RESPONSIBLE INVESTMENT POLICY IN THE US

A BRIEFING FOR PRI SIGNATORIES

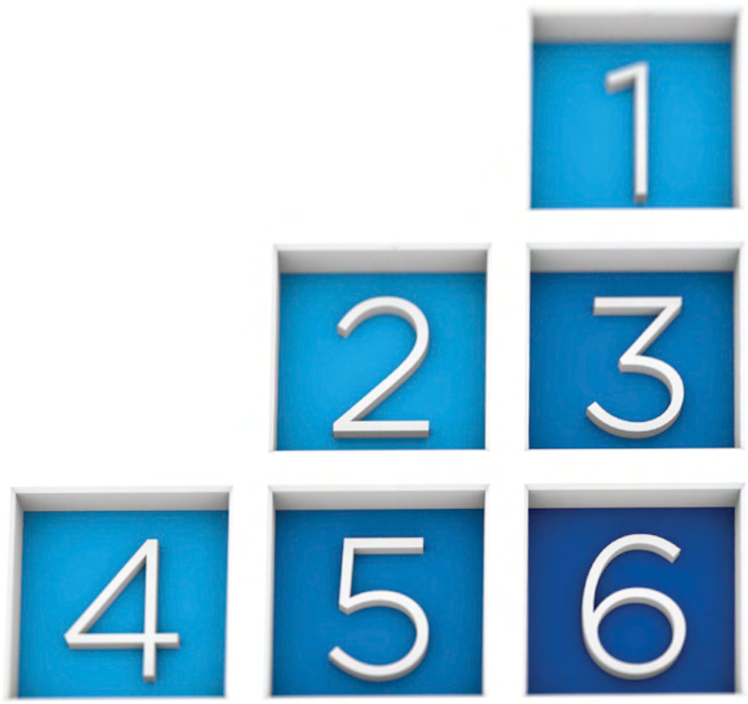
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

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

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



PRI's MISSION

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

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

INTRODUCTION

The US is the world's largest capital market, and American investors are increasingly focused on long-term investment approaches that require the inclusion of environmental, social and governance (ESG) factors. The US is also the PRI's single largest market with more than 345 signatories and $36 trillion in assets under management. In recent years, we have seen US policy makers and regulators seek input on or adopt policies that help promote or support long-term value creation.

Demand for responsible investment is rooted at the investor level, where many US asset managers and owners have embraced, embedded and endorsed ESG incorporation as vital for achieving long-term value creation and a sustainable financial system. According to the US SIF, socially responsible investments increased by 33% to more than $8.5 trillion from 2014 to 2016[1]. Also promising is that 30% of corporate retirement plans now incorporate ESG factors into their investment decisions[2].

Recent investor-led developments demonstrate the level of support and momentum across the country to manage long-term risks and generate value. For example, we saw significant progress on active ownership in 2017. Shareholders of Exxon Mobil and Occidental Petroleum voted in favor of requiring greater disclosures related to climate risks. Several states, localities and other entities have also committed to the Paris Climate Agreement, seeing the clear investment risks related to climate change and the need for supportive policy environments for long-term investor returns.

This briefing discusses recent policy developments – particularly around fiduciary responsibilities, stewardship and financial disclosures – that could, or perhaps already have, impacted ESG integration in the US. It is not intended to be comprehensive, but is a starting point for discussions with our signatories on the PRI's policy views and US engagement strategy.

Highlights of the briefing include:

- Support for recent Labor Department (DOL) policies acknowledging that ESG issues can contain financial value and that retirement plan fiduciaries may take ESG factors into account when exercising their right to vote.
- Concern with legislative efforts, such as the Financial CHOICE Act, that could weaken the ability of shareholders to engage with companies and fellow investors on corporate governance and risk management.
- Calls for increased ESG-related disclosures to enable investors to make more informed decisions about long-term value creation that can support a more sustainable financial system.

While the majority of the PRI's policy efforts in the US have been focused at the federal level, several state and local public pension systems have committed to ESG integration. As part of the Fiduciary Duty in the 21st Century project, we intend to take a deeper dive into ESG integration at the state level in 2018.

We strongly encourage all of our signatories to share their views on existing and new policy proposals. We welcome your feedback on past and current work. To become better engaged, signatories can:

- Subscribe to our policy newsletter to receive updates on the PRI's policy work.
- Join our recently formed Global Policy Reference Group (GPRG) comprised of leading policy professionals from around the world. The purpose of the group is to ensure the PRI's, and our signatories', policy engagement is current, international and aligned with responsible investment objectives. If you are interested in joining the GPRG, please email jenny.waits@unpri.org.
- Attend the PRI's annual conference – PRI in Person – in San Francisco, September 12 – 14, 2018. For additional information please visit our events website, where you can also view highlights from the 2017 conference in Berlin.

1 US SIF, 2016 Report Trends Highlights
2 Callan Institute, 2016 ESG Interest and Implementation Survey

FIDUCIARY RESPONSIBILITIES

ESG GUIDANCE

In October 2015, the DOL issued critical guidance (Interpretive Bulleting 2015-01), which acknowledged that ESG factors can have a financial impact on retirement plan investments. This was the third bulletin relevant to ESG integration and the Employee Retirement Income Security Act of 1974 (ERISA), released by the DOL, since 1994. ERISA sets the rules for private retirement plans in the US. While the Clinton Administration issued guidance stating that ESG factors could be used as "tie-breakers" when all other factors were considered equal, the Bush Administration walked back this approach with guidance in 2008, stating that non-economic factors should rarely be considered during investment analysis. Unsurprisingly, this caused significant confusion among plan fiduciaries.

The Obama Administration echoed sentiments from the guidance issued under the Clinton Administration, stating that ESG factors could be used when all other factors were considered equal. However, the DOL also stated that when ESG factors have economic value, they are "**more than just tie-breakers, but rather are proper components of the fiduciary's analysis of the economic and financial merits of competing investment choices**." The PRI, through its Fiduciary Duty in the 21st Century project, concluded that failing to consider long-term investment value drivers, which include ESG issues, in investment practice is a failure of fiduciary duty. We strongly support the 2015 DOL guidance.

CONFLICT OF INTEREST RULE

In April 2016 and after six years in the making, the DOL published its long-awaited Fiduciary Rule. As the retirement landscape in the US continues to change, and more individuals depend on Individual Retirement Accounts (IRAs), the Department sought to ensure that all Americans received retirement advice that was in their best interest. While employer-sponsored retirement programs were already required to be handled by a fiduciary, IRAs were not subject to the same standards. The rule, and its related exemptions, was designed to create a more reliable and transparent retirement system that eliminated conflicts of interest in the market. For example, advisors would no longer be able to recommend products simply because they could result in higher commissions.

The new Administration expressed concern that the implementation of the rule and its related exemptions would lead to increased costs and fewer investment options for consumers. This is a belief held by many business groups, including the Chamber of Commerce and the Financial Services Roundtable that sued the DOL over the rule. In February 2017, President Trump signed a memorandum directing the DOL to re-examine the rule.

While parts of the rule – including the definition of a fiduciary – came into effect in June 2017, the DOL has delayed the effective date for the related exemptions until July 2019. These exemptions, which are a core component of the rulemaking, would have enabled retirement advisors to continue receiving various fees, including commissions, as long as they contractually agreed to put their clients' best interests first. Since this component contained the legally enforceable provision of the rulemaking, the path forward remains uncertain at present (January 2018). The DOL stated that it intends to use the 18-month effective date delay to best determine how to revise or repeal the rulemaking. The PRI supports robust fiduciary standards and policies that lead to a fairer and transparent market.

STEWARDSHIP (ADVOCACY, ENGAGEMENT, PROXY VOTING)

DOL PROXY GUIDANCE

At the end of the Obama Administration in 2016, the DOL issued Interpretive Bulletin (IB) 2016-1, which confirmed that ESG issues were consistent with shareholder engagement under ERISA. Similar to the DOL's 2015 ESG Guidance, the Proxy IB replaced guidance issued in 2008 and reaffirmed interpretations from guidance that was released under the Clinton Administration in 1994.

The DOL issued the new guidance to address concerns that the 2008 guidance prevented retirement plan fiduciaries from exercising their right to vote on ESG issues. The 2016 preamble states that: "The Department is concerned that IB 2008-2 has been read by some stakeholders to articulate a general rule that broadly prohibits ERISA plans from exercising shareholder rights, including voting of proxies, unless the plan has performed a cost-benefit analysis and concluded in the case of each particular proxy vote or exercise of shareholder rights that the action is more likely than not to result in a quantifiable increase in the economic value of the plan's investment."

The PRI welcomed the 2016 clarification from the DOL. We believe it is essential for shareholders, including retirement plans, to be able to exercise their rights through proxy voting. The Fiduciary Duty in the 21st Century project called on regulators and policy makers to clarify that fiduciaries must take into account ESG issues in their active ownership activities.

Last year, the PRI launched the proxy vote declaration system – a voluntary opportunity for PRI signatories to publicly declare how they intend to vote on shareholder resolutions around ESG issues. This is a way to help build good practice and encourage greater transparency on voting activity.

SEC STAFF LEGAL BULLETIN NO. 141 (CF)

The SEC released new guidance on the issue of shareholder proposals in the form of a Staff Legal Bulletin in November 2017. The most notable change is regarding ordinary business exceptions, which enable boards to table a resolution that "deals with a matter relating to the company's ordinary business operations." Staff Legal Bulletin No. 141 delegates greater responsibility to the board on ordinary business exceptions. It states that when a company submits a no-action request to the SEC to use the exception, the organization should now include an analysis from the board on the issue at hand.

The 2018 proxy season will shed more light on how this change impacts the no-action request process. However, shortly after the Bulletin's release, Apple Inc. sent the SEC no-action request letters on shareholder proposals relating to climate and human rights issues, referencing the new guidance. Some have expressed concern that the new process could enable more resolutions to be excluded from consideration.

In a speech in November 2017, SEC Chairman Jay Clayton said: "History has shown that shareholder proposals can gain traction and lead to corporate governance changes that better track the long-term interests of Main Street investors. They also create costs, including out-of-pocket costs and the use of board and management time, that otherwise could be devoted to the operation of the company itself." While the Chairman said he would like to address issues around the proxy process, proposed changes would not come for some time.

THE FINANCIAL CHOICE ACT AND THE CORPORATE GOVERNANCE REFORM AND TRANSPARENCY ACT

The PRI remains concerned about legislation that could weaken shareholder rights. The Financial CHOICE Act (H.R.10) was introduced by Financial Services Committee Chairman Jeb Hensarling and passed the House of Representatives in June 2017 without any Democratic support. The bill would mandate that shareholders seeking to submit proposals on a corporate ballot must own at least 1% of the company's outstanding stock over a three-year period, compared to the current $2,000 threshold for one or more years.

The proposal seeks to eliminate the ability of all but a few investors to file resolutions and exercise their voting rights through the shareholder proposal process. Such a change would reduce corporate accountability to long-term investors. The PRI sent a letter to the Financial Services Committee opposing these changes. The Trump Administration has endorsed the provision, revising the $2,000 shareholder proposal threshold and the current resubmission thresholds.

The CHOICE Act also repeals several provisions of the Dodd-Frank Act, which was passed in 2010 after the Financial Crisis to curb risky behaviour by financial institutions and help facilitate a more transparent and sustainable system. In February 2017, President Trump signed an Executive Order (EO) instructing Treasury Secretary Steve Mnuchin to review financial regulations in place and to put forward policy recommendations within 120 days. This resulted in the Treasury Department releasing a series of reports entitled Financial System That Creates Economic Opportunities. One common theme throughout the recommendations is the goal of reducing the number of regulations in place for financial markets – and, in particular, rolling back those created by Dodd-Frank.

The Senate is unlikely to pass the CHOICE Act in its current form. However, it is possible that the Senate will consider different provisions within the bill or that the SEC carries out some of the changes through rulemaking.

The Corporate Governance Reform and Transparency Act (H.R.4015), which passed the US House of Representatives in December 2017 with bipartisan support, would significantly weaken the role institutional investors play in the corporate governance of US companies. The bill requires that proxy advisory firms submit their recommendations to companies prior to publication. If a proxy advisory firm must share its recommendation to management before sharing it with investors, the recommendations have the potential to be biased towards management. As a result, this legislation threatens to undermine equity owners' ability to receive independent information.

We are also concerned that H.R.4015 would impose additional disproportionate compliance costs on proxy advisory firms and add substantial expense to institutional investors. The legislation requires that proxy firms register with the SEC and employ an ombudsman to receive complaints "from the subjects" of voting recommendations. The PRI expressed these concerns in a letter to the Committee ahead of the bill's markup. There is currently no companion bill in the Senate.

THE INVESTOR STEWARDSHIP GROUP PRINCIPLES

In addition to federal policy initiatives, several US investors have put forth and are adhering to a voluntary stewardship code. In February 2017, the Investor Stewardship Group (ISG), a body of large US and international investors, launched a Stewardship Framework for Institutional Investors. The ISG members, representing more than $22 trillion in assets under management, have committed to a set of stewardship principles that require them to evaluate the corporate governance activities of their investee companies and work alongside issuers to encourage adoption and implementation.

The ISG has formalized six principles around corporate governance and six around stewardship. The framework holds institutional investors accountable as stewards of others' money and requires transparency and a commitment to working alongside companies in a constructive manner. Similarly, for public companies, boards are independent, but accountable to shareholders who have a right to vote their interest. The framework goes into effect in January 2018. Several ISG signatories and endorsers are also PRI signatories; we strongly support the efforts of the group.

REPORTING AND RESPONSIBILITY

SEC'S REGULATION S-K

The SEC, under the Regulation S-K framework, requires that public companies file annual disclosure reports. In 2010, the SEC issued guidance "to remind companies of their obligations under existing federal securities laws and regulations to consider climate change and its consequences as they prepare disclosure documents to be filed with us and provided to investors." While the 2010 guidance was a welcome step, little has been done since then to standardize climate-related disclosures.

Despite a lack of enforcement of the 2010 guidance, the SEC sought to update disclosure requirements in April 2016. The Commission issued a Concept Release seeking public comments on efforts to modernize disclosure requirements, including a provision on ESG factors, under Regulation S-K. The PRI welcomed the solicitation and submitted a comment letter requesting that the Commission formally adopts the term "ESG factors." We also put forth recommendations that included requiring a standardized method of reporting ESG risks and opportunities, along with demonstrating clear links to the company's business model, in annual corporate disclosures. However, the SEC has not indicated support for new guidance on this issue in the near future.

FORM 5500 REPORTING

In 2016, the DOL issued a proposed rulemaking to modernize Form 5500, which is the required annual public disclosure form for ERISA-governed retirement plans. As part of the proposal, the DOL sought public comments on whether it should require information on ESG investments.

The PRI believes that clear disclosures of ESG factors would provide valuable information about various risks and opportunities for retirement plans. With that in mind, we submitted a comment letter to the DOL. Since the change of Administration, the DOL's project has been placed on hold.

CONFLICT MINERALS DISCLOSURES

The Dodd-Frank Act required the SEC to issue a rule around certain companies disclosing the use of conflict minerals – tantalum, tin, gold or tungsten – in products. The intent was to provide investors with relevant information about the origins of materials and help reduce violence in the mining areas of the Democratic Republic of Congo and nearby regions. The final rule has had a series of legal challenges on the issue of freedom of speech.

Republicans in Congress have repeatedly tried to repeal the rule on the basis that the disclosures are burdensome, require increased supply chain tracking that impose additional costs, and that the information is unnecessary for investment decisions. The Financial CHOICE Act included a repeal provision, a standalone repeal bill passed out of the House Financial Services Committee, and there have been several attempts by the House to defund the SEC's enforcement of the program through appropriation bills.

The PRI supports strong disclosure requirements around conflict minerals. From October 2009 through September 2012, a group of PRI signatories, led by Hermes Fund Managers and representing $635 billion in assets under management, engaged with 18 consumer electronics companies in the US, Europe and Japan on the topic of conflict minerals. The engagement achieved positive results. Based on an evaluation of company performance and disclosure among the companies following the PRI engagement evaluation framework, scores for overall company performance increased by an average of 23% from 2010 to 2011. Several investors in the group actively participated in the development and adoption of the SEC's Conflict Minerals Rule.

VOLUNTARY STANDARDS

The Sustainability Accounting Standards Board (SASB) has developed standards that allow for comparability across industries and a framework of materiality-focused, industry-specific key performance indicators to improve ESG integration for investors and companies. Last year, the PRI joined SASB in hosting a webinar on how SASB standards can help PRI signatories fulfill their PRI commitments and adhere to the values that undergird the PRI principles.

The Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), which is co-chaired by Michael Bloomberg, recently put forth disclosure recommendations that marked a turning point on how companies, banks, insurers, investors and regulators understand and respond to climate risk and opportunity. The PRI released a report with Baker McKenzie reviewing the recommendations in the context of seven countries, including the US. The analysis found that the TCFD's recommendations were consistent with the SEC's Regulation S-K and can provide helpful metrics and strategies for documenting climate-related financial risks.

Lastly, in March 2017, the New York Stock Exchange (NYSE) also affirmed its commitment to ESG disclosure, with the launch of a central repository of ESG reporting resources, including a range of tools to help companies understand ESG disclosure. Nasdaq OMX also released an ESG reporting guide for its Nordic and Baltic markets, which it has committed to modifying for the US market.

The PRI believes that recent developments around voluntary standards are a step in the right direction for stronger disclosure policies in the US.

FINANCIAL ACCOUNTING STANDARDS BOARD

In 2016, the Financial Accounting Standards Board (FASB), which sets accounting standards for public companies, released a proposal to update disclosure requirements. The proposal recommended including a disclosure requirement for disaggregated information on taxes.

The PRI wrote to FASB Technical Director, Susan Cosper, in support of these efforts. Our response included recommendations put forward by a PRI-convened investor taskforce on corporate tax responsibility to facilitate better understanding of tax-related risks and encourage dialogue with investee companies. The taskforce also contributed to the PRI's report, Engagement guidance on corporate tax responsibility: Why and how to engage with your investee companies.

STATE LEGISLATION

In early 2017, California state Senator Ben Allen (D-Santa Monica) introduced SB 560, the Climate Risk Bill, which would require state pension systems to consider "financial climate risk" within their funds. The bill would also mandate that the funds include risk assessments in their annual financial reports beginning in 2020.

California is home to CalPERs, the largest public pension fund in the country, and CalSTRS. Both pension funds are at the forefront of ESG integration. CalSTRS issued a statement opposing SB 560, stating it would like to see a number of changes to the bill, including changing the term financial "climate risk" to "climate-related financial risk." CalSTRS would also like clarification that the fund will only act in line with fiduciary responsibilities, and for the annual reporting requirement to be removed.

CONCLUSION

The PRI remains optimistic about the continued rise of responsible investment in the US. Despite the introduction of legislation in the US House of Representatives that could have serious implications for ESG issues, American investors continue to demand ESG integration to generate long-term growth. There has also been significant advancement in US policy in recent years – most notably the DOL's acknowledgement that when ESG issues contain financial value, they should be considered a core part of a fiduciary's investment analysis.

The PRI's Blueprint document, launched last year, focuses on our ESG priorities for the next decade. We are committed to collaborating with policy makers to address barriers to responsible investing. We will support investors in engaging federal and state law makers and regulators to further advance policies that not only support, but also encourage, ESG investing for long-term growth and value creation.

This briefing paper has been prepared for US and international signatories interested in US policy making on responsible investment and climate change. It is not intended to be exhaustive nor does it constitute legal advice. The paper was published in January 2018. For questions or comments, please email policy@unpri.org.

Prepared by Jenny Waits and Will Martindale.

The Principles for Responsible Investment (PRI)

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

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

More information: www.unpri.org

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

United Nations Global Compact

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

More information: www.unglobalcompact.org

United Nations Global Compact