PRI Principles for Responsible Investment

SUSTAINABLE FINANCIAL SYSTEM: NINE PRIORITY CONDITIONS TO ADDRESS

EXECUTIVE SUMMARY

About this report

The PRI consulted with signatories between June and August on a Sustainable financial system, principles, impact. This consultation set out the PRI's work on a sustainable financial system which will form part of its ten-year Blueprint for Responsible Investment, due for release in March 2017. As part of the consultation we identified 30 underlying conditions that could cause the financial system to fail to support sustainable economic development and undertook to prioritise the leading causes. We updated the list of conditions following the signatory consultation. For a full description of the consultation results, see the Summary of the feedback.

In this report, we set out our process for identifying and prioritising the underlying conditions, provide an overview of the nine priority conditions and explain why certain conditions from the long-list will be monitored, but did not make the priority list.

Following our consultation Sustainable financial system, principles, impact we have identified nine key underlying conditions that we propose focusing our work on:

1) Short-term investment objectives
2) Attention to beneficiary interests
3) Policy maker influence on markets
4) Capture of government policy by vested interests
5) Influence of brokers, rating agencies, advisors and consultants on investment decisions
6) Principal-agent relationships in the investment chain
7) Cultures of financialisation and rent-seeking in market actors
8) Investment incentives misaligned with sustainable economic development
9) Investor processes, practices, capacities and competencies

The nine prioritise underlying conditions are situated in crucial points across the financial system. Four of these (1,6,7,9) relate to the relationship between asset owners and investment managers. One relates to the relationship between beneficiaries and investors (2); one to the relationship between investors and companies (8); and one to the relationship between investors and consultants, bankers and brokers (5). The remaining conditions (3,4) are important interactions between the investment supply chain and policy makers, regulators, society and companies that contribute to a sustainable financial system.

Our work will continue to be supported by the PRI's Sustainable Financial System Advisory Group and PRI's Policy Committee, and will culminate in a set of recommendations for the PRI Board to consider as part of the PRI's Blueprint for Responsible Investment, which will report our plans to signatories in March 2017.

While the nine priority conditions will be used to focus our work, we will continue to monitor the full long-list of more than 30 conditions over the life of the Blueprint and reprioritise if warranted.

In later updates we will address our approach to monitoring the drivers of change that could influence the financial system and measurement frameworks for any initiatives we undertake.

Prioritising the conditions

In the consultation document, we divided the risks and challenges facing the financial system into four areas and identified more than 30 underlying conditions within them that could undermine the resilience of the financial system or could cause the system to fail to support sustainable economic development.

PRI signatories affirmed in their consultation responses that our list comprised the key underlying conditions that should frame our work

Four areas of risk and challenge facing the financial system:

- 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
- Economic externalities

To prioritise these 30 conditions into a list we could work with, we used two tests. First we ranked the conditions based on the extent to which they could undermine a sustainable system. We did this by comparing the condition to the 11 characteristics of a sustainable financial system in our Supplementary Consultation Report. Next, we identified causal relationships between the conditions. We prioritised the nine conditions that were both were both highly ranked and caused other conditions.

Questions that we used to prioritise the conditions for our short list of nine.

- In an otherwise well-functioning financial system, would the condition undermine a sustainable system* (or lead to an unsustainable financial system)?
- Does the condition cause other conditions (from our list)?

*We defined a sustainable financial system as a resilient system that contributes to the needs of society by supporting sustainable and equitable economies, while protecting the natural environment[1]. Within this, such a system should enable: savers to reliably manage and store their income for future use; custodians or trustees to protect and build financial value; and companies, governments and other parties to access capital for investment, innovation and consumption. We used the desirable system characteristics to qualify what this definition meant in practice.

1 For a more complete definition see Section 4 of Sustainable financial system, principles, impact: Supplementary report.

"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 Statement

Clarifying system scope

In the consultation document we proposed the scope of the financial system that the PRI should primarily focus 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/regulations.

We also proposed that the PRI's secondary focus should be on macro-prudential authorities and the banking sector.

PRI signatories broadly agreed in their consultation responses with this scope. Many stated that retail investment schemes and related services should be clearly identified as being in-scope.

NINE PRIORITY CONDITIONS

1) SHORT-TERM INVESTMENT OBJECTIVES

When institutional investors emphasise short-term investment objectives (or behave in a manner that emphasises short-term over long-term investment performance), in an otherwise well-functioning financial system, the prevalence of short-term investment objectives would mean that long term risks and value creation opportunities would be given less attention in investment decision-making, and that accountability, remuneration and incentive structures would be focused on short-term outcomes. That is, short-termism at the top of the investment chain, would lead to short-term objectives and thinking being cascaded throughout the investment system.

A focus on short-term investment performance means that investors are less likely to invest in opportunities with a positive long-term net present value, including those that provide wider societal or sustainability-related benefits. It creates pressures on companies to focus on short-term financial performance, and to pay less attention to strategy, fundamentals and long-term value creation, e.g. they may reduce R&D spending, forego investment opportunities with a positive long-term net present value or fail to develop sustainable products that could open new markets or increase their customer base.

When analysing the prevalence and consequences of short-term investment objectives, we acknowledge that many asset owners state that they have long-term investment objectives and identify themselves as long-term investors. However, their ability to reach these objectives may be limited by factors such as pension fund deficits (and the pressure to narrow such deficits over the short-term), having to meet liquidity requirements to pay benefits, and performance frameworks that emphasise short-term financial performance against peers.

Implementation is also an issue. Even asset owners with long-term investment objectives can signal that short-term performance is important if they emphasise short-term performance in remuneration and performance management arrangements and in their meetings with their investment managers.

2) ATTENTION TO BENEFICIARY INTERESTS

A financial system that frames beneficiary interests solely in financial returns is inevitably one that struggles to properly account for social, environmental and ethical considerations: it can harden into a system that is not able to engage with or respond to beneficiary interests, or respond to the needs and interests of a sustainable economy and long-term future financial value. These conditions can be reinforced if beneficiaries are unclear about their long-term interests or about how to engage with their pension funds or the individuals or organisations charged with managing their savings.

Beneficiaries' interest in financial returns relates to the usefulness of their savings in future. If the future is severely resource constrained, inequitable and insecure – in a way that affects future financial returns and purchasing power – beneficiaries are unlikely to receive the intended benefits of their savings.

It is also clear that beneficiaries' interests extend beyond whether their pensions are paid or savings protected. In practice beneficiaries have wider and longer-term interests, such as concerns about the health and well-being of the economy, the health of social and environmental structures, and the prospects of future generations.

Despite beneficiaries having wider interests, many investors and policy makers frame beneficiary interests solely in financial terms, with this often further reduced to a focus on short-term financial performance. There are various reasons, including: investors may not have sought to ascertain or understand the views of their beneficiaries; beneficiaries may not have the knowledge or understanding of the financial system to articulate their interests in ways that make sense to investors; beneficiaries may not have common interests; legal frameworks and institutional practices – see, for example, the PRI's work on fiduciary duty – may appear to prohibit investors taking account of beneficiary interests in their decision-making. The overall effect is the same. In an otherwise well-functioning financial system, the financial system will tend to discount or ignore these interests when making investment decisions.

3) POLICY MAKER INFLUENCE ON MARKETS

If policy makers design policies that do not address market norms and practices, or provide conflicting signals to markets, the policy measures can be ineffective. For example, the desired policy outcomes may not be achieved within the timeframes required, capital may not flow at the scale or the rate required, investors may not use their influence to encourage companies and other actors to take action, and the problems that policy interventions were intended to address may continue to persist. It may also mean that investors pay less attention to ESG issues in their investment processes and decision-making.

PRI research (for example, on fiduciary duty, on the case for investor engagement in public policy) consistently points to two specific gaps in policy makers' approach.

The first is that financial ministries (e.g. treasuries, market regulators) often have limited understanding of or concern for ESG issues, or of the specific role that investors play in relation to social or environmental outcomes. This often reflects a belief that investors should not or cannot be social actors (perhaps other than to the extent that they should provide capital for government policy priorities).

The second is that policy makers outside of the financial ministries tend to have limited understanding of how financial markets work or of how to incentivise investors to support the development and implementation of policy on ESG issues. Policy makers are often sceptical of investors' views and motivations, sceptical that policy interventions targeted at investors can make a meaningful difference to the delivery of wider social and environmental outcomes or see the economy (its needs, and the changes and developments that occur within it), determining the shape of the financial economy, not the other way around.

4) CAPTURE OF GOVERNMENT POLICY BY VESTED INTERESTS

When political pressure leads policy makers to prioritise the interests of firms over the interests of the public, ensuing regulation can mean that public goods are not properly valued, externalities are not adequately priced and information asymmetries exist in markets. These all affect capital flows: investors are incentivised to invest in areas that are harmful rather than beneficial to society or the environment. Natural resources can be excessively exploited and pollution and other negative externalities can be incentivised. In turn, these impacts can undermine the long-term health and well-being of social, environmental and economic structure and systems that investors rely on to deliver long-term investment returns.

Long-term investors recognise that effective policy and regulatory action on ESG issues such as climate change, labour standards, bribery and corruption and tax is essential to enable them to deliver long-term investment returns, while supporting sustainable and equitable economic development and protecting the natural environment. Yet, the needed policy and regulatory action is frequently undermined or delayed by pressure from groups with commercial or political goals that run contrary to addressing these issues, e.g. intensive lobbying by the fossil fuel industry and its trade bodies against climate change-related legislation.

This is not intended as an argument for firms excluding themselves from policy making processes. The development and implementation of policy and regulation in any sphere of public policy is a matter of negotiation and dialogue. Long-term investors understand that policy decisions need to balance a variety of interests and considerations, including national economic priorities, employment, and sustainable development. Different groups and stakeholders inevitably have different views on whether or not regulation is required, what form this regulation should take and who should be subject to regulation.

5) INFLUENCE OF BROKERS, RATING AGENCIES, ADVISORS AND CONSULTANTS ON INVESTMENT DECISIONS

The business models of market actors such as brokers, rating agencies and consultants often focus on short-term financial performance, often downplay the importance of long-term value creation and ESG issues and often amplify the negative impacts of other underlying conditions identified in this paper. If brokers are remunerated on the basis of trading volumes, they will have an incentive to encourage investment strategies with higher rates of portfolio turnover; if credit rating agencies are paid by the issues of bonds, they will have an incentive to award higher ratings; if advisors are rewarded on transaction value, they are incentivised to develop more complex deals.

The privileged position occupied by these market actors means that they are important influences on the manner in which institutional investors invest. In many jurisdictions, obtaining such advice is even a statutory requirement (e.g. asset owners may be required to obtain advice from investment consultants, for portfolios to invest in securities that meet a minimum credit rating) and/or following such advice can be a statutory defence in the event of prosecution.

Many institutional investors are resource-constrained and lack the capacity or confidence to critically interrogate the advice being provided to them, however, meaning the advice is not treated with appropriate scepticism and as just one input into decision-making.

These advisers are also under pressure to deliver what their clients directly request, creating a self-perpetuating cycle where advisers don't address ESG issues because they think their clients don't consider them important, and investors don't address these issues because their advisers don't raise them.

6) PRINCIPAL-AGENT RELATIONSHIPS IN THE INVESTMENT CHAIN

Principal-agent problems can mean that the views of asset owners are not properly communicated to companies or to other investment actors[2]. They can exacerbate short-term pressures (each link in the investment chain typically has a shorter-time horizon than the one above it), introduce significant transaction costs for monitoring and oversight, lead to ESG issues and sustainability impacts being seen as lower importance and can lead to incentives (e.g. investment management fees, executive remuneration) that are at odds with the goals of a sustainable financial system.

Sources of principal-agent problems include:

- The high level of intermediation – the more intermediaries there are between the ultimate owner and the asset or company in question, the more potential opportunities for principal-agent problems;
- The high time and cost required to monitor agents – reflecting the frequent information asymmetries between agents and principals (e.g. companies generally know much more about their activities, operations and impacts than investors ever will);
- Diversified ownership – it can be difficult for individual investors to hold companies to account, and resources that can be allocated to monitoring individual companies are limited;
- Lack of asset owner influence – being one of an investment manager's many clients and being invested in pooled vehicles limits an asset owner's ability to hold the investment manager to account;
- Poor accountability and oversight processes – asset owners may not clearly signal to investment managers the importance they assign to ESG issues, or investors may not signal to companies the importance they assign to good ESG performance.

Principal-agent structures are an enabling framework for diversified investment strategies, and these two features of the financial system are reinforcing. Although we have not included diversified investment strategies in our list of priority conditions, we will consider their influence when we research principal-agent problems further.

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 where issues that are less easily financially quantified receive less attention. Financialisation results in the financial system paying much less attention to considerations such as the value of a clean and healthy environment, the provision of decent work or the wider health of the economy, or in considering them narrowly in terms of their ability to affect financial performance.

A financial system that is exclusively focused on financial returns is inevitably one that struggles to properly account for wider social, environmental and ethical considerations. That is, it can harden into a system that is not able to engage with or respond to beneficiary interests, or respond to the needs and interests of wider society.

While rent-seeking is not an inevitable consequence of financialisation, it is closely related: an emphasis on quantity of money as an institution's primary measure of success means that quantity money also becomes the primary measure of success for individuals within the organisation. This approach encourages behaviours that seek to use market position to extract financial value from transactions as a precursor to serving client interests.

2 The importance of asset owners having clearly defined views and ensuring that these views are driven through the investment value chain is a key theme of the PRI's How asset owners can drive responsible investment: Beliefs, strategies and mandates.

8) INVESTMENT INCENTIVES MISALIGNED WITH SUSTAINABLE ECONOMIC DEVELOPMENT

Market and regulatory failures, such as poor or inadequate valuation of public goods and inadequate pricing of externalities, can distort incentives. They can mean that investors are incentivised to invest in areas that are harmful rather than beneficial to society or the environment. Natural resources can be excessively exploited and pollution and other negative externalities can be incentivised. In turn, these impacts can undermine the long-term health and well-being of social, environmental and economic structure and systems that investors rely on to deliver long-term investment returns.

9) INVESTOR PROCESSES, PRACTICES, CAPACITIES AND COMPETENCIES

The manner in which investors give effect to their beliefs and values, both within their own organisation and in the delegated investment chain, can signal to the investment market as whole that sustainability is not a priority for asset owners. This limits the willingness of investment consultants and investment managers to focus on sustainability issues in their products and in their advice, limits the incentive for investors to engage with the companies in which they invest and can fuel board and trustee scepticism about the investment importance of sustainability issues. The processes, practices, capacities and competencies that flow from these beliefs set a framework for the priorities and outcomes of investment activity.

The PRI's How asset owners can drive responsible investment: Beliefs, strategies and mandates identifies ways investors can ensure that they deliver on these beliefs and values, including to:

- Include in mandates high-level statements from investment beliefs on sustainability or ESG issues;
- Embed sustainability commitments in investment mandates;
- Deliver sustainability commitments across asset classes;
- Communicate sustainability commitments to service providers;
- Integrate sustainability considerations into the selection, appointment and monitoring of investment consultants and investment managers.

REMAINING CONDITIONS

The following conditions from the long-list did not make the priority list due to being: substantially caused by other conditions; very similar to prioritised conditions; assessed as having lower causal influence in the system. We will monitor these items over the course of our work for links to the priority conditions, and changes in their importance.

1. Relationship between investors and companies

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Diversification of investment, and loss of ownership control in corporations	This relates to investors with diversified portfolios having lower shareholdings in individual companies, such that their engagement and ability to influence company management and large or dominant shareholders is limited.	We have identified diversification of investment and low control in corporations as having a reinforcing relationship with principal-agent relationships (Condition 6) in the investment supply chain. We will therefore consider the influence of diversified investment approaches when we research principal-agent relationships further.
Weaknesses in corporate governance regulation, limiting ownership control	This relates to weaknesses in corporate governance regulations (e.g. those affecting shareholder rights) or, in many markets, the weaknesses in the enforcement of those regulations.	Weaknesses in corporate governance regulation may affect the willingness or ability of investors to hold companies to account for their ESG performance. There may be many reasons for these regulatory weaknesses. As with all conditions that relate to weaknesses in regulation in our analysis, we look to other conditions that influence or cause that weakness to exist. From our list of conditions, principal-agent relationships (Condition 6) and policy maker knowledge of how to influence markets (Condition 3) are particularly relevant. Policy capture by vested interests may also influence these regulatory weaknesses (Condition 4).

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Lack of transparency by companies and investors in terms of how they address ESG Issues	This relates to the lack of transparency by investors on how they take account of ESG issues in their investment processes, and the lack of transparency by companies on their ESG practices and performances. It also relates to the lack of integration of ESG issues into wider business and investment performance.	This condition emerges as a result of other underlying conditions, in particular beneficiary interests (Condition 2), principal-agent relationships (Condition 6), culture of financialisation (Condition 7) and investor practices and processes (Condition 9). While we have not identified transparency as an underlying condition, we expect that improving transparency will be one of the key themes in the activities that we propose, in particular when we propose investment industry-led activities.
Lack of attention to ESG issues in investment research and decision-making	This relates to investors' emphasis on financial performance (both at the level of the individual investment and at the portfolio level) and the corresponding lack of emphasis placed on ESG issues.	This condition emerges as a result of other underlying conditions: short-term investment objectives (Condition 1), culture of financialisation (Conditions 2 and 7), policy capture by vested interests (Condition 4), the views and perceptions of advisers and market actors (Condition 5), investment incentives misaligned with sustainable economic development (Condition 8), and investor practices and processes (Condition 9).

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

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Lack of alignment between the financial system and sustainability goals	This relates to the externalities and other market failures that limit the incentive for asset owners to pay attention to sustainability-related issues.	We have focussed on investment incentives misaligned with sustainable economic development (Condition 8) as a causal driver of this condition.

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Lack of transparency (e.g. Managers to owners, Owners to Beneficiaries, Advisors to clients)	This relates to transparency between all of the actors in the intermediated investment chain, and the relationship of transparency to monitoring practices and performance.	This condition emerges as a result of other underlying conditions, in particular beneficiary interests (Condition 2), principal-agent relationships (Condition 6), culture of financialisation (Condition 7) and investor practices and processes (Condition 9). While we have not identified transparency as an underlying condition, we expect that improving transparency will be one of the key themes in the activities that we propose, in particular when we propose investment industry-led activities.
Weaknesses in regulation (including lack of clarity on overall governance of financial system)	This relates to the rights given to investors to hold their agents to account, and to the rights given to beneficiaries to hold asset owners to account.	Weaknesses in regulation are covered under principal-agent relationships (Condition 6). We see strengthening regulation as a potential solution to some of the principal-agent issues identified in Condition 6.
Insufficient attention to "do no harm"	This relates to the requirements on asset owners and other investment actors to pay explicit attention to social and environmental issues in their investment practices and processes. It also relates to the weight assigned to these issues in investment decision-making.	This condition emerges from other underlying conditions, in particular short-termism (Condition 1), financialisation (Conditions 2 and 7), policy capture by vested interests (Condition 4), the views and perceptions of advisers and market actors (Condition 5), the lack of alignment between investment incentives and sustainable economic development (Condition 8), and investor practices and processes (Condition 9).
Disconnect between investment decisions and the economy	This relates to the level of attention that investment actors are required to pay to the wider economic impacts of their activities, and of the impacts of the financial system as a whole on the wider economy.	This condition emerges from other underlying conditions, in particular short-term investment objectives (Condition 1), values of financialisation (Conditions 2 and 7), policy capture by vested interests (Condition 4), investment incentives misaligned with sustainable economic development (Condition 8), and investor practices and processes (Condition 9).

3. The operation of markets in which we invest

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Lack of alignment between markets and sustainability goals	This relates to externalities and other market failures which limit the incentive for asset owners and investment managers to pay attention to sustainability-related issues.	This condition is covered by investment incentives misaligned with sustainable economic development (Condition 8).
Incoherence or inconsistency in government policies	This relates to the capacity and expertise of policy makers to relate incentives to sustainability concerns, and the implications for policy design and implementation.	This condition emerges from other underlying conditions, in particular policy maker knowledge of how to influence markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8).
Lack of transparency	This relates to transparency along the entire investment chain, as well as transparency about the relationship between the financial system, the economy, society and the environment. It also relates to the role that transparency plays in investors' (and other stakeholders') ability to monitor practices, processes and impacts both within and external to the financial system.	This condition emerges as a result of other underlying conditions, in particular beneficiary interests (Condition 2), principal-agent relationships (Condition 6), culture of financialisation (Condition 7) and investor practices and processes (Condition 9). While we have not identified transparency as an underlying condition, we expect that improving transparency will be one of the key themes in the activities that we propose, in particular when we propose investment industry-led activities.
Weaknesses in oversight of the financial system by regulators and market authorities	This relates to the manner in which the roles and responsibilities of regulators and market authorities are both designed and implemented.	This condition emerges from other underlying conditions, in particular policy maker influence on markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8).

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Common investment strategies and common investment advice	This relates to the tendency for investors to make similar assumptions (e.g. about liquidity), to take similar actions and to make similar investment decisions at the same point in time.	This condition has been included in the services of advisers and market actors (Condition 5), with herding and common investment practices and advice falling within the scope of Condition 5.
Tax incentives and the impact of tax regulation	This relates to differences in tax treatment, at both the national and international level, that drives capital and innovative efforts (e.g. tax arbitrage) away from sustainable economic development.	This condition emerges from other underlying causes, in particular capture of policy by vested interests (Condition 4) and culture of financialisation (Condition 7).

4. Economic externalities

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Policy incoherence or inconsistency (Sustainability policy), leading to market failures and externalities	This relates to the externalities and other market failures that arise as a result of weaknesses in policy design and which, in turn, limit the incentive for asset owners and investment managers to pay attention to sustainability-related issues.	This condition is covered by policy maker influence on markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8).
Ineffective policy implementation and oversight (coordination and implementation of policies)	This relates to the weaknesses in the monitoring and implementation of policy and the limiting of the incentives for investors to take account of ESG/sustainability-related concerns in their investment processes.	This condition is covered by policy maker influence on markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8).

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Common law precedents	This relates to court judgements that limit the incentive for investors to take account of ESG/sustainability-related concerns in their investment processes.	This condition is covered by policy maker influence on markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8).
Inadequate financial policy to address sustainability challenges	This relates to weaknesses in financial policy, and to the potential tensions between financial policy and other forms of policy goals, which can limit the incentive for investors to take account of ESG/ sustainability-related concerns in their investment processes.	This condition is covered by policy maker influence on markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8).
Governance and regulatory failings	This relates to weaknesses in wider market and societal governance, e.g. bribery, corruption, political instability, conflict.	This condition is covered by policy maker influence on markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8).
Lack of attention to the social and environmental consequences of investment	This relates to pressure on investors to focus on short-term drivers of financial performance, and to pay correspondingly less attention to long-term performance and sustainability-related impacts.	This condition is covered by policy maker influence on markets (Condition 3), policy capture by vested interests (Condition 4), and investment incentives misaligned with sustainable economic development (Condition 8). It will also be discussed in relation to short-termism (Condition 1) and principal-agent issues (Condition 6).

ISSUE	DESCRIPTION	WHAT IS THE RELATIONSHIP TO THE PRIORITY CONDITIONS?
Growth paradigm	This relates to the framing of economic success in terms of growth (in GDP, in consumption, in standards of living), and how this leads to over-consumption of natural and other resources.	Although this condition is a foundation for government policy making, we consider that it does not have a direct relationship with investment policies or practice. Although we are yet to propose projects or activities to respond to the priority conditions, this is one area we already believe is well covered by a range of economic think tanks and institutions. Further, we have covered relevant aspects of this condition in policy capture by vested interests (Condition 4) and investment incentives misaligned with sustainable economic development (Condition 8).

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