survey and 500 providing written submissions to our consultation on accountability and diversity, our signatory base is deeply involved and invested in the direction we will collectively take over the next decade.

It is our hope that by conducting this work, investors – a critical part of the financial system – will be better equipped to contribute to the resilience of the financial system and in turn, support sustainable economic development and fulfil their obligations to their clients and beneficiaries.

The Board will ensure the PRI remains focused on delivering reforms that bring benefits to signatories and that its work is robust, well planned and well-sequenced. By doing so, we will be more effective and impactful, ultimately delivering the change that we set out to achieve.

Martin Skancke
Chair, PRI Board

BACKGROUND

"We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole. The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation."

PRI Mission

Why the PRI is carrying out this consultation

Our Mission is to contribute to the development of a more sustainable financial system. We do this primarily by working with institutional investors worldwide to encourage them to implement the six Principles in a manner that is consistent with their fiduciary responsibilities, and by fostering good governance, integrity and accountability. Our ultimate objective, enshrined within the Preamble to the Principles, is to improve signatories' ability to meet their commitments to beneficiaries and better align their investment activities with the broader interests of society.

A decade after our launch in 2006, and as part of its 2015-18 Strategic Plan, titled "Moving from Awareness to Impact", we are consulting extensively with signatories and stakeholders to review our progress and impact to date and to set a clear course of action for the future. This is to ensure we are continuing to advance our Mission and that the Principles remain fit-for-purpose given the evolving nature of responsible investment practices.

This consultation follows an external evaluation by sustainability consultancy Steward Redqueen which, as well as assessing the PRI's achievements to date, made recommendations for its future development. Its report recommended that the PRI create more clarity around its purpose and ambition; seek greater "real world" impact; improve its accountability processes; and help facilitate better differentiation between signatories depending on the progress they have made.

This consultation has 4 objectives:

1. **Determine which of the obstacles to a sustainable financial system lying within market practices, structures and regulation ("financial system risks") the PRI and its signatories should work together to address.**

   This consultation outlines and seeks feedback on the underlying causes of risk and sustainability challenges in the financial system, the drivers that will influence these, and the framework we will use to prioritise projects it can lead to address these in the future. We will prioritise 5–10 projects to support the development of a more sustainable financial system after the consultation period closes.

2. **Determine the extent to which the PRI should use the Sustainable Development Goals (SDGs) as a framework to encourage real world impact through its signatories.**

   This consultation is also intended to gather views on how the PRI and signatories, through their responsible investment activities, should seek to have greater impact on the external environment. Specifically, this paper asks whether the newly adopted UN Sustainable Development Goals (SDGs) – which aim to deliver (amongst other objectives) increased productivity, labour supply and ultimately stronger economic growth – provide a useful framework for measuring the impact of responsible investment on the external environment. However, this paper also invites other opinions about how responsible investment can better contribute to societal goals, and how this contribution could be measured.

3. **Determine whether the Principles should be updated to reflect the issues raised in this paper.**

   The consultation asks whether the Principles need to be updated to better capture the issues raised in this paper, including the important role that the PRI and signatories can play in addressing financial system risk and promoting a sustainable financial system, as envisaged by the Mission.

4. **Determine how the PRI should define success over the next decade.**

   In its independent evaluation of the PRI's progress to date, Steward Redqueen noted that when the PRI was first established it did not set targets or measures of success for its longer term development. This consultation seeks views on how the PRI should define success over its second decade and the targets it should use to monitor its progress towards achieving its Mission.

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

Preamble to the Principles

"Aligning the financial system for sustainability is not some far-off notion, but is already happening. A 'quiet revolution' is taking place as investment institutions, policymakers and, increasingly, financial regulators address the need to build robust and sustainable financial systems for 21st century needs. But this shift is still at an early stage and needs to be deepened."

UNEP Inquiry into the Design of a Sustainable Financial System [2015]

Investors have an important role to play in delivering a more sustainable financial system. A resilient financial system will enable participants in the system to better meet the needs of their beneficiaries. A financial system that aligns its activities and objectives with the limits of the natural environment and the needs of a fair and equitable society, as envisaged by the Preamble to the Principles, can better fulfill its purpose in society and be more resilient as a result.

DEVELOPING A SUSTAINABLE FINANCIAL SYSTEM

Why investors should act

The financial system is an integral part of modern economies, and makes an important contribution to societal wellbeing. It enables individuals, organisations and governments to reliably store and access their income and assets for present and future use. It should also ensure that capital is available to support productive investment, innovation and present and future consumption. Ultimately, it should support sustainable and equitable economic development.

The reality, however, is that the financial system does not function as effectively as it should. It does not exhibit the characteristics that market participants would typically associate with being sustainable, such as being fair; resilient; transparent; efficient; inclusive; well-governed and aligned with society's needs.

It is susceptible to risks and sustainability challenges that can manifest themselves in various ways: in the relationship between investors and companies; in the relationship between companies and their managers, owners, beneficiaries and advisers in the investment chain; in operation of the markets in which we invest; or as externalities.

Some risks and sustainability challenges, whether they lead to specific shock events or accumulate over time, can limit the ability of the financial system to operate efficiently and equitably. Systemic risks have the potential to bring down the entire financial system, which can undermine the ability of fiduciaries and other institutional investors to fulfill their purpose. This is undoubtedly material to investors, in particular asset owners, who have a responsibility to minimise risk and maximise returns over the longer term. Because the operation of the financial system influences the performance of institutional investors, those same investors should consider the operation of the financial system as a whole, including its purpose, its design, its effectiveness and its resilience to risks and sustainability challenges.

However, many signatories find they are making limited progress on responsible investment, and in some cases investing in a manner that damages the economy and the natural environment, because the broader financial system does not incentivize sustainable economic development, due to many of the conditions that are outlined in this paper.

Investors therefore have a strong self-interest in supporting a more sustainable financial system. They can – and should – work together to identify and address underlying conditions that make the financial system less sustainable in society and less resilient.

The PRI's role and contribution

The six Principles that underpin the PRI address the relationships between investors and investee companies, and the degree to which ESG issues inform those relationships. However, the PRI has always recognised that implementing the Principles takes place within a wider context. Its Mission states that: "An economically efficient, sustainable global financial system is a necessity for long-term value creation."

We are already supporting signatories to respond to financial system risks, including: integrating externalities such as climate change; providing guidance to asset owners on how to embed ESG considerations into mandates; improving corporate sustainability disclosure via the Sustainable Stock Exchanges initiative; and re-stating the case for action on ESG issues as part of investors' fiduciary duty.

The objective of this programme is to support the development of a sustainable financial system. We define this as a system that contributes to the needs of society, supports sustainable economic development and ensures the health of the natural environment. This will involve creating the conditions – for example, in market practices, market structures and regulation – that enable the realisation of a sustainable financial system while also addressing the key obstacles to progress.

To have a clearer view on how to address financial system risks and sustainability challenges, we need to:

- Examine the work of others;
- Look to the future;
- Be clear about the type of financial system we want;
- Examine the risks and sustainability challenges that contribute to an unsustainable system;
- Understand the drives change in the financial system;
- Prioritise our future work effort.

We reviewed 20 key research reports published since 2008 on financial sector reform (see Appendix 1), and consulted with financial system and investment experts. We have identified the parts of the financial system that investors and the PRI can influence, and identified more than 30 underlying conditions that could threaten the sustainability of the system. As we work to fulfill our Mission, we must also be mindful of how the financial system will change over time and consider how this could undermine our efforts. This paper also identifies factors driving these changes.

Through the course of the consultation with signatories and stakeholders, we will further discuss the type of financial system we want, including the purpose of the system and its desirable characteristics.

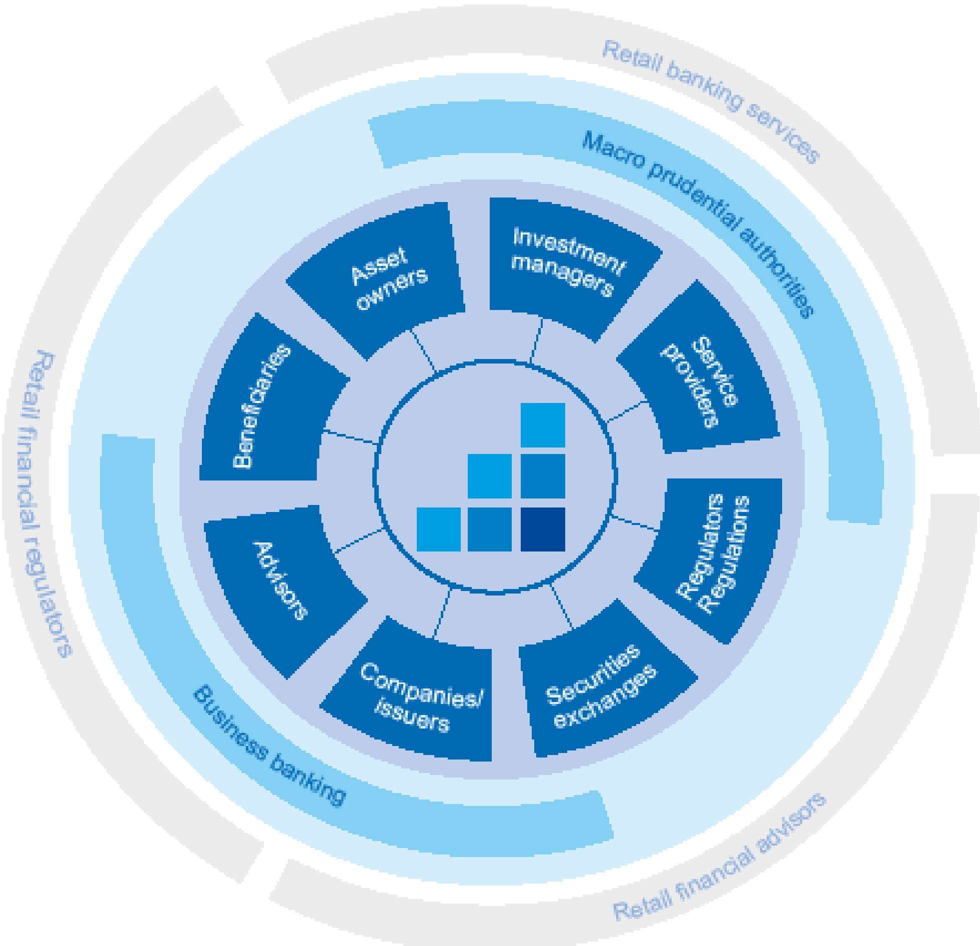
In addition to this consultation document, we will publish our analysis of the 20 key research reports and a supplementary discussion of the elements of this programme for the information of signatories.

Scope

Given the PRI's signatory base, and where we are likely to have the most influence, the **primary focus** of this programme is on the investment value chain, including 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), companies and issuers, securities exchanges, and related regulators and regulations.

As its **secondary focus**, the programme includes those parts of the financial system that, while important to our membership, are areas where the PRI has less direct influence. Examples include macro prudential authorities (e.g. those responsible for wider monetary and economic policy settings) and the banking sector (including its role as a source of c

It **excludes** retail financial advisors, banks (as deposit-taking institutions and credit providers to individuals), retail financial regulation or regulators (with the exception of managed investment schemes).



QUESTION

1) Do you agree that these inclusions and exclusions adequately capture the scope of the financial system that the PRI should focus on?

○ YES ○ NO

Should any elements be added to the scope? Should any elements be removed from the scope?

Underlying causes of risk and their consequences

We have categorised the areas of risk and challenge facing the financial system into four areas:

- the relationship between investors and companies;
- the relationship between investors and managers, owners, beneficiaries and advisers in the investment chain;
- the operation of markets in which we invest; and
- externalities.

Within these four areas, we have identified more than 30 underlying conditions which could cause the system to fail to support sustainable economic development[1]:

1. The relationship between investors and companies

- Diversification of investment, and loss of ownership control in corporations
- Weaknesses in corporate governance regulation, limiting ownership control
- Principal-agent relationships, and challenges in ensuring company management acts in investors' interests
- Lack of incentives to encourage or require more sustainable business activities
- Lack of transparency by companies and investors in terms of how they address ESG issues
- Short-term focus on financial returns
- Lack of attention to ESG issues in investment research and decision making

An **example** of an underlying condition in the relationship between investors and companies is that diversification of investment has led to a loss of ownership control in corporations.

Investors with diversified portfolios have lower shareholdings in individual companies. In turn, this means that they have less influence over company management, less incentive to engage with individual companies (because each company represents a relatively small part of the investment portfolio) and less ability to influence large or dominant shareholders.

Consequences of this underlying condition include for example that shareholders may be ill-equipped to hold boards to account or that corporate remuneration structure and scale may be inconsistent with owner's interests.

2. The relationship between investors and managers, owners, beneficiaries and advisers in the investment chain

- Lack of attention to wider beneficiary interests
- Cultures, values, greed and decision-making processes within the investment system
- Principal-agent relationships (Intermediation)
- Lack of alignment between the financial system and sustainability goals
- Short-term focus on financial returns
- Investor practices and process (E.g. governance, risk assessment, [skills, knowledge, beliefs, values] disclosure)
- Lack of transparency (e.g. Managers to owners, Owners to Beneficiaries, Advisors to clients)
- Weaknesses in regulation (including lack of clarity on overall governance of financial system)
- Insufficient attention to "do no harm"
- Disconnect between investment decisions and the real economy

1 For descriptions of the 30 underlying causes of risk and a further 60 related consequences, refer to Appendix 2 and the detailed supplementary report.

An **example** of an underlying condition in the delegated investment chain is intermediation through principal-agent relationships.

While Principals should monitor and properly oversee their agents, the complexity and length of the investment chain can make this extremely difficult.

Consequences of this condition may include misaligned incentives (e.g. direct chain and service providers), information asymmetries and as a result, a lack of alignment of interests in the delegated investment chain.

3. The operation of markets in which we invest

- Lack of alignment between markets and sustainability goals
- Lack of policy maker understanding of the best levers to drive or motivate investor behaviour
- Incoherence or inconsistency in government policies
- Lack of transparency
- Weaknesses in oversight of the financial system by regulators and market authorities
- Short term focus by market actors (E.g. exchanges, brokers)
- Common investment strategies and common investment advice

An **example** of an underlying condition in the structure and function of markets is a lack of policy maker understanding or emphasis on the best levers to drive or motivate investor behaviour.

A **consequence** of this condition can be that policy is ineffective at encouraging or requiring investors to take account of ESG/sustainability-related concerns in their investment processes.

Further consequences of this condition include a lack of market incentives for long-term behaviours by investors and relatively poor investor understanding of the aggregate impact of investment activities on the society.

4. Externalities

- Policy incoherence or inconsistency (sustainability policy), leading to market failures and externalities
- Ineffective policy implementation and oversight (coordination and implementation of policies that are there)
- Common law precedents
- Capture of policy by vested/sectoral interests
- Inadequate financial policy to address sustainability challenges
- Governance and regulatory failings
- Lack of attention to the social and environmental consequences of investment
- Growth paradigm

An **example** of an underlying condition that leads to externalities in the economy is the capture of policy by vested or sectoral interests.

Examples of the consequences of policy capture include inadequate or ineffective market incentives, misallocated capital flows and insufficient attention to ESG/ sustainability-related concerns in investment processes.

A detailed list of consequences for each area of underlying risk is available in Appendix 2. We believe that focussing on the underlying conditions that cause risks and challenges in the system is likely to provide the most useful insights for meaningful reform. It is also a useful formulation when thinking about the operation of the system as a whole as underlying conditions may need to be addressed simultaneously or in specific sequence. Once we have prioritised the leading causes of an unsustainable financial system, potential points of intervention can be identified.

QUESTION

2) Do you agree that this list, and the more detailed list in the supplementary document, adequately captures the causes of risks and challenges to the development of a sustainable financial system that PRI should address?

O YES O NO

Should any risks, challenges or causes be added to the current list? Should any risks, challenges or causes be removed from the current list?

Drivers of change

We have identified the drivers of change that influence the financial system, to inform where the PRI and its signatories might seek to intervene (see Appendix 3). Identifying these drivers will ensure the PRI's work remains relevant to the financial system of the future. Building on the work of the World Economic Forum, in The Global Financial System: Policy Recommendations for the Future , we identify seven major forces shaping the future financial system:

- demographic change;
- structural changes in the design of pensions;
- the growth of emerging markets;
- technology;
- regulation after the global financial crisis;
- trust in the financial system;
- financial inclusion.

We also recognise that a variety of geopolitical and other forces will shape the future. While these may have limited direct impact on the financial system, they will profoundly alter the context within which the financial system works and, in turn, have consequences or implications for the financial system. They include but are not limited to:

- Environmental degradation (e.g. climate change);
- Natural resource depletion;
- The erosion of multilateralism;
- The rise of nationalism;
- Protectionism;
- Systemic corruption;
- Conflict.

QUESTION

3) Do you agree that the drivers of change identified in the paper are the most important to monitor to ensure the PRI's work remains relevant to the financial system of the future?

O YES O NO

Should any drivers be added to the current list? Should any drivers be removed from the current list?

How the PRI will determine which projects to progress

Following this consultation, we will develop a shortlist of 5-10 projects that we believe will materially contribute to a sustainable financial system and for which the PRI has a unique advantage in leading investor activities. The projects will aim to contribute to the type of financial system we want, be within the scope of the system that we can influence and address the drivers of change within the system.

Further, we will consider the PRI to be well-positioned to work in a specific area in the following circumstances:

- There is a representative role for investors on the issue in question. That is, investors can play a role in correcting or mitigating the causal factor or the symptoms that result.
- There is a role for the PRI and the PRI signatory base: we are an authoritative, credible body with a large signatory base. This provides legitimacy, credibility, knowledge and expertise.
- 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.
- We can deliver the projects or interventions in question: we have a robust model for scaling up and delivering change projects on investment and policy. This can be summarised as including: (a) performing research (using in-house expertise and/ or external expert resources, in conjunction with relevant partners as appropriate), (b) building expertise (through the research process), (c) identifying actions or interventions necessary to address the issues in question, (d) implementing and delivering, through raising resources, building implementation teams and effective partnerships.
- The issue in question requires 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 such as ESG capacity needs in the European institutional investment industry, policy and regulation (e.g. fiduciary duty project, public policy submissions).

Without pre-empting our future work, potential solutions that we would take forward in specific projects would likely be in the following areas:

- investment practices;
- industry structures;
- policy and regulation;
- data and information;
- norms and culture;
- skills and knowledge;
- networks and communication channels.

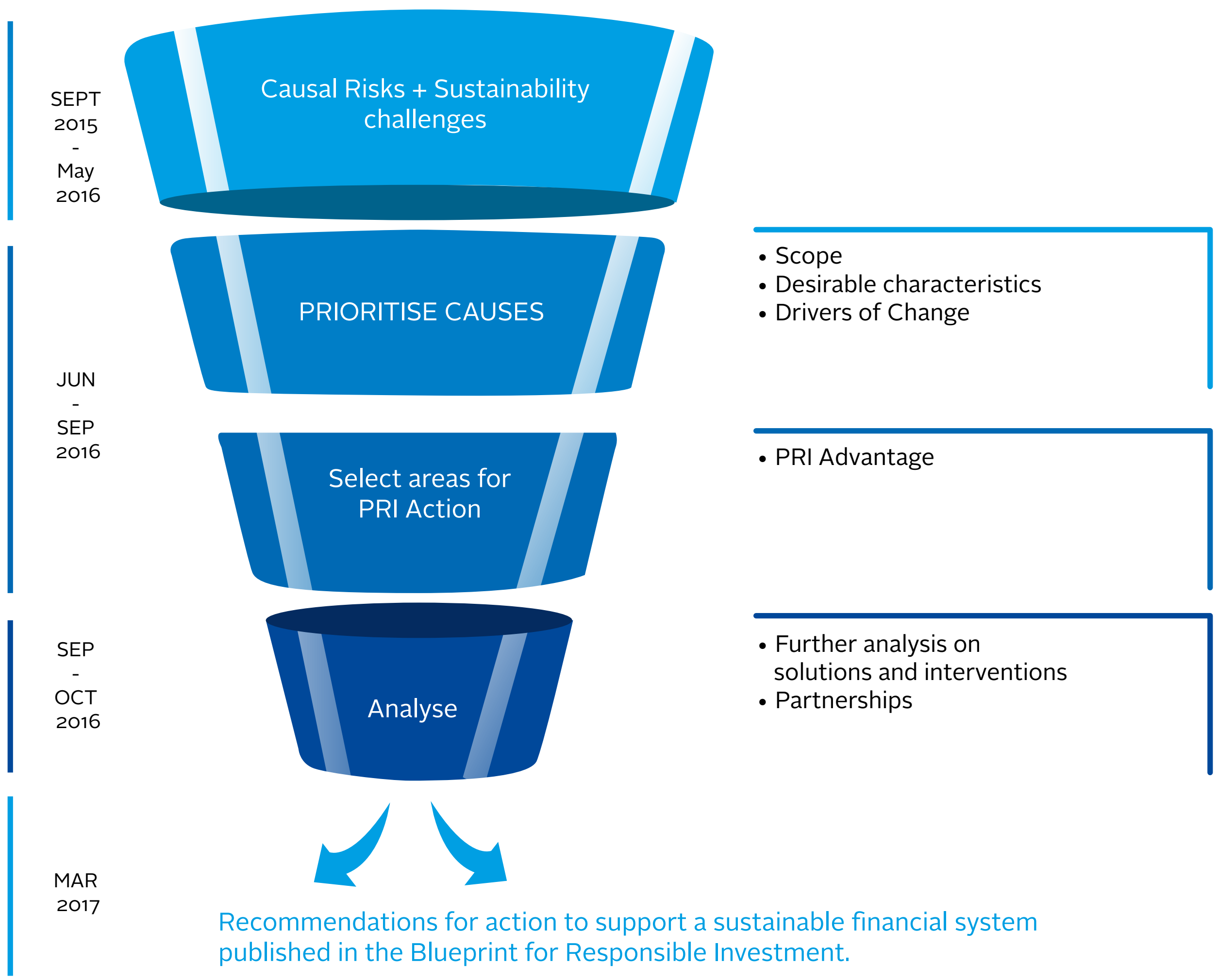
Example of potential projects or interventions

Underling cause: Weaknesses in financial policy to address sustainability issues contributes to inadequate or misallocated capital flows.

Possible interventions could include:

Investment practices: Support the development of liquid markets for green infrastructure financing instruments.

Data and information: Develop national capital raising plans that explain how governments intend to finance the delivery of a zero carbon economy and the delivery of the Sustainable Development Goals.



ALIGNING INVESTMENT WITH SOCIETY:

THE SUSTAINABLE DEVELOPMENT GOALS

Why investors should act

The Preamble to the Principles states that responsible investment may better align investors with the "broader objectives of society". These societal objectives can be considered to include the 17 Sustainable Development Goals (SDGs), which were agreed at the United Nations General Assembly Resolution in September 2015.[2]

The 17 goals aim to, among other things, take action on climate change and the environment, improve access to health and education, boost innovation and infrastructure, and build strong institutions and partnerships. Each of the goals will be achieved by meeting a number of specific targets. For investors, they constitute a plan for development, supported by governments and their citizens, which will influence investment risk and opportunity, over time. The SDGs are an economic imperative. Their achievement would mean greater productivity, increased labour supply and ultimately stronger growth.

As the UN-supported organisation for responsible investment, the PRI has a responsibility to examine how it can fulfil the expectations in the SDGs and potentially integrate them into investment activity. The external evaluation of the PRI by Steward Redqueen also recommended the PRI and its signatories aim more explicitly for "real-world change" through their responsible investment activities. Contributing to the SDGs could provide one framework for signatories and the PRI to measure and demonstrate this impact.

The PRI's role and contribution

We collaborated with ShareAction to ask signatories for their views on the relevance of the SDGs to their investment activities. The findings are based on responses to a survey from more than 50 investors with US$5.9 trillion in assets under management and interviews with 12 other stakeholders. A majority (65%) of respondents agreed that acting on the SDGs "aligns with their fiduciary duties" and 62% believe that acting on the SDGs "can create opportunities for increased investment returns". 44% agree that "weak progress towards the SDGs represents a material risk for our organisation" and more than half identified working toward achieving all 17 SDGs as having either high or medium potential to help meet their organisations' investment objectives. 75% of respondents said they are already taking action on three or more SDGs.

It can be concluded from this survey that there is interest among signatories for greater support from the PRI for their activities related to the SDGs. A similar conclusion can be drawn from our recent signatory survey, with a large majority of signatories highlighting climate change as a key area for further analysis and support.

To some degree, the work of the PRI and signatories is already aligned with the SDGs. The PRI's activities indirectly contribute to nine of the SDGs,[3] including: 2) Hunger; 3) Health; 6) Water; 7) Sustainable Energy; 8) Decent work and employment; 13) Climate change; 15) Biodiversity and deforestation; 16) Peace and Justice; 17) Global Partnership.

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2 Paragraphs 39, 44, 67, 69, 89 all refer to partnerships with private actors and calls for their contribution to their advancement.

3 PRI conducted an issue-based assessment of the relationship between current initiatives and the SDGs.

This contribution is indirect because our work is several steps removed from the targeted outcomes within the SDGs. For example, we support investors in their work with third parties – generally companies and governments – who then conduct activities that may influence the SDGs. ESG engagements and some policy activities make the most direct contribution to the SDGs. We can conclude that our current Mission- and Principle-based framework contribute to the SDGs. However, the extent of that impact is not well understood and we have not attempted to quantify or track the qualitative or quantitative impact of its activities on the SDGs.

One other development that deserves mention is that a growing number of signatories are already moving from a process-based approach towards an approach explicitly aimed at generating more sustainable outcomes and impact.

Options for the PRI

There are several options available to better integrate the SDGs into the responsible investment activities of signatories and the PRI, including:

1) Further develop the Reporting Framework so that in addition to policy and process-based reporting indicators, it also captures the outcome or impact of signatory responsible investment activities (possibly using the SDGs as an impact framework). Signatories could then be recognised and rewarded for their work via our reporting and assessment process.
2) Define and measure the impact of the PRI and investors' current activities in support of the SDGs and communicate publicly about the ways these activities support the SDGs.
3) Link the PRI's work on a Sustainable Financial System to environmental and social outcomes, both from a system risk perspective and from the perspective of fulfilling the purpose of the financial system, including funding sustainable economic development. This work may be embedded in our reporting and assessment process and/or a further Principles.
4) Conduct policy and research activities in support of specific SDGs of concern to signatories from an investment materiality perspective.
5) Focus our Investment Practices work on providing guidance as to how responsible investment and ESG integration can contribute to SDGs.
6) Carry out further work to elaborate how Principle 2 (ESG integration in active ownership) could operate as a delivery mechanism for SDG activities by investors (by partnering to prepare analysis on investee company contribution to the SDGs and provide guidance on company engagement in relation to the SDGs).

Any of these approaches could provide the basis for explicitly recognising the importance of responsible investment activities' positive ESG impact, and therefore signatories' contribution to the SDGs within the Principles.

QUESTION

4) How can the PRI better support signatories to align their responsible investment activities with the SDGs?

QUESTION

5) How can the PRI better capture the impacts and outcomes of signatories' responsible investment activities via its Reporting Framework (e.g. signatory contribution to the SDGs)?

UPDATING THE PRINCIPLES

The six Principles were drafted in 2006 and, as previously noted, were conceived with the relationships between investors and investee companies as their primary concern – they apply specifically to signatories' investment activities. As part of the Preamble, signatories "commit to evaluate the effectiveness and improve the content of the Principles over time" when they sign the PRI. Our 10-year anniversary provides an opportunity to do this, especially in light of the financial crisis and the implications it has had for how investors think about financial system risks.

The six Principles remain our primary focus. The PRI's Mission calls for it to promote a sustainable global financial system that supports long-term value creation and benefits the environment and society as a whole

While they have been fully developed and provide an action framework for signatories, the PRI has never explicitly created an enabling framework within its guiding documents for its Mission, which calls for the organisation to work to "address [...] obstacles to a sustainable financial system that lie within market practices, structures and regulation

Acting to improve the financial system as a whole is likely to be a new approach for many signatories. The approach sits outside a traditional view of their role as actors purely responding to the environment they operate within, and implementing the six Principles, which focus largely on investment policy and process.

It may therefore further benefit signatory activities if an explicit reference to work in support of a sustainable financial system is codified in the PRI's Principles and the action framework. By making explicit reference to this work, signatories would have a clearer reference point and common understanding on which to develop, measure and report their progress in these areas. Over time, the PRI's reporting and assessment framework could also be developed so that signatories can be recognised and rewarded for this work.

Any changes to the Principles would need to be formally approved via a vote of PRI signatories and the PRI Board, with the agreement of the United Nations.

QUESTION

6) Should the Principles be updated to include a clear reference to the need for signatories to take steps to address broader financial system risks and promote a sustainable financial system that benefits society as a whole, as stated in the PRI's Mission? This could be achieved by adding a seventh Principle, for example.

○ YES ○ NO

Additional comments:

QUESTION

7) Can you identify any other revisions that may need to be made to the existing six Principles to ensure they better reflect the responsible investment activities and priorities of signatories?

○ YES ○ NO

Additional comments:

MEASURING THE PRI's PROGRESS AND IMPACT

In its evaluation, Steward Redqueen noted that when the PRI was established it did not set targets or measures of success, although it now has KPIs and measures of success for its three-year strategic plans and annual business plans. It also notes that our Reporting Framework is focused on capturing investment policies and processes rather than actual progress made by signatories and the impacts and outcomes of their responsible investment activity on the external environment and society.

Our ultimate goal is to make responsible investment mainstream in the financial industry, specifically with institutional investors. The longer-term perspective should therefore be that reporting on responsible investment activity and outcomes relevant to a sustainable economy become part of the normal reporting processes of financial institutions. If integrated reporting on CSR/ESG issues by companies is one of the goals of the PRI and its signatories, integrated RI/ESG reporting by financial institutions should be one of our goals over the next 10 years. However, this long-term goal should not divert attention from the short- and mid-term need for improvements in signatory reporting and accountability.

QUESTION

8) How would you define success for the PRI in 10 years' time? What metrics should the organisation use to determine whether it has achieved this and what targets should it set for itself? Comments:

QUESTION

9) Should the PRI partner with other established reporting organisations (e.g. GRI, IIRC) to develop investor reporting supplements for their sustainability reporting frameworks (as per Steward Redqueen's recommendation)?

○ YES ○ NO

Comments:

CONSULTATION RESPONSE FORM

We strongly encourage all signatories and stakeholders to participate in this formal consultation, which will open on 6 June and close on 5 August 2016. Submissions should be made in writing via the online consultation platform accessible at unpri.org/consultation.

Translations will be available in French, German, Spanish, Portuguese and Japanese within the consultation platform, or in PDF format by emailing priconsultation@unpri.org. Submissions should be made in English. Please submit ONE response per organisation.

We will host two webinars in July 2016 to present the key elements of this consultation and respond to questions. Please see the Events page to register or listen to a replay.

We are committed to a transparent and inclusive consultation process. All submissions will be a matter of public record and posted in full on our website after the consultation period closes.

The PRI Board will review the consultation feedback in September 2016 and develop recommendations, which will be presented at the PRI's Signatory General Meeting (SGM) on 6 September 2016 at PRI in Person in Singapore. A summary of this feedback, as well as the Board's response, will be published after the meeting. If required, a signatory vote will be carried out following the SGM to confirm support for any recommendations that require changes to the PRI's Articles of Association or Principles.

Please direct any questions to priconsultation@unpri.org

While you may respond to as many or as few questions as you wish, we would particularly welcome feedback on the questions in **bold.** Please limit your response to each question to 400 words.

APPENDIX 1
Key research reports analysing risks and challenges

The PRI has identified the following 20 reports as the key contributions to the debate about addressing systemic risk and reforming the financial system following the financial crash of 2008. They offer important insights into the structure and operation of the financial system, and identify potential areas of work to improve its sustainability and make it more resilient to specific risks. They provided a useful starting point for the PRI's work on systemic issues.

- [Aviva] Aviva Roadmap for Sustainable Capital Markets (2015)
- [Brown] Achieving Sustainable Growth, Wealth Creation and Poverty Reduction (2011)
- [European Commission] Long-Term Financing of the European Economy (2014)
- [FCLT] Focusing Capital on the Long Term Portfolio Guide (2015)
- [FCLT Perspectives] Perspectives on the Long Term (2015)
- [Future Fund] Long-Term Investing as an Agency Problem (2015)
- [G20/OECD] High-Level Principles of Long-Term Investment Financing by Institutional Investors (2013) and Report on Approaches to Support Implementation of the G20/OECD High Level Principles on Long-Term Investment Financing by Institutional Investors (2015)
- [IISD] Financial Stability and Systemic Risk: Lenses and Clocks (2012)
- [Industry Super Australia (ISA)] Facilitating Capital Formation (2013-2015)
- [Lake] Financial Reform, Institutional Investors and Sustainable Development (UNEP Inquiry, 2015)
- [Lydenberg] The Investment Integration Project (2015)
- [OECD] Aligning Policies for the Transition to a Low-Carbon Economy (2015)
- [Preventable Surprises] Institutional Investors and Climate-Related Systemic Risk (2015)
- [PRI] Signatory Consultation: Overcoming Barriers to a Sustainable Financial System (2013)
- [Roosevelt Institute] Rewriting the Rules (2015)
- [UK Parliamentary Inquiry] Parliamentary Commission on Banking Standards (2013)
- [UNEP] The Financial System We Need (UNEP Inquiry, 2015)
- [WEF 2011] The Future of Long-term Investing (2011)
- [WEF 2012] Measurement, Governance and Long-term Investing (2012)
- [WEF 2015] The Global Financial System: Policy Recommendations for the Future (2015]

APPENDIX 2
Examples of consequences of underlying risks

Category of risk	Consequence
Relationship between investors and companies	• Shareholders ill-equipped to hold boards to account • Corporate remuneration scale and structure • Shareholders unable to hold boards to account • Corporate remuneration scale and structure • Misalignment of incentives • Lack of (financial) materiality of many ESG issues • Lack of recognition of potential (financial) materiality of ESG issues • Ineffective accountability processes • Lack of reflection on ESG or sustainability issues • Asymmetric information between the owners (investors) and managers (corporations) of capital • Transaction costs associated with monitoring and oversight • Lack of attention to sustainability impacts • Strategy and incentives are short term (Company and investor) • Lack of attention to sustainability impacts

Category of risk	Consequence
Delegated investment chain	• Relationship between fiduciary duty and the broader interests of society • Disempowerment of consumers / savers / beneficiaries • Financial literacy of consumers / savers / beneficiaries • ESG literacy and capabilities of consumers / savers / beneficiaries • Weaknesses in regulation and oversight as a result of lobbying • Accountability, incentives and remuneration structures • Misaligned incentives (e.g. direct chain and service providers), and lack of alignment of interests • ESG capacities and expertise of asset owners • Lack of demand for sustainability-related products and services • Limited consumer / saver / beneficiary engagement • Lack of attention to ESG issues in investment research (Credit, Investment) • Lack of accountability for ESG performance and impacts • Multiple weaknesses in relationships between the investment and the banking sector • Mandate design favours short term performance • Short term investment strategies including High Frequency Trading • Investor sustainability governance and capabilities • Investment beliefs, risk management practices focus on transferring rather than managing risk. • "Toxic" behaviours like latency. Internal trading platforms – dark pools. • Lack of accountability for ESG performance and impacts • Lack of asset owner accountability to beneficiaries • Lack of attention to ESG issues in investment research (credit, Investment) • Markets not meeting or delivering on long-term societal needs

Category of risk	Consequence
Structure and function of markets	• Lack of understanding of what good ESG regulation looks like among governments • Accounting and valuation standards • Relationships between credit rating agencies and companies or issuers being rated • Investor impunity for the negative ESG impacts of investments (lack of accountability for individuals and institutions) • Weaknesses in corporate disclosures on ESG issues (lack of standardisation) • Lack of consideration of ESG issues in investment decision making (because of externalised costs, market failures) • Poor understanding of impact of investment activities on the economy • Lack of incentives (e.g. loyalty driven securities, tax advantages for long-term investors) for long-term behaviours • Lack of clear reporting frameworks (to ensure consistent, meaningful reporting) • Poorly integrated financial regulation • Lack of attention to unintended or undesirable consequences (e.g. liquidity and capital rules constraining the availability of capital for green investments) • Transaction costs associated with monitoring and oversight • Inefficient markets • Cultures and values within the financial system • Short-term return seeking behaviour (e.g. pressure to narrow funding deficits) • Short term investment strategies including High Frequency Trading • Amplification of impacts, e.g. Pro-cyclicality, herding, market bubbles

Category of risk	Consequence
Externalities	• Lack of demand for sustainability-related products and services • Lack of innovation in sustainability-related products and solutions • Inadequate or misallocated capital flows • Inadequate/ineffective incentives • Limited investment in markets with governance and sustainability challenges • Inequitable distribution of the costs and benefits of investment and related activities (e.g. unemployment following the financial crisis) • Example impacts • Fossil fuel usage • Excessive greenhouse gas emissions • Physical impacts associated with climate change • Natural resource depletion, e.g. water, forests • Ecosystem services (eg. reduction in pollinators, biodiversity) • Social impacts, e.g. unemployment, poverty • Human rights • Quality and priorities for economic growth • Government finances • Sustainable development • Political instability • Inequality (financial) • Inequality (risks and benefits) • Diversity • Bribery and corruption • Access to water • Pollution • Toxic/hazardous chemicals (management, disposal) • Access to land/land rights

APPENDIX 3
Key drivers of change in the financial system

Key Driver	Commentary
Demographic change	• Ageing populations (numbers of pensioners, increases in longevity) will affect the asset and liability profiles of pension funds and of public welfare systems. The specific impacts will depend on other public policy interventions (e.g. measures to encourage people to work beyond current retirement ages, measures to improve public health). • Millennials and their views on financial services, pensions and social/environmental issues.
Structural changes in the design of pensions	• Move away from defined benefit (DB) schemes to defined contribution (DC) schemes and to hybrid DB/DC schemes (e.g. 'target benefit schemes'). • Increasing use of personal pension plans, such as 401(k) schemes in the US and of alternative savings vehicles (e.g. the recently announced Lifetime ISAs in the UK). • Changing roles and influence of pensions system actors (e.g. investment consultants, banks, investment managers).
The growth of emerging markets	• Emerging markets occupy an increasingly important role in the international financial system. By 2020, total financial assets on a global basis are estimated to approach US$900 trillion, a 50% increase from 2010, with developing economies accounting for approximately 25% of this total. • Can the international financial system of the future connect financial services providers, corporates, public institutions and households with access to a range of quality, affordable financial products and services while also protecting customers from risks, enabling saving and investment, and supporting the creation of jobs and enterprises through the efficient allocation of credit and capital?
Technology	• Includes alternative providers of capital, payment platforms and automated investment solutions. • Internet connectivity and digital technologies are redrawing how individuals, institutions and governments interact with one another, produce and consume products and services, and compete for resources, information and customers. • Historical cost paradigms, which served as barriers to entry are eroding. • Traditional financial institutions no longer control the entire value chain. • Technology-enabled innovation may benefit underserved markets segments as a result of improved distribution mechanisms, increased competition, decreased costs and the creation of novel financial products. A key driver of this transformation is expanding global smartphone ownership. • New entrants often fall outside the traditional domain of policy-making and regulation raising questions such as: How sustainable will new business models and products be during times of economic stress? How do FinTech companies ensure appropriate customer data collection and usage practices? What are the related cyber risks?

Key Driver	Commentary
Regulation post the global financial crisis	• The global financial crisis exposed the consequences of a highly interconnected and complex global financial system. • There have been significant changes in regulatory and monetary policies (e.g. capital adequacy, liquidity standards) directed at ensuring the safety and soundness of the financial system and supporting economic growth. • Systemically important institutions have been required to codify resolution plans in the event of liquidation. • Correspondent banking has been identified as an activity that is in retreat within private-sector financial services firms. This could adversely impact developing economies by cutting off a core channel to the international financial system.
Trust/loss of trust	• Poorly designed incentive systems, insufficient risk disclosure, lax corporate governance, weak internal controls and illegal or unethical activities from some market participants were all root causes of the global financial crisis. • The financial sector performs indispensable functions such as enabling saving and investment, providing protection from risks and supporting the creation of new jobs and enterprises. It is critical that the sector operates to provide these functions for society in a stable, sustainable way. • Criticisms of the financial system include implicit subsidies for firms considered "too big to fail" that can allow financial institutions to enjoy privileged access to low-cost funding but protect creditors in the event of failure; the complex and often opaque interconnections that exist among large financial institutions and industry participants; poorly designed incentive systems; excessive leverage; insufficient liquidity; inadequate or unenforced fiduciary standards; and the illegal or unethical activities of some market participants. • The finance industry has also taken a range of steps to change the way it does business. These combined efforts have resulted in a significant reduction in leverage, an increase in reserves and improved capital adequacy. • Changes have been made to the level and structure of compensation and to business practices such as training, whistleblowing, sales and product approvals.
Financial inclusion/ access to financial services	• Financial inclusion is absent for more than 2 billion adults globally. Financial inclusion is recognised as critical to poverty reduction and economic growth. • The digitisation of financial services, including savings, credit, payments, transactions and insurance, has significantly increased the number of financially included individuals over the past few years.

The Principles for Responsible Investment (PRI) Initiative

The PRI Initiative is a UN-supported international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

More information: www.unpri.org

PRI Principles for Responsible Investment

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

United Nations Environment Programme Finance Initiative (UNEP FI)

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

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

UN Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

United Nations Global Compact